



Income-tax deducted outside India cannot be allowed as deduction under Section 37(1) of the Income-tax Act

Background

Recently, the Ahmedabad Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Elitecore Technologies Private Limited¹ (the taxpayer) held that income-tax deducted outside India, cannot be allowed as deduction under Section 37(1) of the Income-tax Act, 1961 (the Act) since the same is covered under the disabling provisions of Section 40(a)(ii)² of the Act.

The Tribunal observed that if the main provision of Section 40(a)(ii) of the Act does not cover taxes paid abroad, there cannot be any occasion to include, under Explanations to Section 40(a)(ii) of the Act, taxes in respect of which relief under Section 90 and 91 of the Act is not admissible. The Explanations do not extend the scope of Section 40(a)(ii) of the Act but rather explain the scope of the said section. If something is covered by the Explanation, it cannot be said that it is not covered by the main provision.

Facts of the case

- The taxpayer is a wholly owned subsidiary of a U.S. based company engaged in the business of software developments and products. During the relevant previous year, the taxpayer earned income from Indonesia, Malaysia, and Rwanda.

¹ DCIT v. Elitecore Technologies Private Limited (ITA No. 508/Ahd/2016) – Taxsutra.com

Note: This decision deals with various other issues. However, this flash news has been prepared on the foreign tax credit related issue.

² Section 40(a)(ii) - Any sum paid on account of any rate or tax levied on the profits or gains of any business or profession or assessed at a proportion of, or otherwise on the basis of, any such profits or gains shall not be deducted in computing the income chargeable under the head profits and gains of business or profession

The taxes were deducted in the respective source countries in respect of these incomes. The taxpayer claimed a tax credit in respect of the taxes so deducted abroad.

- While the taxpayer has claimed a tax credit of INR55,61,306, the Assessing Officer (AO) has granted the tax credit of the only INR3,10,799.
- The Commissioner of Income-tax (Appeals) [CIT(A)] simply followed his predecessor's order on this issue, in taxpayer's own case for 2009-10, and confirmed the quantification of the eligible tax credit at INR3,10,799. As for the balance amount of INR52,50,507 (i.e. tax deducted abroad at INR55,61,306 *minus* tax credit allowed of INR3,10,799, the CIT(A) held that it should be allowed as a deduction under Section 37(1) of the Act.

Tribunal's decision

- The Ahmedabad Tribunal in the case of Mastek Ltd³ held that taxes paid abroad can be allowed as a deduction under Section 37(1) of the Act. In coming to this conclusion, the Tribunal did not take note of the decision of the Bombay High Court in the case of Lubrizol⁴, which has been approved by the Supreme Court in the case of Smithkline and French India⁵, or even decision in the case of Tata Sons⁶.

³ DCIT v. Mastek Limited [2013] 36 taxmann.com 384 (Ahd)

⁴ Lubrizol India Limited v. CIT [1991] 187 ITR 25 (Bom)

⁵ Smithkline & French India Ltd v. CIT [1996] 219 ITR 581 (SC)

⁶ DCIT v. Tata Sons Ltd [1991] 9 ITR (Trib) 154 (Bom)

- Tax paid outside India, not being a tax levied under the Act, is said to be intact from the bar placed under Section 40(a)(ii) of the Act. Section 40(a)(ii) of the Act, provides that 'any sum paid on account of any rate of tax levied on the profits or gains of any business or profession or assessed at a proportion of, or otherwise on the basis of, any such profits or gains' shall not be allowed as a deduction, *inter alia*, under Section 37(1) of the Act.
- The connotations of expression 'tax' appearing in the above provisions are controlled by definition under Section 2(43) of the Act. The connotations of the expression 'tax' appearing in the above provision extend to any tax, whether under the Act or not, as long as the tax is levied on the profits and gains of business, or assessed at a proportion of, or otherwise on the basis of, any such profits and gains.
- As a matter of fact, the Bombay High Court, in the case of Reliance Infrastructure⁷ referring the decision of the Bombay High Court in the case of Inder Singh Gill⁸ which was rendered in the context of the Income-tax Act, 1922 observed that the ratio of the decision in the case of Inder Singh Gill cannot be applied to the present facts in view of the fact that the Act defines 'tax' as income tax chargeable under the provisions of the Act.
- The taxpayer contended that the meaning of expression 'tax' appearing in Section 40(a)(ii) must remain confined to a tax levied under the Act. However, the Tribunal did not agree upon the taxpayer's contentions.
- If the main provision, as is the claim of the taxpayer, does not cover the taxes paid abroad, there cannot be any occasion to include, under Explanations to Section 40(a)(ii), taxes in respect of which relief under Section 90 and 91 is not admissible. These Explanations do not extend the scope of the Section 40(a)(ii) but rather explain the scope of the said section. If something is covered by the Explanation, it cannot be said that it is not covered by the main provision. If taxes in respect of which tax credit under Section 90 or 91 are covered by the proviso, these are covered by the scope of Section 40(a)(ii) as well.
- If these taxes are covered by Section 40(a)(ii), the theory that meaning of 'tax' under Section 40(a)(ii) must remain confined to the taxes levied under the Act comes to a naught since the taxes in respect of which credits are available under Section 90 or 91 cannot be, under any circumstances, imposed under the Act.
- Accordingly, it has been held that no deduction under Section 37(1) can be allowed in respect of any income tax deducted abroad as the same will be hit by the disabling provisions under Section 40(a)(ii) of the Act.
- The relief granted by the CIT(A), by directing the grant of deduction of INR52,50,507 in respect of income tax deducted abroad in respect of which no foreign tax credit is admissible, under section 37(1) of the Act must, therefore, stand vacated. Accordingly, the taxpayer is allowed only partial tax credit in respect of taxes deducted abroad, the taxpayer cannot be allowed any deduction, in respect of the balance of the taxes so deducted abroad, under Section 37(1) of the Act.

Our comments

The issue with respect to the allowability of tax paid outside India has been a matter of litigation before the Courts. The issue raised before the Courts are whether income-tax paid in a foreign country is eligible for deduction in the computation of profits and gains from business or profession. In this regard, the judicial precedents are divided with majority decisions being in favour of the tax department⁹. However, some taxpayers continue to claim income tax paid in the foreign country both, as a deduction in the computation of profits and gains from business or profession and also as a credit against tax payable on their global income.

With a view to end the judicial conflict and the claim of such double deduction, the Finance Act, 2006 amended the Act by inserting Explanation 1 to sub clause (ii) of clause (a) of Section 40 of the Act so as to clarify that any sum paid outside India and eligible for relief of tax under Section 90 or deduction from the income-tax payable

⁷ Reliance Infrastructure Ltd v. CIT [2017] 390 ITR 271 (Bom)

⁸ S. Inder Singh Gill v. CIT [1963] 47 ITR 284 (Bom)

⁹ Lubrizol (Bombay High Court), SmithKline and French India (Supreme Court)

under Section 91 of the Act is not allowable, and is deemed to have never been allowable, as a deduction under Section 40 of the Act. However, the taxpayers will continue to be eligible for tax credit in respect of income tax paid in a foreign country in accordance with the provisions of Section 90 or Section 91 of the Act, as the case may be.

The Ahmedabad Tribunal in the present case dealt with the Explanations introduced by the Finance Act, 2006 in Section 40(a)(ii) of the Act. The Tribunal did not agree with the taxpayer's contention that the word 'tax' in Section 40(a)(ii) of the Act can have meaning defined under Section 2(43) of the Act, because it would restrict the applicability of Section 40(a)(ii) to the provisions of the Act only. Accordingly, the Tribunal in the present case has held that income-tax deducted outside India cannot be allowed as a deduction under Section 37(1) of the Act since the same is covered under the disabling provisions under Section 40(a)(ii) of the Act.



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