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TAX FLASH NEWS

30 January 2019

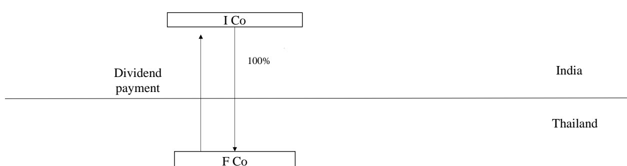
Tax sparing credit is allowed under the India-Thailand tax treaty with respect to 'dividend' income

Background

Recently, the Delhi Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Polyplex Corporation Ltd[1] (the taxpayer) dealt with the issue of availability of 'tax sparing credit'[2] under the India-Thailand tax treaty (tax treaty).

The taxpayer, an Indian company, is having a wholly owned subsidiary in Thailand. During the assessment years 2010-11 to 2013-14, Thailand subsidiary declared dividend which was received by the taxpayer. By virtue of the Investment Promotion Act in Thailand, such dividend income was exempt in the hands of Thailand Company. However, the taxpayer claimed that as per Article 23(3) of the tax treaty it is entitled to claim tax sparing credit of deemed tax payable in Thailand against Indian tax payable.

The diagram representing the structure and the payment is as under:



The Assessing Officer (AO) held that the taxpayer had not paid actual tax in Thailand on such dividend income. It was exempt in Thailand by virtue of Investment Promotion Act of Thailand. The tax treaty provisions did not provide for tax benefit for tax which was not paid at all. Article 23(2) specifically allows relief against income which has been subjected to tax in both the countries. Since the tax was only paid in India, the question of double taxation of income did not arise. The Commissioner of Income-tax (Appeals) [CIT(A)] upheld the order of the AO.

The Tribunal's decision

While relying on Commentary on UN Model Convention and Klaus Vogel Commentary the Tribunal observed that concept of 'tax sparing credit' shall be applicable to the taxpayer, only if dividend income received by taxpayer is taxable in the hands of taxpayer as per the 'Thai tax laws' and exemption is available to the taxpayer either as per the 'Revenue Code of Thailand'[3] or as per the 'Investment Promotion Act' in order to avail credit of such taxes spared in Thailand.

From a co-joint reading of the taxability of dividend income under Thailand Revenue Code and Investment Promotion Act, it has been observed that the exemption was available to the taxpayer on such dividend income under Investment Promotion Act, which would have been otherwise taxable as per the Thailand Revenue Code at 10 per cent. Therefore, as per Article 23(3) of the tax treaty, the taxpayer would be entitled to a credit of such taxes which were deemed to have been payable in Thailand. The taxpayer sought credit at 10 per cent on such dividend, which is the tax that would have been otherwise payable by the taxpayer in Thailand as per the provisions of the Thailand Revenue Code. The tax paid by the taxpayer on dividend income in India is at 30 per cent, which was more than tax payable in Thailand and therefore, there is no violation of provisions of Article 23(2) of the tax treaty.

Our comments

The OECD's Glossary of Tax Terms[4] defines 'Tax Sparing Credit' as a term used to denote a special form of double taxation relief in tax treaties with developing countries. Where a country grants tax

[1] Polyplex Corporation Ltd v. DCIT (ITA Nos. 4347 to 4350/Del/2016) – Taxsutra.com
[2] Credit in the resident country for taxes spared by source country under incentive program of source country

[3] Thailand Income-tax Act
[4] http://www.oecd.org/ctp/glossaryoftaxterms.htm

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incentives to encourage foreign investment and that company is a resident of another country with which a tax treaty has been concluded, the other country may give a credit against its own tax for the tax which the company would have paid if the tax had not been 'spared' (i.e. given up) under the provisions of the tax incentives. Klaus Vogel in his commentary on Double Taxation has also explained the concept of 'Tax Sparing Credit' stating that in accepting the 'tax sparing credit' method, the residence state takes into consideration special measures by which the source state has, for the reasons of economic policy or the like, reduced its tax individually or for certain categories of cases. The tax allowed as credit by the residence state is that which would have been paid in the absence of such a special reduction.

Thus the tax sparing credit, in the context of tax treaty, refers to the provisions in the tax treaties between contracting states which give benefit to the residence country to give credit not only for taxes actually paid in the source country but also for taxes which would have been paid but exempted in the source country due to certain tax incentives.

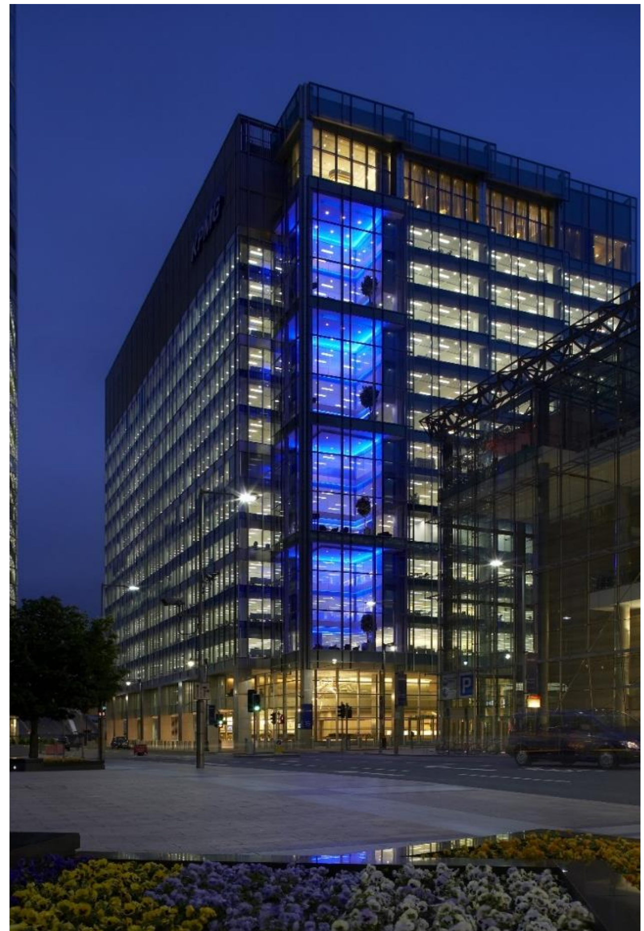
The Delhi High Court in the case of Krishak Bharati Cooperative Ltd[5] dealt with the allowability of tax sparing credit. The High Court while affirming the decision of the Tribunal held that where the taxpayer received dividend income from an Omani company on which it was not liable to pay any tax in Oman by virtue of exemption granted as per Omani tax laws to promote economic development, the taxpayer was entitled for tax credit for deemed dividend tax by virtue of provisions of tax treaty read together with clarifications issued by Sultanate of Oman.

On the similar lines, the Delhi Tribunal in the present case held that 'tax sparing credit' is allowable under the tax treaty on 'dividend' income which is exempt in Thailand by virtue of Investment Promotion Act.

The Supreme Court of Korea[6] while applying 'tax sparing credit' held that 10 per cent deemed foreign tax credit under Article 5(1) of the 2006 protocol is applicable in all cases, to help achieve the goal of attracting foreign investment. Therefore, it is reasonable to consider that the amount of tax that is deemed to have been paid in a source country on dividend income is 10 per cent of the gross amount, even if the tax was withheld in the source country at a reduced rate of 5 per cent. Accordingly, a tax credit should be available to the company for the deemed foreign tax amount.

[4] http://www.oecd.org/ctp/glossaryoftaxterms.htm
[5] Pr. CIT v. Krishak Bharati Cooperative Ltd [2017] 80 taxmann.com 326 (Del)
[6] KPMG news alert, dated 26 September 2017

It is important to note that the India-Thailand tax treaty has been amended in 2015[7] where the 'tax sparing credit' clause has been deleted. However, the above decision can be helpful to claim the benefit of the tax sparing credit under Indian tax treaties which have a similar 'tax sparing credit' clause. Some of the Indian tax treaties having 'tax sparing credit' clause are Singapore, Philippines, Russia, Bangladesh, etc.



[7] Notification No. 88/2015 [F. No. 503/5/2005-FTD-II]/SO 3244(E), dated 1 December 2015

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