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TAX FLASH NEWS

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Taxpayer is eligible for foreign tax credit in India on taxes paid in various foreign countries

The Bangalore Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of ITTIAM Systems Pvt Ltd[1] (the taxpayer) dealt with the issue of eligibility of Foreign Tax Credit (FTC) on the taxes paid in various foreign countries. The Tribunal held that the taxpayer is eligible for full credit of FTC, amounting to taxes paid in USA, Japan and Germany under respective tax treaties. However, in the case of Korea, FTC is limited to taxes paid in Korea or India, whichever is less.

With Taiwan, India does not have a tax treaty. Therefore, FTC is to be computed based on rate of tax applicable in India or Taiwan, whichever is less, on such doubly taxable income.

Facts of the case

The taxpayer specialises in signal processing application and media processing and communication. During the Assessment Year (AY) 2013-14 and 2014-15, the taxpayer earned income from Japan, Korea, Germany and USA. Further, the taxpayer earned income from Taiwan with which India does not have a tax treaty during the relevant year. The taxpayer claimed entire amount of INR 18.05 million as FTC in respect of revenue which was subjected to tax outside India. The FTC claim worked out to the effective tax rate of 14.32 per cent in respect of income taxed outside India and the effective tax rate in India worked out to be 32.45 per cent. Hence, as 14.32 per cent being lower than 32.45 per cent the entire amount was claimed as FTC under the tax treaty. Similarly, for Taiwan, the taxpayer claimed credit of entire taxes paid in Taiwan.

The Assessing Officer (AO) observed that the taxpayer wrongly compared rate of tax outside India with the rate of tax in India. The effective tax rate outside India was calculated by the taxpayer on receipts whereas the effective tax rate payable in India was calculated on income. There is a difference of 9.9 per cent between effective tax rate outside India on receipts and effective tax rate in India on income. As per the tax treaty, relief has to be calculated based on income of that resident and not the receipts. Thus, the taxpayer was eligible for restricted FTC relief of INR 4 million under the tax treaty. The Commissioner of Income-tax (Appeals) [CIT(A)] also allowed partial claim of FTC of the taxpayer.

Tribunal decision

Claim of FTC vis-à-vis treaty countries

On perusal of Article 25 of the India-US tax treaty, it indicates that, if a resident Indian derives income, which may be taxed in USA, India shall allow as a deduction from the tax on the income of the resident, an amount equal to the tax paid in USA, whether directly or by deduction. The conditions mandated in the tax treaty is that if any 'income derived' and 'tax paid in US', then tax relief/credit shall be granted in India on tax paid in US. The same conditions available under the India-Japan and India-Germany tax treaty.

In all the above clauses, for eliminating double taxation of doubly taxable income in the hands of the taxpayer, it would be necessary to establish the taxes paid by taxpayer in USA, Japan, and Germany. The condition stipulated is very clear that FTC is available on taxes paid in these countries.

However, on perusal of the Article 23 of the India-Korea tax treaty, it has been observed that, in India FTC is available to the taxes paid in Korea and such credit shall not exceed the taxes payable in India on doubly taxed income. Thus, there is a difference in FTC available to the taxpayer on taxes paid in USA, Japan and Germany vis-s-vis Korea.

[1] ITTIAM Systems Pvt. Ltd. v. ITO (ITA No. 2464 and 2465/Bang/2017) – Taxsutra.com

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In the present facts of the case, respective treaty countries withheld taxes against income from the source state at a particular rate. Article 25 of India-US tax treaty, Article 23(2) of India-Japan tax treaty and India-Germany tax treaty, allows FTC in India to the extent of tax paid in these countries, whereas, Article 23 of Indo-Korea tax treaty allows taxes paid in Korea and such credit shall not exceed the taxes payable in India on doubly taxed income.

On perusal of treaty provisions, the taxpayer is eligible for FTC in full, amounting to taxes paid in USA, Japan and Germany. The decision of the Karnataka High Court in case of Wipro[2] relied upon. Only in case of Korea, FTC is limited to taxes paid in Korea or India, whichever is less. Therefore, the AO is directed to grant FTC in respect of taxes paid in USA, Japan and Germany. In case of taxes paid in Korea, FTC will be tax actually paid in Korea or payable in India on such doubly taxable income, whichever is lower.

Claim of FTC vis-à-vis Taiwan (with whom India does not have a tax treaty)

India does not have a tax treaty with Taiwan. Therefore, FTC available to the taxpayer against taxes paid in Taiwan will be computed as per the provisions of Section 91[3]. Section 91 provides for deduction of tax paid in any country from the Indian Income tax payable by the taxpayer of a sum calculated on such doubly taxed income, even though there is no tax treaty. Therefore, even in the absence of a tax treaty, by virtue of the statutory provision, the benefit conferred under Section 91 is extended to the income tax paid in foreign jurisdictions.

Section 91 lays down its own conditions for and extent of the relief contemplated to be given to the taxpayer. Once the conditions of Section 91 are fulfilled, resident-taxpayer would be entitled to the deduction under the Income-tax Act, as is payable by him, of a sum calculated on the doubly taxed income at the Indian rate of tax or the rate of tax of the other country concerned, whichever is the lower. Thus, as per Section 91 , in case of Taiwan, FTC is to be computed based on rate of tax applicable in India or Taiwan, whichever is less, on such doubly taxable income.

Our comments

The issue of allowability of FTC has been a matter of debate before the Courts / Tribunal.

The Courts/Tribunal[4] in some of the cases have held that taxpayer is entitled to the credit in respect of income taxes paid in the foreign country. Further, the Delhi Tribunal in the case of Uniparts India Limited[5] held that a resident taxpayer is eligible to claim the credit of the taxes withheld outside India on foreign-sourced income, subject to substantiation of the provisions under which the said taxes were withheld.

However, the Kolkata Tribunal in the case of Arvind Metals and Minerals (P) Ltd[6] held that the taxpayer is entitled for FTC on proportionate basis as per Article 23 of the India-Thailand tax treaty as against full credit claimed by the taxpayer. As per Article 23(2), credit of taxes paid in Thailand shall be allowed against Indian income-tax payable in respect of such income, not exceeding total Indian tax appropriated to Thailand income. Therefore, no refund allowed on excess foreign tax deducted.

With respect to the foreign tax credit relating to income, which is exempt in India, the Mumbai Tribunal in the case of Tata Consultancy Service Ltd.[7] observed that in case of a tax treaty, where a specific tax credit benefit is provided even in respect of income on which the tax has not been paid in India, the taxpayer would be eligible for tax credit under Section 90. However, certain tax treaties do not provide for such benefit unless the income is subjected to tax in both the countries. Accordingly, the Tribunal directed the AO to grant credit to the taxpayer.

The Tribunal in the present case has held that the taxpayer is eligible for full credit of FTC, amounting to taxes paid in USA, Japan and Germany under respective tax treaties. However, in the case of Korea, FTC is limited to taxes paid in Korea or India, whichever is less. With Taiwan, India does not have a tax treaty. Therefore, FTC is to be computed based on rate of tax applicable in India or Taiwan, whichever is less, on such doubly taxable income.

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[2] Wipro Limited v. DCIT
[2016] 382 ITR 179 (Kar)

[3] If any person who is resident in India in any previous year proves that, in respect of his income which accrued or arose during that previous year outside India (and which is not deemed to accrue or arise in India), he has paid in any country with which there is no agreement under section 90 for the relief or avoidance of double taxation, income-tax, by deduction or otherwise, under the law in force in that country, he shall be entitled to the deduction from the Indian income-tax payable by him of a sum calculated on such doubly taxed income at the Indian rate of tax or the rate of tax of the said country, whichever is the lower, or at the Indian rate of tax if both the rates are equal.

[6] Mersen India Private Limited [2013] 353 ITR 628 (AAR), Steria (India) Ltd. [4] Dr. Rajiv I. Modi v. DCIT (ITA No. 1285 [AHD] 2014, dated 21 September 2017), Tata Consultancy Services v. ACIT (ITA No. 5713/Mum/2016), Bhavin Shah v. ACIT (ITA No. 933/Ahd/2013)

[5] Uniparts India Limited v. CIT (ITAs. No.201, 202, 203, 204 & 205/DEL/2015)

[6] Arvind Metals and Minerals (P) Ltd v. DCIT (ITA No 777/Kol/2010)

[7] Tata Consultancy Service Ltd. v. ACIT (ITA no. 5713/Mum/2016)

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