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TAX FLASH NEWS

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Overseas taxes and Medicare would not constitute taxable salary in India

Background

It is not uncommon to see organisations send employees outside India on a short and long term basis. In such cases, these employees could receive salary both within and outside India. In this context, recently the Bangalore Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Shri Sunil Shinde[1] (the taxpayer) has held that overseas taxes and Medicare would not constitute taxable salary in India, while offering overseas salary to tax in India.

Facts of the case

- The taxpayer was an employee of Fidelity Business Services India Pvt. Ltd who was transferred to Fidelity Investments Systems Inc, USA from 7 October 2010 to 21 June 2012. The taxpayer derived income from salary during the Financial Year (FY) 2010-11.
- The taxpayer was an ordinary resident (ROR) in India during the said FY. Further, in the United States (U.S.) he was a non-resident during the year 2010 and a resident in 2011.
- The taxpayer had offered the actual salary income received in U.S. as taxable in his India tax return and claimed Foreign Tax Credit (FTC)[2] in respect of the Federal Tax withheld from his overseas salary.
- The Assessing Officer (AO) in his order added the Federal Tax claimed as FTC to the income of the taxpayer.
- The Commissioner of Income-tax (Appeals) [CIT(A)] upheld the order passed by the Assessing Officer (AO) and enhanced the amount of Federal Tax so added to income.
- Furthermore, the CIT(A) added Medicare paid in the U.S. and State Tax withheld in the U.S., to be part of the total income of the taxpayer, considering the same as benefit in his hands
- Aggrieved by the order passed by the CIT(A), the taxpayer had filed an appeal with the Tribunal.

Taxpayer's contention

- The taxpayer's contention on the three grounds were as under:
  - Ground 1 - The taxpayer argued that the Federal Tax and State Tax do not constitute taxable income based on various judicial precedents[3] for the following reasons:
    - Tax Deducted at Source (TDS) is a diversion of income by overriding title. As the tax deducted would be paid to the Government, only the net income received by the taxpayer should be subject to tax in India
    - Taking a cue from Section 198 of the Act, TDS under the provisions of the Act is only deemed to be income received. However, Section 198 does not refer to TDS outside India
    - Section 5(1)(c) of the Act does not provide for taxation of amounts deemed to accrue/ arise/ be received outside India. Unlike other parts of the said section, deeming fiction does not form basis of taxation in respect of income earned/ received outside India

[1] Shri Sunil Shinde v. CIT [ITA No 2149 (Bang) 2016] – Taxsutra.com
[2] Section 90 of the Act read with provisions of India-USA tax treaty
[3] CIT v. Yawar Rashid [1996] 218 ITR 699 (MP), CIT v. Y.N.S.Hobbs [1979] 116 ITR 20 (Ker), CIT v. Shaw Wallace and Co. Ltd. [1983] 143 ITR 207 (Cal), CIT v. Blundell Spence & Co. Ltd [1952] 21 ITR 28 (Bom), CIT v. Oriental Co. Ltd [1982] 137 ITR 777 (Cal), CIT v. Ambalal Kilachand [1994] 210 ITR 844 (Bom)

- Given the above, the taxpayer contended that the Federal Tax and State Tax are to be considered as income deemed to be received outside India or deemed to accrue/ arise outside India and are therefore not taxable in his hands in India.

➢ Ground 2 – Medicare to be considered as non-taxable perquisite

In respect of Medicare, the taxpayer claimed that the same is not a taxable perquisite in his hands. The taxpayer has placed reliance on various judicial precedents[4] where in case the benefit accruing is purely contingent in nature or the employee does not get a vested right at the time of contribution, then the amount so contributed should not be considered as taxable perquisite

➢ Ground 3 – State Tax to be considered for claiming FTC

The taxpayer contended that if State Tax paid in the U.S. is considered as income in India, he should be allowed to claim FTC of such State Tax in India.

Tribunal's decision

- It has been observed that as per Section 5(1)(c) of the Act, the Federal Tax and State Tax withheld in the U.S. would not constitute income that accrues or arises outside India as the same is not actually received by the taxpayer.

- Accordingly, the Tribunal has accepted the claim of the taxpayer by relying on one of the judgments[5] referred by the taxpayer, drawing reference to Section 5(1)(c) of the Act, which enables taxability of actual income that is received by the taxpayer outside India.

- Therefore, Federal Tax and State Tax were not considered taxable in the hands of the taxpayer and the net income after giving effect to deduction of taxes was considered taxable in India.

- The claim of FTC was remanded to the AO to determine the quantum of FTC as per Article 25 of the DTAA. The FTC claim shall, however, be restricted to the tax payable on the total income before giving effect to FTC.

- With respect to Medicare paid outside India by the employer, the Tribunal agreed with the taxpayer's contention having regard to one of the judicial precedents[6] referred by him. Accordingly, the same was not considered as a taxable perquisite.

Our comments

This decision could provide relief to resident individuals who travel outside India where the foreign taxes are paid by the employer. The taxable income of such taxpayers could stand reduced to the extent of foreign taxes paid by the employer. However, it is imperative to note that the FTC claim is consistent with the proportion of doubly taxed income that is included in the India tax return.

Though the decision has been in favour of the taxpayer, adoption of the same in other jurisdictions could be evaluated on a case-to-case basis as claiming tax benefits on overseas income, especially at lower levels, are often litigious.

The decision has reinstated that any perquisite provided by the employer, the benefit of which has not vested at the time of contribution, should be considered as exempt.

[4] CIT v. Lala Sridhar [1972] 84 ITR 192 (Del), Yoshio Kubo v. CIT [2013] 36 taxmann.com 1 (Del), CIT v. L W Russel [1964] 53 ITR 91 (SC)
[5] CIT v. Yawar Rashid [1996] 218 ITR 699 (MP)
[6] CIT v. Lala Sridhar [1972] 84 ITR 192 (Del)

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Ahmedabad
Commerce House V, 9th Floor,
902 & 903, Near Vodafone House,
Corporate Road,
Prahlad Nagar,
Ahmedabad – 380 051
Tel: +91 79 4040 2200
Fax: +91 79 4040 2244

Bengaluru
Maruthi Info-Tech Centre
11-12/1, Inner Ring Road
Koramangala,
Bengaluru – 560 071
Tel: +91 80 3980 6000
Fax: +91 80 3980 6999

Chandigarh
SCO 22-23 (Ist Floor)
Sector 8C, Madhya Marg
Chandigarh – 160 009
Tel: +91 172 393 5777/781
Fax: +91 172 393 5780

Chennai
No.10, Mahatma Gandhi Road
Nungambakkam
Chennai – 600 034
Tel: +91 44 3914 5000
Fax: +91 44 3914 5999

Gurugram
Building No.10, 8th Floor
DLF Cyber City, Phase II
Gurugram, Haryana – 122 002
Tel: +91 124 307 4000
Fax: +91 124 254 9101

Hyderabad
Reliance Humsafar, 4th Floor
8-2-618/2, Road No.11, Banjara Hills
Hyderabad – 500 034
Tel: +91 40 3046 5000
Fax: +91 40 3046 5299

Jaipur
Regus Radiant Centres Pvt Ltd.,
Level 6, Jaipur Centre Mall,
B2 By pass Tonk Road
Jaipur, Rajasthan, 302018.
Tel: +91 141 - 7103224

Kochi
Syama Business Center
3rd Floor, NH By Pass Road,
Vytilla, Kochi – 682019
Tel: +91 484 302 7000
Fax: +91 484 302 7001

Kolkata
Unit No. 603 – 604,
6th Floor, Tower – 1,
Godrej Waterside,
Sector – V, Salt Lake,
Kolkata – 700 091
Tel: +91 33 4403 4000
Fax: +91 33 4403 4199

Mumbai
Lodha Excelus, Apollo Mills
N. M. Joshi Marg
Mahalaxmi, Mumbai – 400 011
Tel: +91 22 3989 6000
Fax: +91 22 3983 6000

Noida
Unit No. 501, 5th Floor,
Advant Navis Business Park
Tower-B, Plot# 7, Sector 142,
Expressway Noida, Gautam Budh Nagar,
Noida – 201305
Tel: +91 0120 386 8000
Fax: +91 0120 386 8999

Pune
9th floor, Business Plaza,
Westin Hotel Campus, 36/3-B,
Koregaon Park Annex, Mundhwa Road,
Ghorpadi, Pune – 411001
Tel: +91 20 6747 7000
Fax: +91 20 6747 7100

Vadodara
iPlex India Private Limited,
1st floor office space, No. 1004,
Vadodara Hyper, Dr. V S Marg
Alkapuri, Vadodara – 390 007
Tel: +91 0265 235 1085/232 2607/232 2672