

Heads you Quote PAN: Tails you obtain a PAN !!!!!

Permanent Account Number ("PAN"), other than just being a tax payer identification number, is a very important mechanism in the context of International taxation. This is so because, in India, any credit for taxes whether deducted or paid, is given only against a PAN of a person. In terms of international taxation it gains importance, because, for claiming tax credit, the credits against the PAN of foreign entity would act as a proof to substantiate the deduction of tax, and accordingly claim credit for the same.

In spite of PAN being such an important mechanism, foreign companies refrain from obtaining PAN. The main reason for not obtaining PAN is to avoid any reporting to Indian Tax authorities, thereby trying to shield themselves from the wrath of the implausible Income Tax Assessments. The provisions of Section 206AA of The Income Tax Act, 1961 ("Act"), are attracted when the receiver of income, does not quote his PAN. The section mandates deduction of tax at source at higher of the rates in force, rates specified under relevant provision of the Act or 20%. To guard themselves from the atrocities of provision of Sec 206AA of the Act, benefit of Sec 139A(8)(d) of the Act r.w.r 114C(1)(b) or Sec 90 of the Act is taken. The former option was struck down in the judgment of Bosch Ltd¹ while the latter was upheld in the case of Serum Institute of India Ltd² (herein after referred as "Serum"). The deeming provisions of section 9 of the Act being too steep, benefit of Double Taxation Avoidance Treaties are sought after.

The Pune tribunal in the case of Serum broke the stalemate on the ambiguity in the area as to whether Provisions of Sec 206AA of the Act, being a non-obstinate clause, override the beneficial treaty provisions of Sec 90 of the Act. In the case of Serum, the assessee had availed treaty benefit thereby the tax was deducted at a lower rate vis-à-vis the rate mandated by sec 206AA of the Act. The contention of department was that Sec 206AA of the Act would override the beneficial treaty provision and tax should have been deducted at 20%. The Pune tribunal held that the provisions of Sec 206AA of the Act, being a machinery provision cannot override the beneficial treaty provisions. The claiming of treaty benefit is one aspect, the repercussion of claiming treaty benefit is the second aspect.

The quintessence of the second aspect is that, if treaty benefit is claimed, the person claiming treaty benefit is liable to file Return of Income. So, in a way the benefit given by the treaty over the non obstinate clause of provision of sec 206AA of the Act, is taken back by provision of Sec 139 of the Act. Time and again, the Authority for Advance Rulings have in several cases* have held that if treaty benefits are claimed, it is obligatory to file Return of Income. Although the decisions of AAR are binding on the specific assessee in whose case the judgment is given, however, principles can be laid down by such AAR rulings. Provision of Sec 139 of the Act casts an obligation to file return on every person being a company. Sec 2(17) of the Act, which defines 'Company', includes a foreign company. Thus provisions of Sec 139 of the Act requires filing of return by every company!!. Although the scope of provision of Sec 139 is too spacious, it needs to be construed liberally.

The benefit from treaty may be such that it could make the income not taxable in a country or provide lower rate of deduction of tax in that country. In either of the situation, the obligation to file return of income is not changed. Although, vide the judgment of Serum (Supra), the rate at which tax may be deducted would be less than 20%, but the very fact that treaty benefit is claimed would itself throw the person into the apprehensive web of obtaining a PAN because till date there is no mechanism by which a return income can be filed without obtaining a PAN!!.

So a question would arise, that just like it is mandatory to have a valid Tax Residency Certificate for claiming treaty benefits, would PAN also be required for claiming treaty benefits??

- A straight forward answer to the above question would be NO; for the reason being that PAN is not a pre-requisite for claiming treaty benefits, but it is the obligation being cast upon for availing treaty benefits.

Although it is a well-established law³ that provisions of Sec 90 override the general provisions of the Act, however such principle would not be applicable in the case to discharge the liability for filing return/obtaining PAN. This is for the simple reason that Provision of Sec 90(2) of the Act gives an option to opt for the beneficial position, either in the Act or in the treaty. It is due to this that tax is deducted at lower rates as provided in treaty vis-a-vis, the rates provided u/s 206AA of the Act. However in case of filing return of Income, there is no corresponding provision in any treaty which provides that Return of Income should not be filed. It can be explained as follows: the obligation to file return of income is cast by domestic laws, there is no Article in a treaty which requires non filing of Return. So the question of beneficial position does not arise as to be better off in a situation, two alternatives/options are required, whereas, in case of return filing there is no option as such because there is no corresponding Article covering such aspect. To elaborate if the treaty provides deduction of tax @ 10% on a royalty payment, however Sec 206AA, which casts an obligation for deduction of tax @ 20%. In this case, the benefit of 10% will be available as it more beneficial compared to the alternative position under the Act to deduct tax @ 20%. However there is no such corresponding position in the treaties with regards to filing return of income. A situation which is not covered by treaty is to be dealt with domestic laws. Hence the liability of filing of return of income thereby obtaining PAN cannot be dispensed off.

So the whole issue boils down only towards the timing of PAN i.e. either the foreign enterprises obtain a PAN and quote the same thereby avoiding conflict with the provisions of Sec 206AA of the Act or they take treaty benefits and later on obtain a PAN and file Return of Income.

The intention of introduction of Sec 206AA of the Act was to improve compliance with the provision of quoting of PAN in the TDS regime however with due regards to judgment of Serum, the provisions of Sec 206AA of the Act are rendered futile to the extent of dealing with non-residents. Whether the same will be challenged with judicial authorities or there may be an amendment in the Act would have to be observed.

It now remains to be seen that the Castleton⁴ Judgment which opened the gates of fury for the Foreign Investors by the levy of MAT provisions would also oblige them to obtain PAN and thereby bringing their nightmares of unfounded Tax assessments come true, because in the same Castleton judgment, it has been held by AAR authority that the entity claiming treaty benefits is liable to file return of income.

First Section 206AA of the Act being held to be constitutionally Invalid in case of A. Kowsalya Bai⁵ & then the same being brought against Provision of sec 139A(8) in case of Bosch¹, & then now again provisions of section 206AA of the Act, being tapped down in case of Serum; the government should indeed act on the reconstruction of the section with regard to issues being faced. Also the provisions of Section 139 of the Act may be re-looked with due regard to the fact that, there are AAR judgments in favour of assessee[#] stating that Return of Income need not be filed, if after claiming of treaty benefits, the income is not taxable !!. So how is the provision of sec 139 construed in due course of time by the judicial authorities, remains to be seen....

However it is to be noted that it is only the approach of Department that hinders the process of effective and efficient taxation regime. The approach of the legislature cannot be questioned as the government should have the basic data as to which entities are taking benefit of treaty, whether there is any treaty abuse, whether the objectives for which the treaty had been entered into is being achieved or not etc. This data collected by the government in turn helps in decision making.

1 – 28 taxmann.com 228 (Bangalore tribunal)

2 – 56 taxmann.com 1 (Pune tribunal)

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Deere & Co, In re	11 taxmann.com 388
VNU International B.V., In re	198 taxman 454
SmithKline Beecham Port Louis Ltd., In re	24 taxmann.com 153
XYZ, In re	20 taxmann.com 88

3 – UOI v. Azadi Bachao Andolan (SC) (263 ITR 706)

4- Castleton Investment Ltd, In re (AAR) (24 taxmann.com 150)

5 – Smt. A. Kowsalya Bai v. UOI (Karnataka High Court) (22 taxmann.com 157)

Venenburg Group B.V., In re (AAR) (159 Taxman 219)