

Bracing for implementation of Section 206AB of Income-tax Act

Finance Act, 2021 made certain sweeping changes in the provisions relating to tax deduction at source in order to enhance the current tax base and bring more taxpayers into the fold of tax compliances and reporting in the country. One such change with far-reaching implication was introduction of Section 206AB, which mandates deduction of tax at higher rates based on the status of compliance of tax returns filing by the taxpayers.

This Section is made applicable with effect from 1 July 2021. Given the quantum of efforts and complexities involved in getting to readiness for implementation of this Section from 1 July 2021, the industry is in for putting together a mammoth task to facilitate a smoother implementation and take off for the Section.

In this background, let us take a look at some of the intricate details of Section 206AB which may be relevant from the perspective of practical implementation of the Section.

Verbatim reproduction of Section 206AB with certain emphasis –

- (1) *Notwithstanding anything contained in any other provisions of this Act, where tax is required to be deducted at source under the provisions of Chapter XVIIIB, other than section 192, 192A, 194B, 194BB, 194LBC or 194N on any sum or income or amount paid, or payable or credited, by a person (hereafter referred to as deductee) to a specified person, the tax shall be deducted at the higher of the following rates, namely:—*
 - (i) *at twice the rate specified in the relevant provision of the Act; or*
 - (ii) *at twice the rate or rates in force; or*
 - (iii) *at the rate of five per cent.*
- (2) *If the provisions of section 206AA is applicable to a specified person, in addition to the provision of this section, the tax shall be deducted at **higher of the two rates** provided in this section and in section 206AA.*
- (3) *For the purposes of this section "**specified person**" means a person who has **not filed** the returns of income for both of the two assessment years relevant to the two previous years **immediately prior to the previous year** in which tax is required to be deducted, for which the time limit of filing return of income under **sub-section (1) of section 139 has expired**; and the aggregate of tax deducted at source and tax collected at source **in his case is rupees fifty thousand or more in each** of these two previous years:*

Provided that the specified person shall not include a non-resident who does not have a permanent establishment in India.

Explanation.—For the purposes of this sub-section, the expression "permanent establishment" includes a fixed place of business through which the business of the enterprise is wholly or partly carried on.

Analysis of the Section in the form of FAQs –

Q1: From when the Section has been made applicable?

Section 206AB has been inserted in the Income-tax Act, 1961 ('the Act') through Finance Act, 2021 with effect from 1 July 2021. Therefore, as discussed earlier, the compliance of this Section is mandatory from 1 July 2021.

Q2: Is the Section applicable for payments that are subject to tax deduction at source ('TDS') under Section 194C, 194J, 194I 195 etc.?

Yes. Except for the specific carve outs provided under Section 206AB, it is applicable for all other nature of payments under different provisions of Chapter XVII-B which require deduction of tax at source. The carve outs provided in the Section are as below –

Section 192 – TDS on salary

Section 192A – TDS on withdrawal from EPF

Section 194B – TDS on winning from lotteries, crossword puzzles, etc.

Section 194BB – TDS on winning from racehorses

Section 194LBC – TDS on income in respect of investment in Securitization Trust

Section 194N – TDS on cash withdrawal

Q3: What is the applicability of Section 206AB where the payment to a particular vendor is not crossing the minimum thresholds provided under the respective Sections of Chapter XVII-B?

Where the payment is not crossing the minimum thresholds requiring compliance of TDS under various Sections of Chapter XVII-B, provisions of Section 206AB would not be applicable.

Q4: What could be the relevance of non-obstante clause in the Section?

Section 206AB starts with a non-obstante clause overriding all other provisions of the Act. Given this, it would apply even to those cases where the Tax deductees have obtained a Nil or lower TDS certificate from the Tax Office or has provided a declaration under Section 197A of the Act etc.

Q5: What would be the applicable rate of TDS where Section 206AB is triggered?

Where Section 206AB is triggered, the tax shall be deducted at the higher of the following rates:

- (a) Twice the rate specified in the relevant provision of the Act;
- (b) Twice the rate or rates in force; or
- (c) 5%.

However, where both the provision of this Section and Section 206AA are applicable (Section 206AA requires furnishing of PAN where TDS is deductible under the provisions of Chapter XVII-B), the tax shall be deducted at the rates provided in this Section or in Section 206AA, whichever is higher.

Q6: What is the threshold given from a Tax deductor standpoint for applicability of this Section?

There is no minimum threshold given for applicability of this Section from a Tax deductor standpoint. Therefore, the compliance of this Section is mandatory for all the types of Tax deductors irrespective of any threshold in terms of expenses, turnover etc.

Q7: Which years are relevant for FY 2021-22 based on the definition of "Specified person"?

Reading of the definition of "Specified person" in Section 206AB gives an impression that the relevant Previous Years ('PYs') to be considered for this purpose are those years which are immediately preceding the subject Previous Year ('PY') **for which** the due date of filing income-tax return under Section 139(1) has expired.

Based on the above, as of 1 July 2021, the time limit for filing Income-tax return under section 139(1) is expired for FY 2018-19 and FY 2019-20 in case of all the types of taxpayers and as such the due date for FY 2020-21 is not expired. Therefore, these two PYs *i.e.* FY 2018-19 and FY 2019-20 are relevant PYs for checking the applicability of Section 206AB as of 1 July 2021.

However, once the time limit for filing the Income-tax return expires for Financial Year (FY) 2020-21, the relevant PYs would be FY 2019-20 and FY 2020-21.

Q8: What are the possible ways the Tax deductors can ensure compliance of this Section from 1 July 2021?

Given that the Section is applicable from 1 July 2021, before the said date, it is pertinent that the Tax deductors make sufficient arrangements to ensure the compliance of this Section. Tax deductors can reach out to their respective Deductees in this regard to obtain appropriate declaration on compliance of filing of the Income-tax returns for applicable PYs. Such a declaration can be obtained manually from the Deductees or through online forms or by way of survey through survey Apps etc. It also needs to be noted that the confidentiality of the data obtained from the Tax deductees is appropriately maintained in whichever mode the data is obtained. Further, given the sensitivity of the information involved, the Tax deductees may not be willing to share the tax return acknowledgements etc. for this purpose.

Furthermore, the Tax deductors can obtain sufficient indemnities while taking the declaration from the Tax deductees in order to cover the risks of non-compliance involved in this regard.

Q9: Should a separate declaration be taken once the Section 139(1) due date for FY 2020-21 gets over?

Right now, there is no mechanism or platform available for the Tax deductors to check the compliance of Income-tax return filing by the Deductees. Given this, it would be useful if the Tax Department comes up with an online platform which can provide the requisite data for determining the applicability of Section 206AB in case of the vendors. However, in the absence of any such platforms, it may be required to take a top-up declaration / confirmation from the vendors in relation to the status of filing of tax return for FY 2020-21.

Q10: What happens if the Tax deductee has filed the tax return for one of the years in the applicable two PYs?

Such a Deductee would not be treated as "Specified person" since the definition of "Specified person" is triggered only when the Deductee has not filed the tax return **for both the two** assessment years. Given this, technically Section 206AB provisions should not be applicable where the tax return is not filed for one of the years.

Q11: What happens if the Tax deductee has filed the tax returns after the due date of filing return under section 139(1) of the Act?

A Tax deductee will be treated as a "Specified person" where he has not filed the tax returns for both the applicable PYs. As such, the Section does not require that the Tax deductee should have filed the tax return within the due date mentioned in Section 139(1), for not being treated as a "Specified person" under the Section.

Given this, it appears that even if the Deductee has filed the tax return after the due date of filing the return under Section 139(1), the Deductor should not be required to apply the provisions of Section 206AB of the Act in such cases since the requirement of filing of the tax return has been met by the Tax deductee.

Q12: What happens if the Tax deductee is not liable to file the tax return under the provisions of the Act and therefore he has not filed the returns for applicable PYs?

It may be noted that Section 206AB does not provide an exemption in such cases. However, the Tax deductors can keep in mind the threshold of INR 50,000 of TDS while determining the applicability of Section 206AB in case of such Deductees.

Q13: Would the compliance be necessary if the tax deduction done by the Deductor is less than INR 50,000 in case of any particular Deductee for both the applicable PYs?

A Tax deductee would be treated as a "Specified person" if the aggregate of TDS and tax collected at source ('TCS') in his case is INR 50,000 or more in each of the two PYs. Therefore, the aggregate of TDS / TCS should be calculated from the perspective of the all the TDS / TCS available to the Tax deductee concerned (as may be reflected in his Form 26AS) and not from the perspective of the quantum of TDS / TCS made by the subject Tax deductor.

Q14: What happens if the TDS is less than INR 50,000 in one of the two applicable PYs and the Tax deductee has not filed the tax returns for both the applicable PYs?

In such a scenario, the Tax deductee should not be treated as a "Specified person" since the Section requires the aggregate of TDS and TCS to be INR 50,000 or more in **each** of the applicable PYs.

Q15: Is there any relaxation for non-residents who are subject to TDS under section 195 of the Act?

Yes, a non-resident who does not have a "permanent establishment" (PE) in India is outside the purview of applicability of Section 206AB.

Further, it may be noted that Section 206AB has provided an inclusive definition of PE for this purpose, wherein it suggests that a PE includes a fixed place of business through which the business of the enterprise is wholly or partly carried on. Given that the Section provides a definition for PE, the relevance and applicability of this definition *vis-à-vis* relevance and applicability of the definitions typically provided for PE in the Double Taxation Avoidance Agreements may become a matter of debate in future. It may be also relevant to include a reference of the PE definition / PE contemplated under Section 206AB of Act in the PE related declarations that are typically obtained from the non-resident vendors for the purposes of withholding under Section 195 of the Act.

Q16: What could be the potential implications in case of non-compliance of Section 206AB?

The following implications could possibly arise where a Tax deductor does not comply with the provisions of Section 206AB of the Act –

- ◆ Classification as "assessee in default" in terms of Section 201 of the Act
- ◆ Interest in terms of Section 201(1A) of the Act
- ◆ Penalty in terms of Section 221 of the Act
- ◆ Penalty in terms of Section 271C of the Act
- ◆ Where there is said to be a short-deduction of tax due to trigger of Section 206AB, potentially disallowance of expense in terms of Section 40 of the Act
- ◆ Disclosure in Clause 34 of Form 3CD

(Source: Taxmann.com)