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DIRECT TAX REVIEW

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Section 206AA does not override the beneficial provisions of the tax treaty

The ITAT Pune bench in the case of Serum Institute of India Limited (taxpayer) held that where tax has been deducted on the basis of beneficial provisions of the tax treaties, section 206AA cannot be invoked by the AO to insist on deduction of tax at 20%, having regard to the overriding provisions of section 90(2), which provides that tax treaties override domestic law in cases where the provisions of tax treaties are more beneficial to the taxpayer.

Facts of the case

The taxpayer is engaged in the business of manufacture and sale of vaccines, and it is a major exporter of vaccines. During the financial year 2010-2011, the taxpayer made payments to non-residents on account of interest, royalty and fee for technical services. These payments were subject to withholding of tax under Section 195.

The tax rate provided in the tax treaties was lower than the rate prescribed under the Act, and therefore in terms of the provisions of Section 90(2) of the Act, tax was deducted at source by applying the beneficial rate prescribed under the relevant tax treaties.

Assessing Officer's contention

The tax department noted that on account of payment of royalty and fee for technical services in case of some of the non-residents, the recipients did not have Permanent Account Number (PAN). Relying on Section 206AA, the tax department treated payments to those non-residents who did not furnish the PAN as cases of 'short deduction'. Accordingly, demands were raised on the taxpayer for the short deduction of tax and also for interest under section 201 (1A) of the Act.

Commissioner of Income Tax (Appeal)'s contention

The CIT (A) held that section 206AA would override the other provisions of the Aot but not the provisions of section 90(2). Therefore, where the tax treaties provide for a tax rate lower than that prescribed in 206AA, the provisions of the tax treaties shall prevail and the provisions of section 206AA of the Act would not be applicable. Accordingly, the CIT (A) deleted the tax demand raised by the tax department.

Tribunal's Ruling

The ITAT held as under:

- In case of non-residents, tax liability in India is liable to be determined in accordance with the provisions of the Act or the tax treaty, whichever is more beneficial to the taxpayer, haivng regard to the provisions of section 90(2).

- The Supreme Court in the case of Azadi Bachao Andolan and Others held that the tax treaties will prevail over the general provisions contained in the Act to the extent they are beneficial to the taxpayer.
- The tax treaties provide for scope of taxation and/ or a rate of taxation which was different from the scope/ rate prescribed under the Act. For the said reason, the taxpayer deducted tax at source having regard to the provisions of the respective tax treaties where a beneficial rate of taxation is provided.
- Even the charging section 4 as well as section 5 of the Act which deals with the principle of ascertainment of total income under the Act is also subordinate to the principle enshrined in section 90(2) as held by the Supreme Court in the case of Azadi Bachao Andolan & Others. Thus, in so far as the applicability of the scope/ rate of taxation with respect to the impugned payments made to the non-residents is concerned, no fault can be found with the rate of taxation invoked by the taxpayer based on the tax treaties which prescribed for a beneficial rate of taxation.
- It would be incorrect to say that though charging sections 4 and 5 (dealing with ascertainment of total income) are subordinate to the principle enshrined in section 90(2), but the provisions of Chapter XVIII-B, governing tax deduction at source are not subordinate to section 90(2).
- Section 206AA is not a charging section but is a part of the procedural provisions dealing with collection and deduction of tax at source. The provisions of Section 195 which casts a duty on the taxpayer to deduct tax at source on payments to a non-resident cannot be looked upon as a charging provision.
- The Supreme Court in the case of Eli Lily & Co observed that the provisions of witholding of tax, i.e., section 195 would apply only to sums paid which are otherwise chargeable to tax under the Act.
- The Supreme Court in case of GE India Technology Centre Pvt Ltd held that the provisions of tax treaties along with sections 4, 5, 9, 90, and 91 of the Act are relevant while applying the provisions of tax deduction at source. Therfore, in view of the aforesaid schematic interpretation of the Act, section 206AA cannot override the charging sections 4 and 5 of the Act.
- Section 90(2) of the Act provides that tax treaties override domestic law in cases where the provisions of tax treaties are more beneficial to the taxpayer. Therefore, where the tax has been deducted on the basis of the beneficial provisions of the tax treaties, the provisions of section 206AA cannot be invoked by the AO to insist on the tax deduction at 20%, having regard to the overriding nature of the provisions of section 90(2) of the Act.
- The CIT (A) has correctly inferred that section 206AA does not override the provisions of section 90(2) of the Act. While making payments to non-residents, the taxpayer correctly applied the rate of tax prescribed under the tax treaties and not as per section 206AA because the provisions of the tax treaties are more beneficial. Accordingly, the Tribunal affirmed the CIT (A)'s ruling.

Source: DDIT vs Serum Institute of India Limited (ITA # 792/ PN/ 2013)

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Depreciation is allowed on gas cylinders owned and leased out by the tax payer – Supreme Court

The Supreme Court in the case of KM Sugar Mills Limited (taxpayer) held that the taxpayer is entitled to depreciation under section 32 once it is proved that the taxpayer is the owner of the leased out gas cylinders and the same are being used for its business purpose.

Facts of the case

The taxpayer company had set up its unit in September 1985 to carry on the business of manufacturing and compressing oxygen, hydrogen, other types of industrial gases or kind substances, etc. For running the aforesaid plant, the taxpayer bought gas cylinders. Since, the, unit had not started functioning, these gas cylinders were leased out to certain parties.

Tax payer's and Assessing Officer's contention

In the income tax return filed by the taxpayer, the taxpayer claimed depreciation on the gas cylinders at the rate of 100%. However, the AO rejected the claim of depreciation on the ground that hiring business was not proved.

Commissioner of Income Tax (Appeal)'s contention

The CIT (A) held that the income received from leasing the gas cyclinders would be treated as business income and hence allowed the depreciation. The CIT (A) order was set aside by the ITAT.

High Court's contention

The High Court conferred with the Tribunal on the ground that the cylinders were not purchased for leasing business and one of the parties to whom the cyclinders were leased out is the manucturer and seller of the cyclinders. The cyclinders were dispached to the other party only a day before the closing of the accounting period.

Supreme Court's Ruling

The SC held as under:

- The reasons given by the Tribunal and the High Court in denying the depreciation do not appear to be valid reasons in law.
- It was not disputed that these gas cyclinders were purchased for business purpose and were leased out to earn out some income, rather than to keep them idle.
- The income which was generated from leasing out those gas cylinders was treated as 'business income'.
- Once the income from leasing those gas cylinders was accepted as 'business income', which was taxed in the hands of the tax payer, the depreciation on

these gas cyclinders cannot be disallowed on the ground that the cylinders were not purchased for 'leasing business'.

- The taxpayer had proved ownership as well as use of these gas cylinders fm business purpose. Therefore, the taxpayer was entitled to depreciation under section 32.
- Accordingly, the decision of the High Court is set aside and the taxpayer is entitled to claim depreciation.

Source: KM Sugar Mills Limited vs CIT [Civil appeal # 2550 of 2004 dated 25-03-2015. Date of pronouncement 06-04-2015]

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Information as per the database of the tax authorities cannot be a base for making addition to the income of the taxpayer

The ITAT Delhi in case of Basant Kumar (taxpayer) held that information as per the database of the tax authorities cannot be legally sustainable basis for making addition to the income of the taxpayer.

Facts of the case

The taxpayer is engaged in the business of distribution of telecom products in the district of Haryana. During the assessment proceedings, the AO observed that as per form 26AS, the taxpayer has received INR 8.11 million from a telecom vendor. However, the taxpayer has accounted for only INR 2.23 million. The taxpayer claimed that the balance amount of INR 5.87 million represented carious tokens and coupons, referred to as 'Vendor Currency' which was directly issued to the retailers.

The AO noted that the amount of INR 5.87 million was included in the payments referred to in form 16A, in respect of which taxes were deducted at source. Accordingly, the AO made additions of INR 5.87 million on account of suppressed receipts.

The AO held that the income accrues to the taxpayer because as per section 2(24) of the Act, an income includes any sum or money in cash or kind, either received or receivable under any head of income.

The CIT (A) deleted the additions made by the AO. The CIT (A) observed that the AO has to make further enquiries and bring material on record to conclude that the taxpayer had in fact received the amount stated in form 26AS. The evidence collected by the AO indicated that the amount was received by the various retailers as per the promotional scheme of the telecom vendor. While making the payment directly to the retailers, the vendor resorted to the tax withholding in the hands of the taxpayer since various retailers were not having their permanent account number.

Tribunal's contention

The Tribunal held as under:

- It is only elementary that information as per the database of the tax authorities cannot be, by itself, a legally sustainable basis for addition being made to the income of the taxpayer and that such inputs are at best starting points for appropriate inquiries.

- There is nothing more than these information inputs which have been put against the taxpayer. As evident from affidavit filed by the taxpayer, the amount of INR 5.87 million shown in form 26AS was neither received by the taxpayer nor receivable by the taxpayer. The said amount was directly paid by the vendor to the retailers and a complete list of which was provided by the vendor.
- The vendor had given a complete breakup of INR 5.87 million and given details of the retailers to whom the related payments has been made. There was no material to come to the conclusion that taxpayer ever received any such coupons or payments and that the same are not reflected in his books of accounts or bank statements.
- The fact that these payments were made by the coupons and vouchers, etc., can also not be put against the taxpayer since the taxpayer never received the same and there was no evidence to the contrary.
- The confusion has started because vendor deducted tax at source in respect of the vouchers etc., and stated the name of the taxpayer as collective receipient of the entire sum.
- Accordingly, the CIT(A) was justified in deleting the addition of INR 5.87 million.

Source: ITO vs Basant Kumar (ITA # 4679/ Del/ 2012)

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CBDT notifies increase in transport allowance exemption

The CBDT vide notification # 39/ 2015/ F No 142/ 02/ 2015 – TPL has increased the transport allowance exemption from INR 800 to INR 1, 600 per month and the income tax rules have been amended acordingly.

Further, in case of an employee, who is blind or orthopedically handicapped with disability of lower extremities, the exemption has been enhanced from the existing limit of INR 1, 600 per month to INR 3, 200 per month.

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