KPMG

#KPMGjosh

TAX FLASH NEWS

23 March 2020

Since the tax credit is not available, taxes paid in a foreign country are allowed as business expenditure

Recently, the Ahmedabad Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Virmati Software & Telecommunication Ltd[1] (the taxpayer) held that Foreign Tax Credit (FTC) is to be computed on the basis of 'net income' and not on the basis of 'gross receipts'. Further, since FTC is not available under the Act[2], the taxpayer is eligible for a deduction of such taxes paid in a foreign country as business expenditure[3].

Facts

During the Assessment Year (AY) 2012-13, the taxpayer earned income from the foreign parties based in Afghanistan[4] on which the foreign parties deducted the tax. The taxpayer claimed that it had paid taxes in the foreign country at the rate of 7 per cent which was less than the rate of tax in India. Therefore, it was eligible for the tax relief under Section 91 of the Income-tax Act, 1961 (the Act) with respect to the entire amount of tax deducted by the foreign parties. However, the Assessing Officer (AO) observed that the rate of tax is to be worked out on net income and not on gross receipts as claimed by the taxpayer. Accordingly, the AO worked out the proportionate amount of tax with respect to foreign income which was eligible for tax relief[5].

Before the Tribunal, the taxpayer alternatively contended that the amount of tax paid in a foreign country which was not eligible for foreign tax credit[6], was allowed as business expenditure[7].

[1] Virmati Software & Telecommunication Ltd v. DCIT [ITA No. 1135/AHD/2017] – Taxsutra.com
[2] Under Section 91 of the Act
[3] Under Section 37(1) of the Act
[4] India does not have a tax treaty with Afghanistan
[5] Under Section 91 of the Act
[6] Benefit under Section 91 of the Act
[7] Under the provisions of Section 37(1) of the Act

Tribunal decision

The amount of tax/super tax needs to be divided by the whole amount of income to work out the rate of tax. The term 'whole amount of income' denotes the income which is arrived after deducting the expenses. The term 'gross receipts' has not been used anywhere in Section 91 of the Act. Even under the normal parlance, the income denotes only to the net profit i.e. gross receipts minus the expenditure. The Tribunal held that the only profit should be considered while determining the rate of tax in the foreign country and the same needs to be compared with the rate of tax in India.

The taxpayer has not given any working about the expenses incurred in the foreign country against the gross receipts. Thus, in the absence of sufficient details, the AO should work out the proportionate amount of income eligible for relief under Section 91 of the Act. Accordingly, the Tribunal held that the rate of tax was worked out on net receipts of income and not based on gross receipts as claimed by the taxpayer.

The Tribunal observed that the amount of tax paid in a foreign country which was not eligible for FTC under Section 91 of the Act was to be treated as expenditure eligible for deduction as business expenditure[8]. The deduction was allowable because such tax was paid in the course of the business and the corresponding business receipts were offered to tax in India. The Tribunal relied on the decision of the Bombay High Court in the case of Reliance Infrastructure Ltd[9].

[8] Section 37(1) of the Act
[9] Reliance Infrastructure Ltd v. CIT [2017] 390 ITR 271 (Bom)

© 2020 KPMG, an Indian Registered Partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved.

Our comments

In various cases it has been held that FTC was to be computed on the basis of 'income' and not on the basis of 'gross receipts'. In the instant case also, the Tribunal held that FTC is to be computed on the basis of 'net income' and not on the basis of 'gross receipts'.

In June 2016, the Central Board of Direct Taxes[10] introduced FTC rules which came into effect from 1 April 2017. The rules provide clarity on various aspects of claiming FTC. However, the issue with respect to computation of FTC whether on the basis of 'gross receipts' or 'net income' has not been dealt with by such rules.

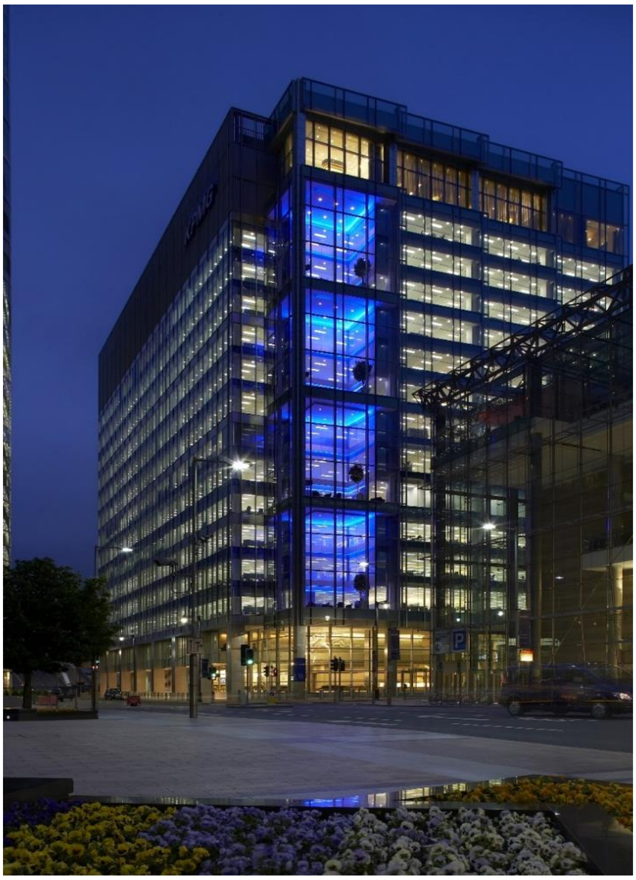
With respect to deduction of foreign tax paid as business expenditure, the Courts/Tribunal[11] in some of the cases have held in favour of the tax department that income-tax paid in a foreign country was not eligible for deduction in the computation of profits and gains from business or profession. However, on the other hand, the Courts/Tribunal in some of the cases[12] have held that taxes paid abroad can be allowed as business expenditure.

Explanation 1 to Section 40(a)(ii) of the Act provides that any sum paid outside India and eligible for relief of tax under Section 90 or deduction from the income-tax payable 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 / 91 of the Act, as the case may be.

However, the Bombay High Court in the case of Reliance Infrastructure Ltd held that if the benefit of double taxation relief is not available on the foreign tax paid, the said amount should be allowed as business expenditure. The High Court further held that foreign tax does not come under the purview of the definition of 'tax' as defined in Section 2(43) of the Act. When the taxpayer is not eligible to avail benefit under Section 90/91/90A of the Act, then foreign tax should not be considered as a tax within the meaning of Section 40(a)(ii) and further, since the same is also not 'tax' within the meaning of Section 2(43), it is an allowable expenditure.

The Ahmedabad Tribunal in the case of Elitecore Technologies[13] held that tax deducted outside India cannot be allowed as a deduction under Section 37(1) of the Act since the same was covered under the disabling provisions of Section 40(a)(ii) of the Act.

However, the Ahmedabad Tribunal in the present case relied on the decision of Reliance Infrastructure Limited and held that the taxpayer was eligible for deduction of FTC as business expenditure.



[10] CBDT Notification No. 54/2016, dated 27 June 2016
[11] CIT v. Tata Sons Ltd. [2011] 43 SOT 27 (Bom)
[12] DCIT v. Mastek Limited [2013] 36 taxmann.com 384 (Ahd)
[13] DCIT v. Elitecore Technologies Private Limited [2017] 165 ITD 153 (Ahd)

© 2020 KPMG, an Indian Registered Partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved.

home.kpmg/in/socialmedia

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

Bengaluru
Embassy Golf Links Business Park,
Pebble Beach, 'B' Block,
1st & 2nd Floor,
Off Intermediate Ring Road, Bengaluru – 560071
Tel: +91 80 6833 5000

Chandigarh
SCO 22-23 (1st Floor),
Sector 8C, Madhya Marg,
Chandigarh – 160 009.
Tel: +91 172 664 4000

Chennai
KRM Towers, Ground Floor,
1, 2 & 3 Floor, Harrington Road,
Chetpet, Chennai – 600 031.
Tel: +91 44 3914 5000

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

Hyderabad
Salarpuria Knowledge City,
6th Floor, Unit 3, Phase III,
Sy No. 83/1, Plot No 2,
Serilingampally Mandal,
Ranga Reddy District,
Hyderabad – 500 081.
Tel: +91 40 6111 6000

Jaipur
Regus Radiant Centre Pvt Ltd.,
Level 6, Jaipur Centre Mall,
B2 By pass Tonk Road,
Jaipur – 302 018.
Tel: +91 141 - 7103224

Kochi
Syama Business Centre,
3rd Floor, NH By Pass Road,
Vytilla, Kochi – 682 019.
Tel: +91 484 302 5600

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

Mumbai
1st Floor, Lodha Excelus,
Apollo Mills,
N. M. Joshi Marg,
Mahalaxmi,
Mumbai – 400 011.
Tel: +91 22 3989 6000

Noida
Unit No. 501, 5th Floor,
Advant Navis Business Park,
Tower-A, Plot# 7, Sector 142,
Expressway Noida,
Gautam Budh Nagar,
Noida – 201 305.
Tel: +91 0120 386 8000

Pune
9th floor, Business Plaza,
Westin Hotel Campus, 36/3-B,
Koregaon Park Annex,
Mundhwa Road, Ghorpadi,
Pune – 411 001.
Tel: +91 20 6747 7000

Vadodara
Ocean Building, 303, 3rd Floor,
Beside Center Square Mall,
Opp. Vadodara Central Mall,
Dr. Vikram Sarabhai Marg,
Vadodara – 390 023.
Tel: +91 265 619 4200

Vijayawada
Door No. 54-15-18E,
Sai Odyssey,
Gurunanak Nagar Road, NH 5,
Opp. Executive Club, Vijayawada,
Krishna District,
Andhra Pradesh – 520 008.
Tel: +91 0866 669 1000

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

© 2020 KPMG, an Indian Registered Partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved.

The KPMG name and logo are registered trademarks or trademarks of KPMG International.

This document is meant for e-communication only