

TAX FLASH NEWS

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Taxpayer is eligible for Foreign Tax Credit relating to exempt income in India under the India-Japan tax treaty

Recently, the Delhi Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Canon India Pvt. Ltd.¹ (the taxpayer) dealt with the issue of eligibility of Foreign Tax Credit (FTC) when the taxpayer's income was exempt in India. The Tribunal held that the taxpayer is eligible for FTC on the entire amount of taxes withheld in Japan under the India-Japan tax treaty (tax treaty). The Tribunal relied on the decision of its Co-ordinate Bench in the case of HCL Comet².

Facts of the case

The taxpayer claimed deduction under Section 10A of the Income-tax Act, 1961 (the Act) against the income earned by Software Technology Park (STP) Unit. During the Assessment Year 2004-05, the taxpayer had rendered software related services to its Associated Enterprise (AE) in Japan. Income from these software services in Japan was subjected to tax in Japan at 20 per cent pursuant to Article 12 of the tax treaty. Total tax deducted at source in Japan was INR 39.61 million. The taxpayer had claimed foreign tax credit of INR 543,360 despite total taxes deducted at source in Japan amounting to INR 39.61 million. The claim was restricted to actual income tax liability which was substantially low as the taxpayer was eligible for exemption under Section 10A and had significant brought forward losses.

Subsequently, the taxpayer filed additional objections before the Dispute Resolution Panel (DRP) claiming the entire amount of INR 39.61 million withheld by Japanese entity as tax credit. This claim was made in view of the Karnataka High Court's decision in the case of Wipro Ltd³. However, the DRP did not adjudicate upon this additional claim. Subsequent to DRP's

directions, the AO rejected the contention of the taxpayer stating that Karnataka High Court's decisions was pending before the Supreme Court.

Tribunal's decision

In so far as the claim of full credit of tax paid in Japan is concerned, the Tribunal relied on the decision of its co-ordinate Bench in the case of HCL Comet where the Tribunal under the India-USA tax treaty considering Section 10A observed as follows:

- By virtue of the statutory provision i.e., Section 10A, the income of the taxpayer from exports in respect of the said unit is exempt from payment of income tax. This relief under Section 10A is in the nature of exemption although termed as deduction. However, for this exemption, the said income namely profits, and gains derived by an undertaking, is to be chargeable to tax under the Act. The said exemption is only for a period of 10 years.
- Various cases⁴ have held that merely because exemption had been granted in respect of the taxability of a particular source of income, it cannot be formulated that the entity was not liable to tax.
- In view of the above, it follows that the income under Section 10A was chargeable to tax under Section 4 and was includible in the total income under Section 5, but no tax was charged because of the exemption given under Section 10A only for a period of 10 years.
- Merely because the exemption had been granted in respect of the taxability of the said source of income, it cannot be postulated that the taxpayer was not liable to tax. The said exemption granted

¹ Canon India Pvt. Ltd. v. ACIT (ITA No. 468/Del/2021) – Taxsutra.com

² HCL Comet (ITA No. 5555/Del/2014, 6162/Del/2013)

³ Wipro Ltd v. DCIT [2016] 382 ITR 179 (Kar)⁴ Steria India Ltd v. DCIT [2018] 255 Taxman 110 (Del)

⁴ Wallace Flour Mills Co. Ltd. v. Collector of Central Excise [1989] 4 SCC 592, Kasinka Trading v. Union of India [1995] 1 SCC 274

under the statute has the effect of suspending the collection of income tax for a period of 10 years. It does not make the said income not leviable to income tax. The said exemption granted under the statute stands revoked after a period of 10 years. Therefore, the case falls under Section 90(1)(a)(ii) of the Act.

- Thus, the Delhi Tribunal directed the AO to consider the claim of foreign tax credit as per the directions of the Karnataka High Court in the case of Wipro Ltd.

It was observed that the India-Japan tax treaty is worded in similar lines with that of India-USA tax treaty. Consequently, the taxpayer is eligible for FTC claim on the amount of tax withheld in Japan under the tax treaty.

Our comments

The issue whether FTC is available on the entire amount of taxes paid in a foreign country when the taxpayer's income is exempt in India, has been a subject matter of debate before the Courts.

The Mumbai Tribunal in the case of Blue Star Infotech Ltd.⁵ directed the tax officer to allow credit of foreign tax paid in Japan against tax levied on corresponding income eligible for deduction under Section 10B in India.

The Karnataka High Court in the case of Wipro Ltd.⁶ held that the income exempt under Section 10A was actually chargeable to tax under Section 4 and the exemption only suspends collection of income tax for a period of 10 years. Thus, such a case falls under Section 90(1)(a)(ii) and the taxpayer would be entitled to take credit of Income-tax paid in the foreign country in respect of such income.

With respect to the foreign tax credit relating to income, which is exempt in India, the Tribunal in the case of Tata Consultancy Service Ltd.⁷ observed that the taxpayer would be eligible to avail tax credit under Section 91 if India does not have any tax treaty with such country. The Tribunal observed that where the respective tax treaty provides for a specific tax credit benefit 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 of the Act. However, certain tax treaties⁸ 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 FTC on the entire amount of taxes withheld in Japan under the India-Japan tax treaty even though taxpayer's income was exempt under Section 10A in India.



⁵ Blue Star Infotech Ltd v. ACIT [2015] 154 ITD 81 (Mum)

⁶ Wipro Ltd. v. DCIT [2016] 382 ITR 179 (Kar)

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

⁸ Dr. Rajiv I. Modi v. DCIT (ITA No. 1285 [AHD] 2014, dated 21 September 2017)

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