Foreign Tax Credits

Bengaluru Study Group of The Chamber of Tax Consultants

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P V Srinivasan

Corporate Advisor

Mobile :+919845057597

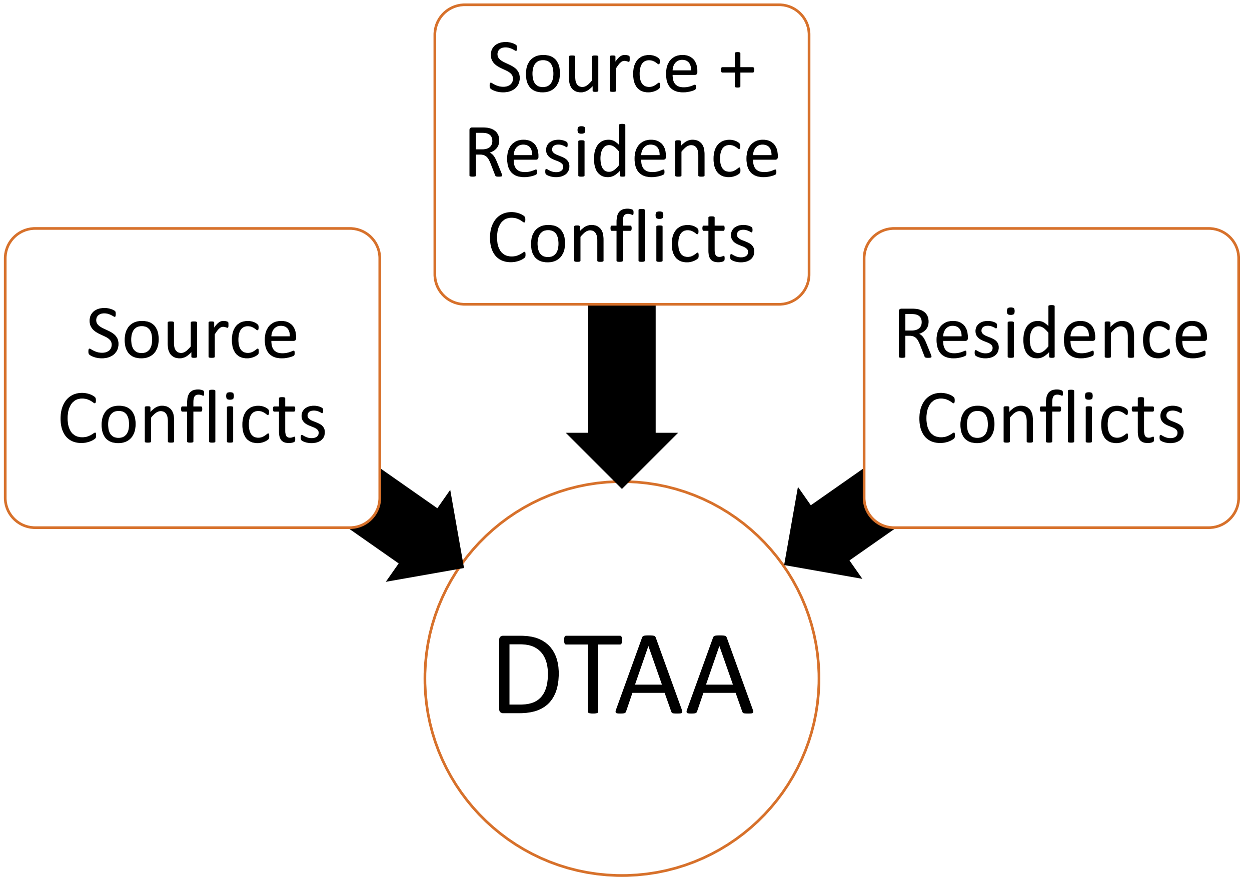
Email: pvs@pvsadvisors.com

Agenda

1. International juridical double taxation.
2. Methods for elimination of double taxation.
3. FTC Rules
4. Foreign Tax Credit – Section 91 of the IT Act.
5. Foreign Tax Credit – Section 90 and power to enter into DTAA.
6. Foreign Tax Credit – Credit Method in DTAA.
7. Foreign Tax Credit – Perceived situations of denial.
8. Priority of Adjustments.
9. MAT / AMT and Foreign tax Credit.
10. Deduction for foreign taxes.
11. Foreign Tax Credit – Optimal Method, Carry-back / forward aspects.
12. Triangular cases.

International Juridical Double Taxation

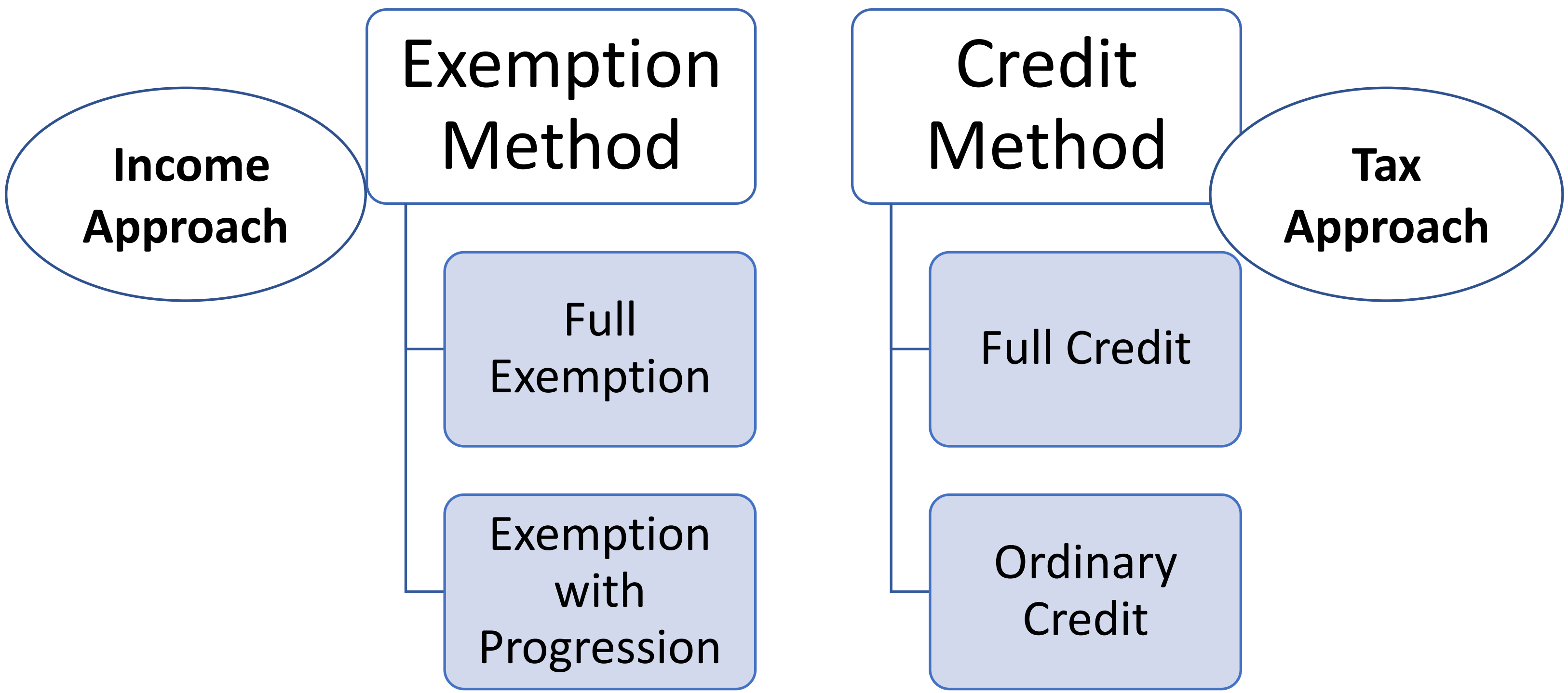
Two or more countries impose taxes on the **same taxpayer** and on the **same income** (maybe for the **same period**).



Methods of Elimination of Double Taxation

Relief from double taxation - Methods

- Elimination of double taxation by the State of which the taxpayer **<u>is a resident</u>**.



- **Tax sparing (Double Non-taxation)**

Relief by way of deduction for FTC

Country R	Country S

Country R

- ***No source of income in Country R.***
- ***Global income taxed, deduction for FTC.***
- ***Income tax rate of 35%***

Country S

- ***Source income of USD 100,000/-.***
- ***Income tax rate of 35%***

Particulars	Country R	Country S
Taxable Income	65,000.00	100,000.00
Tax paid	**22,750.00**	**35,000.00**
PAT	42,250.00	65,000.00

Total Tax Paid	57,750.00
ETR	57.75%

Beneficial for carry-over of loss in Country R.

Relief from double taxation – Exemption Method

Country R	Country S

Country R

- ***No source of income in Country R.***
- ***No tax on income sourced outside Country R.***
- ***Income tax rate of 35%***

Country S

- ***Source income of USD 100,000/-.***
- ***Income tax rate of 35%***

Particulars	Country R	Country S
Taxable Income	0.00	100,000.00
Tax paid	**0.00**	**35,000.00**
PAT	0.00	65,000.00

Total Tax Paid	35,000.00
ETR	35.00%

Beneficial - if tax rate in Country S is lower than tax rate in Country R.

Relief from Double Taxation (Article 23 / 24) DTAA - India- Bulgaria, Czechoslovakia, Poland*

2. In both the Contracting States, double taxation will be avoided in the following manner:
   a) Where a resident of a Contracting State derives income which in accordance with the provisions of this Agreement, **may be taxed** in the other Contracting State, the first mentioned State shall, subject to the provisions of sub-paragraph (b) of this paragraph, **exempt such income from tax** but may, in calculating tax on the remaining income of that person, **apply the rate of tax** which would have been applicable if the exempted income had not been so exempted.

   b) Either the Contracting States, when imposing taxes on its residents may include in the tax base upon which such taxes are imposed, the items of income which according to the provisions of Articles 10 (Dividends), 11 (Interest) and 12 (Royalties & FTS) of this Agreement may also be taxed in the other State **but shall allow as a deduction from the amount of tax computed on such a base an amount equal to the tax paid in the other Contracting State. Such deduction shall not, however, exceed that part of tax leviable by the first mentioned State, as computed before deduction is given, which is appropriate to the income, which in accordance with the provisions of Arts. 10, 11 and 12 of this Agreement may be taxed in the other State**.

*** Also refer DTAA with United Arab Republic (Egypt) which capture Exemption and Credit Methods in Article XXIV**

Relief from double taxation – Full Credit Method

Country R	Country S

Country R

- ***No source of income in Country R.***
- ***Taxed on global income***
- ***Income tax rate of 35%***

Country S

- ***Source income of USD 100,000/-.***
- ***Income tax rate of 35%***

Particulars	Country R	Country S
Taxable Income	100,000.00	100,000.00
Tax paid	**35,000.00**	**35,000.00**
Less: Tax paid in country S	**35,000.00**	
Additional tax to be paid	**0.00**	
PAT	65,000.00	65,000.00

Total Tax Paid	35,000.00
ETR	35.00%

Eliminates the benefit from lower tax rate in Country S

Relief from double taxation – Ordinary Credit Method

Country R	Country S
• *Another source income of USD 100,000.* • *Taxed on global income* • *Income tax rate of 20%*	• *Source income in this country = USD 100,000/-.* • *Income tax rate of 35%*

Particulars	Country R		Total of country R	Country S
	earned in country R	earned in country S		
Taxable Income	100,000.00	100,000.00	200,000.00	100,000.00
Tax paid	**20,000.00**	**20,000.00**	**40,000.00**	**35,000.00**
Tax paid in country S	**0.00**	**35,000.00**	**35,000.00**	
Less: Credit allowed	0.00	20,000.00	20,000.00	
Additional tax to be paid	**20,000.00**	**0.00**	**20,000.00**	

Total Tax Paid	55,000.00
ETR	27.50%

- Fairly common form of tax administration.
- If the Country S tax rates greater than Country R – then higher aggregate tax.
- If the Country S tax rates are lesser than the Country R tax rate – ETR at Country R rate.

Underlying Tax Credit

Mitigates economic double taxation of same income in the hands of same / different assessee

Illustration – Article 23 of the India-Mauritius DTAA

1. In the case of dividend paid by M Ltd.* to I Ltd.** and I Ltd. owns at least 10% of the shares of M Ltd. - FTC shall include the amount of tax payable by M Ltd. in Mauritius in respect of the profits out of which such dividend is paid;
2. *And vice versa*, i.e., - In the case of a dividend paid by I Ltd. to M Ltd. and M Ltd. owns at least 10% of the shares of I Ltd. - FTC shall include the amount of tax payable by I Ltd. in India in respect of the profits out of which such dividend is paid.

Other DTAAs incorporating UTC Principle – India-Singapore DTAA (both India & Singapore), India-UK DTAA (only UK), India-USA DTAA (only USA), India-Spain DTAA# (only Spain)

Company resident in Mauritius
****Company resident in India***
#Spain Company should hold 25% of the capital of Indian Company

Foreign Tax Credit –
Rule 128 under the Income Tax Rules

FTC Rules

- FTC Rules in force from 1st April 2017

Particulars	Rule Reference	Details
Meaning of Foreign Tax	128(2)	Country with which India has a DTAA – Taxes covered under the said DTAA Others – Income Tax payable under the law in force in that country or specified territory referred to in clause (iv) of the Explanation to section 91.
Mode of granting FTC	128(1)	By way of deduction or otherwise (i.e. direct payment)
Year of availability	128(1) & Proviso to 128(1)	In the year in which the income corresponding to such tax is offered to/assessed to tax in India; Proportionately - where corresponding income is offered to tax in more than one year, in the same proportion of income.

FTC Rules

Particulars	Rule Reference	Details
Tax against which FTC available	128(3) 128(6)	Tax, surcharge and cess under Income-tax Act 1961 MAT u/s 115JB; AMT u/s 115JC
Tax Exclusions for FTC	128(3)	Any sum payable by way of interest, fee or penalty
Disputed FTC	128(4) Proviso to 128(4)	No FTC Credit; Available in the year of such income being offered/assessed to tax in India if, within six months from the end of the month of the dispute-settlement, the following are furnished – (i) Evidence of settlement of dispute; (ii) Evidence to the effect that the liability for payment of such foreign tax has been discharged; (iii) An undertaking that no refund qua such amount has directly/indirectly been claimed.

FTC Rules

Particulars	Rule Reference	Details
Mode of computing FTC	128(5)(i) Proviso to 128(5)(i)	Aggregate of the amounts of credit computed separately for each **<u>source of income</u>** arising from a particular country or specified territory outside India; FTC shall be lower of – - Tax payable under the Act on such income; - Foreign tax paid on such income Foreign tax paid exceeding the amount of tax payable in accordance with DTAA to be ignored. **No refund of FTC.**
Exchange Rate for FTC Conversion	128(5)(ii)	Telegraphic transfer buying rate on the last day of the month immediately preceding the month in which such tax has been paid or deducted
Excess FTC – MAT/AMT Credit	128(7)	Excess FTC against the tax payable u/s 115JB/115JC vis-à-vis normal tax, to be ignored for computing the amount of credit u/s 115JAA/115JD in respect of the taxes paid u/s 115JB/115JC.

FTC Rules

Particulars	Rule Reference	Details
Documentation	128(8)	(i) Statement of income from the foreign country offered for tax for the previous year and of foreign tax deducted or paid on such income in Form No.67; (ii) Certificate/statement specifying the nature of income and the amount of tax deducted therefrom or paid by the assessee - (a) From the tax authority of the foreign country; (b) From the person responsible for deduction of tax; (c) Signed by the assessee, accompanied by an acknowledgement of online payment or bank counter foil or challan in case of payment and proof of deduction where the tax has been deducted.

FTC Rules

Particulars	Rule Reference	Details
Form 67	128(9)	Form No.67 to be furnished on or before the due date u/s 139(1) of the Act (to be uploaded online)
Refund of FTC	128(10)	Form No.67 to be furnished in a case where the carry backward of loss of the current year results in refund of FTC claimed in any earlier previous year.

Foreign Tax Credit under the Income Tax Act

Section 91 corresponds to Section 49D of 1922 Act

India – Foreign tax credit (FTC) provisions

- Section 91 deals with FTC for taxes paid in any **<u>country</u>** with which there is no DTAA u/s 90.
- **Unilateral** Relief Mechanism:
- Person should be **resident** in India in any previous year.
- Person must prove that:

He had income which accrued or arose outside India in that previous year;

↓

That income is not one which is deemed to accrue or arise in India;

↓

He has paid tax in any country with which there is no DTAA u/s 90.

Section 91 – Formula for FTC

FTC = Calculated on **doubly taxed income** at the "**Indian rate of income-tax**" or "the rate of tax of the foreign country", whichever is lower.

Indian rate of tax	• **rate determined by dividing the amount of Indian Income Tax under the provisions of the Act but before deduction of any relief due under this [chapter IX], by the Total Income.**
rate of tax of the other country	• **Amount of income-tax and super-tax actually paid less all relief due, divided by the whole amount of income as assessed in the said country.**
Income tax in relation to the other country includes	• **excess profit tax or** • **business profits tax charged on the profits** • **by the Government of any part of that country or local authority in the country**

Effect of DTAA

CIT vs. C.S. Murthy – 169 ITR 686 (AP)

- If any particular slice of foreign income is not subject to tax in the assessment made in India, it is not possible to treat such foreign income not subjected to tax in India also as forming part of doubly taxed income for the purpose of section 91.

1. In Bombay Burmah Trading Corpn. Ltd. [2003] 259 ITR 423 on pooling of eligible income and credit, the Bombay High Court held that the computation of foreign tax credit will be done only on country-wise basis. *"The relief u/s 91(1) is by way of reduction of tax by deducting the tax paid abroad on such doubly taxed income from tax payable in India. Under the circumstances, the scheme is clear.* ***The relief can be worked out only if it is implemented country-wise.*** *If the argument of the Department is to be accepted then, it would be impossible to compare the rate of tax of the foreign country with the rate under the Indian Income-tax Act"*
2. The relief has to be calculated on the basis of per country limitation method and not on the basis of overall limitation method.

Foreign Tax Credit and power to enter into DTAA

Section 90 corresponds to Section 49A of 1922 Act

Purpose of Double Taxation Conventions

Title in most Model Conventions:

- Convention between [State A] and [State B] for the avoidance of double taxation and prevention of fiscal evasion with respect to taxes on income and capital gains.

- Convention between [State A] and [State B] for the avoidance of double taxation and prevention of fiscal evasion with respect to taxes on income and capital gains and for encouragement of mutual trade and investment.

- **Section 90 of the Income-tax Act**: Power granted to the Central Government to enter into agreement with Government of any other country outside India / specified territory outside India.

Section 90*

S. 90(1)(a)

- **For the granting of <u>relief</u> in respect of:**
- **(i) <u>income</u> on which have been <u>paid both income-tax under the Act and income-tax in the other country in DTAA</u> – i.e. <u>avoid double taxation of income</u>.**
- **(ii) income tax <u>chargeable</u> under the Act and under the domestic tax law in force in the other country in DTAA <u>to promote mutual economic relations, trade and investment</u> – S.90(1)(a)(ii)#**

S. 90(1)(b)

- **For <u>avoidance</u> of double taxation of income under the Act and the domestic law in force in the other country in DTAA. [without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty shopping arrangements aimed at obtaining reliefs, provided in the DTAA for the indirect benefit to residents of any other country.**

*Substituted w.e.f. 1-4-2004

#Power of Central Government has been greatly widened and it can now enter into agreement not only for avoidance of double taxation, but also for granting relief for income exempt from taxation.

Section 90(1) – Retrospective or Prospective Amendment

1. Indo-US Treaty entered into on 20.12.1990 vide notification GSR 199(E) dated 20.12.1990.
2. The substituted section came into force from 1.4.2004.
3. The benefit claimed by the assessee is by virtue of the terms of the agreement. The agreement came into existence in 1990.
4. The amendment in 2004 is giving effect to the terms of agreement of 1990. Terms of the agreement more beneficial than the provisions of the Act prior to the amendment.
5. After the amendment, the amended provision is in conformity with the benefit agreed to be given under the agreement.
6. Therefore, if prior to the amendment, there was no thorough provision granting the said benefit as the said benefit was conferred on the assessee under DTAAs, the assessee was entitled to the said benefit as DTAAs override the provisions of Income Tax Act.
7. In view of the matter, it is **<u>not necessary</u>** to go into the question whether the amended provision is retrospective or clarificatory in nature when the terms of the agreement are more beneficial and the assessee is entitled for such benefit which is now conferred by way of amendment.
8. Even for the period prior to the amendment, the assessee is entitled to this benefit.

Section 90

S. 90(1)(c)

- **For <u>exchange of information</u> for the prevention of evasion or avoidance of income-tax chargeable in either country or <u>investigation</u> in cases of such evasion or avoidance.**

S. 90(1)(d)

- **For <u>recovery</u> of income-tax by either country.**

Foreign Tax Credit –
Credit Method Article in DTAA

India – USA: Article 25(2)

- ***Where a resident of India <u>derives income</u> which, in accordance with the provisions of this Convention, <u>may be</u> taxed in the United States, India shall allow as a deduction from the <u>tax on the income of that resident</u> an amount equal <u>to the income-tax paid in the United States</u>, whether directly or by deduction.***
- ***Such deduction shall not, however, exceed that part of the income-tax (as computed before the deduction is given) which is attributable to the <u>income which may be taxed in the United States</u>.***

Interpretation of Article 25(2) of India-US DTAA

Para 58 and 59 of the Karnataka High Court Judgment in 382 ITR 179

1. If a resident Indian derives income, which may be taxed in United States, India shall allow as a deduction from the tax on the income of the resident, an amount equal to the income tax paid in USA, whether directly or by deduction.
2. Where the Indian resident pays no tax on such income derived, whereas the said income is taxed in the United States, India shall allow as a deduction from the tax on the income of that resident an amount equal to the income-tax paid in the United States.
3. The provision is in conformity with section 90(1)(a)(ii) of the Act i.e. **the income tax chargeable under the Act and the corresponding law in force in USA**.
4. **It is not a requirement of law** that the assessee, before he claims credit under the Indo-US convention or under the provisions of the Act **should pay tax in India on <u>such</u> income**.
5. The condition imposed is to restrict the credit to income of the previous year. The income tax paid in the same calendar year in USA is to be accounted for two financial years in India.

Wipro Ltd vs DCIT: 382 ITR 179 Karnataka High Court

1. Section 90(1)(a)(ii) provides relief from double taxation where income of assessee is **chargeable under income-tax Act** as well as in corresponding law in force in foreign country.
2. Therefore, assessee would be entitled to take credit of income tax paid in a foreign country even in relation to income which is exempt under section 10A.
3. An income which is exempt under section 10A is actually chargeable to Income-tax Act under section 4; exemption only suspends collection of income tax for a period of 10 years and, thus, such a case falls under section 90(1)(a)(ii) and assessee would be entitled to take credit of Income-tax paid in foreign country in respect of such income.

India – Singapore : Article 25(2)

- ***Where a resident of India <u>derives income</u> which, in accordance with the provisions of this Agreement, may be taxed in Singapore, India shall allow as a deduction from the <u>tax on the income of that resident</u> an amount equal to the <u>Singapore tax paid, whether directly or by deduction</u>.***
- ***Where the income is a dividend paid by a company which is a resident of Singapore to a company which is a resident of India and which owns directly or indirectly not less than 25 per cent of the share capital of the company paying the dividend, the deduction shall take into account the Singapore tax paid in respect of the profits out of which the dividend is paid. Such deduction in either case shall not, however, exceed that part of the <u>tax</u> (as computed before the deduction is given) which is attributable to the income which may be taxed in Singapore.***

India – Canada : Article 23(3)

In the case of India, <u>double taxation</u> shall be avoided as follows :

The amount of Canadian tax paid, under the laws of Canada and in accordance with the provisions of the Agreement, whether directly or by deduction, by a resident of India, in respect of income from sources within Canada which has been <u>subjected to tax</u> both in India and Canada shall be allowed as a credit against the <u>Indian tax payable in respect of such income but in an amount not exceeding that proportion of Indian tax which such income bears to the entire income chargeable to Indian tax.</u>

Interpretation of Article 23(3) of India-Canada DTAA

Para 60 to 63 of the judgment of the Karnataka High Court in the case of Wipro Limited in **382 ITR 179**

1. Benefit of Article 23 would be available to assessee in India only in respect of the income from sources within Canada which has been **subjected to tax both in India and Canada**, which forms part of the total income of the assessee and has suffered tax in India under the Income tax Act and has suffered tax in Canada also i.e. **assessee has paid tax both in India as well as Canada on the same income.**
2. Only then the agreement provides the tax paid in Canada shall be allowed as a credit against the Indian tax payable in respect of such income.
3. However, the said benefit is confined only to the extent of an amount not exceeding that portion of the Indian tax, which such income bears to the entire income chargeable to Indian tax.
4. In other words, if the income tax paid in India is less than the income tax paid in Canada, the assessee would be entitled to relief only to the extent of tax paid in India and not to the extent of income tax paid in Canada.
5. The clause is in conformity with **Section 90(1)(a)(i)** of the Act.
6. As a corollary, if the assessee is exempted from payment of tax in India, then if the same income is subjected to tax in Canada, according to the treaty, there is no double taxation. Therefore, the benefit of this treaty is not available to the Indian assessee.
7. **Section 10A(4) formula:** Some export profits taxed in Canada as well as India – relief is available.

FTC in India-Australia / UK DTAA

- **India – Australia DTAA** : Para 4 : In the case of India, **double taxation** shall be avoided as follows:
  a) The amount of Australia tax paid under the laws of Australia and in accordance with the provisions of this Agreement, whether directly or by deduction, by a resident in India in respect of income from sources within Australia **which has been subjected to tax both in India and Australia** shall be allowed as a credit against the Indian tax payable in respect of such income **but in an amount not exceeding that proportion of Indian tax which such income bears to the entire income chargeable to Indian tax**; and …….
- **India –UK DTAA** : Para 2: Subject to the provisions of law regarding the allowance as a credit against Indian tax of tax paid in a territory outside India (which shall not affect the general principle hereof), the amount of United Kingdom tax paid, under the law of the United Kingdom, and in accordance with the provisions of this Convention, whether directly or by deduction, by a resident of India, in respect of income from sources within the United Kingdom which has been **subjected to tax both in India and the United Kingdom** shall be allowed as a credit against the Indian tax payable in respect of such income **but in an amount not exceeding that proportion of the Indian tax which such income bears to the entire income chargeable to Indian tax**.

Effect of DTAA

CIT Vs R.M. Muthiah – 202 ITR 508 (Kar)

Levy only by the domestic law

- If no liability is imposed under the domestic law, the question of resorting to the agreement would not arise.
- No provision of the agreement can possibly fasten a tax liability where the liability is not imposed by the domestic law.

Relief

- If a tax liability is imposed by this Act, the agreement may be resorted to for negating or reducing it.

More Beneficial

- In case of difference between the provisions of the Act and the agreement, the provisions of the agreement would prevail over the provisions of the Act and can be enforced by the appellate authorities.

Circular No. 333 dated 02-04-1982 to the same effect.

Interpretation of "term"

Where any term used but not defined either in the Income-tax Act or in the agreement or :

- Conflicting interpretations.
- Sec 90(3): Central Government empowered to define such "term" by way of notification in the Official Gazette.
  - Unless the context requires otherwise;
  - Is not inconsistent with the provisions of the Act or the agreement.

Notification No. 91 / 2008 dated 28-08-2008: How to interpret income that "may be taxed" in the other country.

- Such income shall be included in taxpayers total income chargeable to tax in India in accordance with the provisions of the Act.
- Relief shall be granted in accordance with the method for elimination or avoidance of double taxation provided in the agreement.

India – Foreign tax credit (FTC) provisions

***For treaty countries:* FTC provisions are contained in the respective DTAAs.**

Current legal position adopts a Country-by-country approach

- **Excess credits** from high tax countries cannot be used to offset low taxes in other countries. Results in cumulative higher effective tax rate for the tax payer.
- **Tax concessions** allowed by a foreign country for investments made in that country do not effectively accrue to the investor.
- **Tax spared** by the source country accrue to the residence country.

Method of granting FTC not oriented to India emerging as net exports of technical services

Tax Sparing: India – Cyprus Treaty: Article 25(4)

- The tax payable in a Contracting State mentioned in paragraph 2 and paragraph 3 of this Article shall be deemed to include the tax which would have been payable but for the tax incentives granted under the laws of the Contracting States and which are designed to promote economic development.
- For the purpose of paragraph 2 of Article 10 of the amount of tax **shall be deemed** to be 10 per cent or 15 per cent, as the case may be, of the gross amount of dividend,
- For the purposes of paragraph 2 of Article 11, the amount of tax **shall be deemed** to be 10 per cent of the gross amount of interest and
- For the purpose of paragraph 2 of Article 12, the amount of tax **shall be deemed** to be 15 per cent of the gross amount of royalties and fees for included services and for the purpose of paragraph 2 of Article 13, the amount of tax shall be deemed to be 10 per cent of the gross amount of technical fees.

Tax Sparing: India – Malaysia Treaty: Article 24(3)

- The term **"tax paid in Malaysia**" shall be deemed to include the tax which would, under the laws of Malaysia and in accordance with this Agreement, have been payable on any income derived from sources in Malaysia had the income not been taxed at a reduced rate or exempted from Malaysia tax in accordance with the provisions of this Agreement and the special incentives under the Malaysian laws for the <u>**promotion of economic development of Malaysia**</u> which are in force at the date of signature of this Agreement or any other provisions which may subsequently be introduced in Malaysia in modification of, or in addition to, those laws so far as they are agreed by the competent authorities of the Contracting States to be substantially similar character.

Note: DTAAs with Australia, Canada, France, UK etc. provide for "tax sparing" for respective residents of those countries claiming exemption from , or reduction of, Indian tax -10A, 10B, 80HHC, 80HHD, 80-I, 10(4), 10(15)(iv). **No** reciprocal "tax sparing" provision for residents of India.

Foreign Tax Credit –
Perceived situation of denial

FTC – Perceived denial situations

- **Scope** : Certain taxes not being covered by the tax treaty.
- **Mismatch Periods** : Varying assessment periods / practices.
- **Income basis**: Varying basis of assessment.
- **Income Character** : Change in characterization of income.
- **Source Rules**: Conflict in determining source
- **Deemed Tax Credits** – lower the foreign tax pay-out
- **Residence**: Shifting residential status.
- **Treaty Abuse / GAAR**

Foreign tax credit may get denied in the above situations

Situation 1: Taxes not covered – State taxes

1. Article 2 of tax treaties specifies only those taxes it covers.
2. Some DTAAs cover only "Federal taxes" on income and capital. Non-federal taxes (political sub-divisions) will fall outside the tax treaty.
3. Possibility of double taxation?
4. **Issue:**
   a) Whether FTC is to be allowed for a tax paid in a foreign county, which is not covered by the DTAA?
   b) Whether the assessee, resident In India, is entitled to FTC when India has no agreement with the States where tax is levied on the income of the assessee?
6. Relief for taxes not covered by DTAA
   a) Unilateral measures in each State's domestic law to grant relief from double taxation of taxes not covered by the tax treaty.
   b) Relief to be granted by applying Section 91 of the IT Act, which does not **discriminate** between state and federal taxes.
   c) Sec 91 refers to "country" and "income-tax" in relation to any country.
   d) Tata Sons Ltd Vs DCIT (ITAT- Mum)

Relief for taxes not covered by DTAA

Para 64 to 66 of the judgment of the Karnataka High Court in the case of Wipro Limited in 382 ITR 179

1. Explanation (iv) u/s 91 defines the expression income tax in relation to any country includes excess profit tax or business profits tax charged on the profits by the Government of any part of that country or a local authority in that country.

2. Even though, India has not entered into any agreement with the State of a Country and if the assessee has paid income tax in that State, the income tax paid in relation to that State is also eligible for being given credit to the assessee in India.

3. The argument that in the absence of an agreement India and the State, the benefit of Section 90 is not available to the assessee is ex-facie illegal and requires to be set aside.

FTC for branch profits tax

1. **Tax characterization** determines whether it is covered by a tax treaty.
2. State imposing the tax should govern the tax characterization for tax treaty purposes.
3. Branch profits tax (BPT) is a federal tax.
4. Article 14 of the India – USA DTAA authorises USA to levy Permanent Establishment Tax. It is a tax imposed on business profits of a company, which represents dividend equivalent amount.
5. Though BPT is levied as an equivalent of tax on dividend, yet it is not a tax on dividend. it is a tax on profits?
6. **Issue:** Is BPT eligible for FTC?

Unilateral measures in domestic law required to overcome limitation arising out of characterization of taxes

Dividend Distribution Tax / Tax on distributed income

1. DDT poses problems in eliminating juridical double taxation.
2. Section 115-O :
   a) Tax on distributed profits of domestic companies.
   b) No deduction for the company distributing the dividend.
   c) No deduction for the shareholder receiving the dividend.
3. Creates a situation for granting FTC for underlying tax.
4. Only some tax treaties allow FTC for underlying tax.
   - E.g. India - Mauritius tax treaty expressly allow FTC for underlying tax where the beneficial ownership of a company in a company resident in the other state exceeds 10%.
5. Effect of Sub-section 1B: “Grossing up” read with Explanatory Memorandum.

1. **Buyback tax**: Tax on distributed income.
2. “Buyback” of shares results in alienation of the shares from its holder.
3. Some DTAAs provide that capital gains tax on alienation of shares shall be taxable in the country in which the person is resident.
4. With regard to income from alienation of shares, the US has sourcing rules that are conflicting with the sourcing rules in India.
5. Tax on distributed income u/s 115QA also poses problems of eliminating juridical double taxation.

Levy of dividend distribution tax could result in double taxation

FTC for Fringe Benefits Tax (Sec 115WA)

Charge of FBT

- FBT shall be charged in addition to income-tax charged under the Act.
- In respect of fringe benefits provided or deemed to have been provided by an employer to his employees during the previous year.
- Tax on fringe benefits shall be *<u>payable</u>* by the employer.

Circular No. 8/ 2005 : Q23: FBT is a liability qua employer.

Recovery of FBT: Created a higher eligibility criteria for granting FTC.

FBT is a "surrogate tax" on employer

Situation 2 : Different assessment periods

1. **Taxation is about timing.**

2. When States have different assessment periods it could result in:

   - Variance in timing of deductible expenses.

   - Variance in timing of income.

3. As a result, there could be double taxation.

4. It is easy to visualize the distortions that could be caused by:

   - Section 43B / 40a(i)

   - Provisions allowing deferment of income.

   - Income Computation and Accounting Standards

May also lead to “double tax credit “without tax avoidance !

Situation 3: Different payment / assessment practices

1. FTC often gets denied only on account of technicalities and vagaries in tax administration.
2. Corporate tax returns to be filed in India by 30th November.
3. Foreign (source) country:
   - FTC for tax by way of deduction (WHT) or otherwise (payment)*****.
   - Could permit longer periods for payment of taxes and filing of tax return.
   - Subsequent tax assessment could also enhance the tax liability.
   - Omission to claim FTC in the Original / Revised Return.
4. Such events cause delays in quantifying the amount of FTC.
5. Granting FTC is an obligation of the Resident State. The presumption is that a State does not intend to breach its treaty obligations.

- ***CIT v. Petroleum India International [2013] 351 ITR 295 (Bom.)***: The credit in India for foreign taxes would be allowable in the year in which the **<u>foreign income is assessable in India</u>**, irrespective of the year in which the income has been assessed or tax has been paid in the foreign country.

Tax treaties have a status superior to domestic law – CBDT circular 333

Situation 4: Different assessment bases

- Different methods of determining income could cause double taxation:
  - Source State having more generous depreciation rules than residence State resulting in less taxable income in the Source State.
  - Expenses deducted in one State may be capitalized in another.
  - Gains on account of foreign exchange fluctuations.
  - Indexation benefit available for capital gains in the Residence State but not available in Source State.
  - Unilateral Transfer Pricing Adjustments.

Tax treaties hardly address such variations

Situation 5 : Issues in characterization of income

1. Source State interpreting “ordinary business income” as “royalties and fees for technical service”.
2. Tax is levied by invoking Article 12.
3. Residence State may take a view that income being in the nature of business profits, the source State [in the absence of a PE] ought not have taxed such income.
4. FTC may be denied by the residence State.

- ***Som Datt Builders (P.) Ltd v. ITO [1989] 29 ITD 495 (Kol.)***
- It was held that for the availability of tax credit, it is not necessary that both State R and State S should tax the income under an identical head. However, the prerequisites for claiming tax credit is that the **income should relate to the same person in both the States**.

FTC for taxes paid as per law and not for mere payments to tax department

Situation 6 : Conflict in source of income

Conflict as to source arise on account of:

1. States may characterize income or capital differently.
2. Result in application of different tax treaty Articles.
3. States may differ in the interpretation of tax treaty rules allocating the right to tax.
    - E.g. Inter-company transfer pricing principles which requires primary adjustment (of profit) and also secondary adjustment (say, as disguised dividend).

Definition of terms as in domestic tax law apply to interpret tax treaties

Situation 7: Deemed Tax Credits

1. Many developed countries provide incentives such as R&D Credit. The credit is against regular federal taxes.
2. When R&D Credit is allowed to a PE in a foreign country, the federal tax pay-out would be lower.
3. **Issue :** Whether FTC is to be allowed for the gross foreign tax (before the R&D credit is reduced) or the net pay-out of foreign tax?
4. **Possible View:**
   a) Reduction of tax is only a mechanism of disbursement of R&D Credit.
   b) Administrative formality of collecting a higher income-tax and separately granting R&D Credit is avoided (principle stated in SC judgment in J.B. Boda & Co. Pvt. Ltd on empty formality and meaningless ritual).
   c) R&D Credit ought to be included in computing the profits or gains from business;
   d) Gross foreign tax is to be considered as “income-tax paid” in the foreign country, eligible for FTC.
   e) Treaties, typically support this view.

Situation 8 : Shifting residential status

1. X an employee seeks voluntary retirement while serving for a company in State A. Compensation upon termination of employment to be paid over a five years period.
2. After retirement, X settles as a tax resident in State B. Ceases to be a tax resident of State A.
3. State A can claim that VRS compensation paid to X is sourced in State A as it related to a former employment in State A.
4. Based on residential status, State B will tax VRS compensation. State B can also deny FTC on the ground that employment was not exercised in State A during the relevant year.
5. State B can also tax the compensation as “other income”.
6. **Article 15 (Dependent Personal Services) gives the Source State a right to tax only when employment is exercised in that State.**

Situation 9: Situations of treaty shopping/ GAAR

1. "**Treaty shopping**" refers to the use of a treaty by persons who are not themselves within the personal scope of the convention.
2. Resident of a State A establishing an entity within State B which is a party to the treaty with another State C in order to take advantage of the provisions of that treaty between State B and State C.
3. Establishing a conduit company in a Contracting State B to receive income from State A.

GAAR: Sec 102(10): "Tax benefit":

a) a **reduction** or avoidance or deferral of tax or other amount payable under this Act; or
b) an increase in a refund of tax or other amount under this act; or
c) a **reduction** or avoidance or deferral of tax or other amount that would be payable under this Act, as a result of a **tax treaty**; or
d) an increase in refund of tax or other amount under tis Act as a result of a tax treaty; or
e) a reduction in total income; or
f) an increase in loss;

in the relevant previous year or any other previous year.

FTC may altogether be denied

Priority of Adjustments

Priority of Adjustments

1. Ratio of the decision of Hon'ble Karnataka High Court in the case of CIT Vs M/s Sami Labs Limited.

   Non Refundable Taxes

   I. Foreign Tax Credit – **u/s 91.**

   II. Foreign Tax Credit – **u/s 90**.

   III. MAT Credit– since it is liable to be adjusted within the period prescribed (10 years).

   Refundable Taxes

   I. Tax deduction at source.

   II. Advance Tax Paid.

   III. Self Assessment Tax.

2. No interest is claimable against FTC / MAT Credit.
3. "Assessed tax" in Sec 234C is an indication of the priority of adjustments.
4. Interest u/s 234B and 234C liable to the extent FTC / MAT Credit is determined as not eligible.
5. Under no circumstances, FTC / MAT credit can become subject matter of refund.

MAT and FTC

Minimum Alternate Tax

1. “Book profit” is deemed to be the total income.
2. Tax payable by the assessee on such total income @ 18.5%.
3. “Book profit” is increased interalia by the amount of income-tax paid or payable, the provisions therefor.
4. In ACIT v. L&T Ltd (ITA No. 4499 (Mum.) of 2008, dated 22-2-2009, it was held that credit in India for foreign taxes would be available even if taxpayer was liable to pay MAT.
5. What is mechanism of computing FTC when tax is paid u/s 115JB?
6. What is the amount of MAT Credit u/s 115JAA after allowing FTC?
7. Second proviso u/s 115JAA(2A) – FTC as per normal computation. Any excess to be ignored.

Working of MAT Credit u/s 115JAA (upto AY 2017-18) under "subjected to tax"				
I	Normal provisions of the IT Act			
	Foreign Sourced Income from State S	A		1,00,000
	Income accruing or arising in India	B		1,00,000
	Worldwide Income	C	A + B	2,00,000
	Deduction u/s 10AA	D		2,00,000
	Total Income	E	C - D	-
	Income-tax paid in State S - Say @ 35%	F	A * 35%	35,000
	Income-tax paid in India - State R @ 35%	G	E * 35%	-
	Foreign Tax Credit	H	Lower of F or G	-
	Total income-tax paid	I	F + G - H	35,000
II	Book Profits u/s 115JB	J	A + B	2,00,000
	Tax on Book Profit - 18.5%	K	J*18.5%	37,000
	Foreign Tax Credit under MAT	L	A*18.5%	18,500
	Balance MAT Tax payable	M	K - L	18,500
III	MAT Credit u/s 115JAA	K	K - G	37,000

Working of MAT Credit u/s 115JAA (from AY 2018-19) under "subjected to tax"				
I	Normal provisions of the IT Act			
	Foreign Sourced Income from State S	A		1,00,000
	Income accruing or arising in India	B		1,00,000
	Worldwide Income	C	A + B	2,00,000
	Deduction u/s 10AA	D		2,00,000
	Total Income	E	C - D	-
	Income-tax paid in State S - Say @ 35%	F	A * 35%	35,000
	Income-tax paid in India - State R @ 35%	G	E * 35%	-
	Foreign Tax Credit	H	Lower of F or G	-
	Total income-tax paid	I	F + G - H	35,000
II	Book Profits u/s 115JB	J	A + B	2,00,000
	Tax on Book Profit - 18.5%	K	J*18.5%	37,000
	Foreign Tax Credit under MAT	L	Lower of A*18.5% and H	-
	Balance MAT Tax payable	M	K - L	37,000
III	MAT Credit u/s 115JAA	K	K - G	37,000

Deduction for foreign taxes

Section 40(a)(ii)

- Any sum paid on account of ***"any rate or tax levied"*** on the profits or gains of any business or profession or assessed at a proportion of, or otherwise on the basis of, any such profits or gains.

- Explanation 1 : For the removal of doubts, it is hereby declared that for the purposes of this sub-clause, any sum paid on account of ***"any rate or tax levied"*** includes and shall be deemed always to have included **any sum eligible for relief of tax** under section 90 or, as the case may be, deduction from the Indian income tax payable under section 91.

- Explanation inserted by the Finance Act, 2006 w.e.f. 1-4-2006.

Reliance Infrastructure Ltd vs CIT: 390 ITR 271 Bombay High Court Judgment dated Dec 20, 2016

1. Referring to earlier decision of Bombay High Court in S. Inder Singh Gill v. CIT [1963] 47 ITR 284.
   a) It is axiomatic that **income tax is charge** on the profits / income.
   b) The payment of income tax is **not a payment made / incurred to earn** profits and gains of business.
   c) Therefore income-tax cannot be allowed as an expenditure to determine the profits of the business.
   d) Taxes such as Excise Duty, Customs Duty, Octroi etc. are incurred for the purposes of doing business and earning profits and / or gains from business or profession. Therefore, such expenditure is allowable as a deduction to determine the profits of the business.
   e) The main part of Section 40(a)(ii) of the Act does not allow deduction in computing the income i.e. profits and gains of business chargeable to tax to the extent, the tax is levied / paid on the profits / gains of business.

Reliance Infrastructure Ltd vs CIT – 390 ITR 271

2. S Inder Singh Gill decision was rendered under the 1922 Act, not under the Income Tax Act, 1961.
3. 1922 Act has similar provisions in Section 10(4) as in Sec 40(a)(ii).
4. No definition of "tax" in 1922 Act as provided in Sec 2(43) of the Act.
5. The ratio of decision in S Inder Singh Gill cannot be applied to the present facts.
6. 1961 Act defines "tax" as income-tax chargeable under the provisions of the Act.
7. By definition, the tax payable under the Act alone on the profits and gains of business are not allowed to be deducted notwithstanding Sections 30 to 38 of the Act.
8. The tax paid abroad would not be covered within the meaning of Sec 40(a)(ii) of the Act in view of the definition of the word 'tax' in Sec 2(43) of the Act.
9. To be covered by Sec. 40(a)(ii), tax has to be payable under the Act.

Reliance Infrastructure Ltd vs CIT – 390 ITR 271

10. Explanatory Notes to the Finance Act, 2006 as recorded in Circular No. 14 of the 2006 dated 28th Dec 2006 records the fact that some of the assessee who are eligible for credit against the tax payable in India on the global income to the extent of tax has been paid outside India under Sections 90 or 91 of the Act, were also claiming deduction of tax paid abroad as it was not tax under the Act. In view of the above, Explanation inserted in 2006 to Sec 40(a)(ii) of the Act, would require in the context thereof that the definition of the word "tax" under the Act to mean also tax which is eligible to the benefits of Sections 90 and 91 of the Act.
11. Tax paid in Saudi Arabia (to the extent relief is not allowed u/s 91) is tax which has been paid abroad for the purpose of arriving global income on which tax is payable in India.

DCIT vs Elitecore Technologies (P.) Ltd -Ahd Trib

1. Assessee is engaged in the business of software developments and products. The assessee earned foreign income from Indonesia, Malaysia and Rwanda, where taxes were withheld from payments.
2. CIT(A) allowed deduction for foreign taxes to the extent relief u/s 90 was not allowed. The AO appealed to the ITAT.
3. Placing reliance on Mastek Ltd v. Dy CIT in [2014] 146 ITD 642 (Ahd-Trib.), it was argued that limitation of deduction of tax does not extend its scope to taxes paid other than under the Income-tax Act, 1961.
4. Referring to the Bombay High Court judgment in Lubrizol India Ltd vs. CIT in [1991] 187 ITR 25, ITAT observed that the above plea was rejected in the context of Sec 40a(ii) itself, though with reference to surtax.
5. "Any tax" refers to any kind of tax levied or leviable on the profits or gains of any business or profession or assessed at a proportion of, or otherwise on the basis of, any such profits or gains.
6. The view was approved by the Supreme Court in the case of Smithkline & French India Ltd. V. CIT [1996] 219 ITR 581.

DCIT vs Elitecore Technologies (P.) Ltd -Ahd Trib

7. In DCIT v. Tata Sons Limited: [2011] 43 SOT 27, the ITAT upheld the disallowance of income tax paid abroad, reversing the relief granted by the CIT(A).

8. ITAT-Ahd in Mastek, which allowed deduction of taxes paid abroad, did not take note of Lubrizol India Ltd (Bom) approved by the Supreme Court and the co-ordinate bench decision in the case of Tata Sons Ltd.

9. It was argued that Reliance Infrastructure Ltd is directly on the issue whereas Lubrizol India Limited is on surtax. ITAT was urged to adhere to judicial discipline and follow binding judgment.

10. ITAT order: ”Tax” in Sec 40(a)(ii) must be taken in the contextual meaning which extends to any tax ascertainable with reference to the profits of the assessee as is evident from the wordings of the section which refer to “**any rate of tax** levied on the profits or gains of any business or profession or assessed at a proportion of, or otherwise on basis of, aby such profits or gains”.

11. The above argument, in the context of deduction in respect of tax outside Income-tax Act, 1961 has already met the approval of the Supreme Court. The law laid down by the Supreme Court binds all under Article 141 of the Constitution of India.

DCIT vs Elitecore Technologies (P.) Ltd -Ahd Trib

12. On Explanations to Section 40(a)(ii), if the main provision does not cover the taxes paid abroad, as claimed by the assessee, there cannot be any occasion to include, under Explanations to Section 40(a)(ii), taxes in respect of which relief u/s 90 and 91 is not admissible.
13. Explanations do not expand the scope of Section 40(a)(ii) but rather explain the scope of the section.
14. If taxes in respect of credit u/s 90 or 91 are covered by the main proviso, these are covered by the scope of Sec 40(a)(ii) as well.
15. The theory that that meaning of "tax" u/s 40a(ii) must remain confined to taxes levied under the Act comes to a naught since the taxes in respect of which credits are available u/s 90 or 91 cannot be imposed under the Act.
16. No deduction u/s 37(1) can be allowed in respect of any income tax withheld abroad. They are hit by disabling provisions u/s 40(a)(ii) of the Act.

Foreign Tax Credit – Equitable Methodology

OPTIMAL CREDIT METHOD FOR FTC

	Country S1	Country S2	Country S3	Country R	Worldwide
Income	100,000	100,000	100,000	100,000	400,000
Rate of taxation	30%	42%	20%		30%
Tax amount	30,000	42,000	20,000		120,000
Total Foreign Sourced Income	300,000				
Total Foreign Taxes Paid	92,000				
Foreign Tax Credit					
A - Country by Country Method	30,000	30,000	20,000		80,000
B - Full Credit Method					92,000
C - Aggregation or Overall Method (with limitation)					
FTC = Resident Income Tax X Foreign Source Income / Worldwide taxable income					90,000
	120,000 X	300,000 /	400,000		
Carry forward / carry back ward					2,000

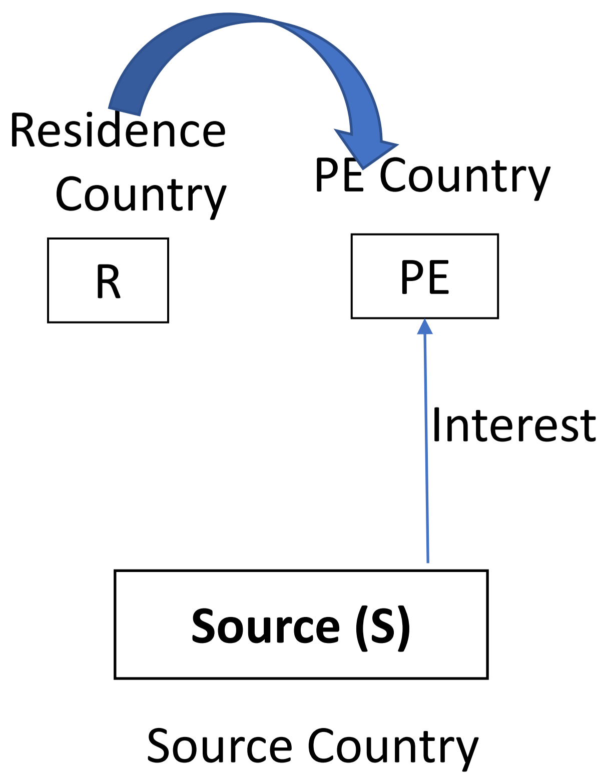
Aggregation method with carry-forward / carry-back – equitable

Carry-back and Carry forward of Excess FTC

Country	Provision	Carry back	Carry forward
USA	§904(c)	1 year	10 years
UK	Section 73 - TIOPA 2010	3 years	Any number of years
Singapore	Section 50(10) – Singapore Income Tax Act	-	Any number of years
Japan	National Tax	3 Years	3 Years
Canada	Sec 126 – Canada Income Tax Act	3 Years	10 Years
France	Article 220(1)(a) of the General Tax Code	☹	☹
India	Sec 90 /91	☹	☹

Foreign Tax Credit – Triangular Cases

PE Triangular Cases – Receipt by a PE



- Interest received by the PE of a resident of "Country R"
  - **R <-> S** treaty applies for taxation in "Country S"
- Credit for "Country S" Taxes:

  In PE Country

  - To give FTC for "Country S" tax. Article 24(3) of **"R – PE"** treaty gets invoked.
  - FTC limit as per **"PE – S"** treaty.

  In "Country R"

  - FTC for "Country S" tax as per "**R – S"** treaty.
  - FTC for PE Country tax as per "**R – PE"** treaty.

Non-discrimination - Article 24(3)- OECD MC

The taxation of a PE which an enterprise of a Contracting State has in the another Contracting State

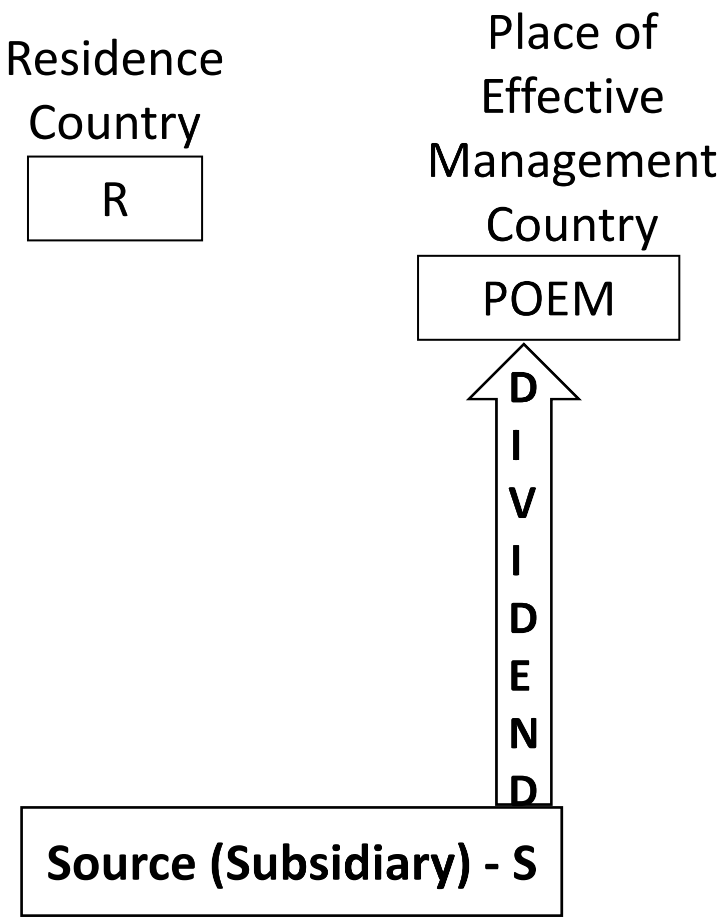
- shall not be less favorably levied in that other State
- <u>than the taxation levied on enterprises of that other State carrying on the same activities</u>.

Two parts:

- PE cannot be subjected to one tax and enterprise of Country S subject to another tax in respect of an identical income.
- The tax impost on PE cannot be more onerous than it is for enterprise of Country S.
- Article 24(1) applies to **any taxation**, whatever form or nature. Article 24(6) emphasis on overriding effect of section 2 (Taxes covered).

This provision shall not be construed as obliging a Contracting State to grant to residents of the other Contracting State any personal allowances, reliefs and reductions for taxation purposes [on account of civil status or family responsibilities which it grants to its own residents].

Dual Residency Cases – Receipts from third state



- **View 1**
  - Both “R – S” and “POEM – S” treaty would apply.
  - “Country S” should apply the treaty which is more beneficial.

- **View 2**
  - As per Article 4(3) of “R- POEM” treaty - recipient is resident of “Country POEM”.
  - Second part of Article 4(3) of “R – S” treaty would, as a corollary, not make recipient resident of Country R.
  - Only “POEM – S” treaty would apply.

Resident - Article 4 – OECD MC

Article 4(1)

- For the purposes of this Convention, the term "resident of a Contracting State" means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature, and includes that State and any political subdivision or local authority thereof. This term, however, does not include any person who is liable to tax in that State in respect of only of income from sources in that State or Capital situated therein.

Article 4(3)

- Where by reason of the provisions of paragraph 1 a person other than an individual is a resident of both Contracting States, <u>then it shall be deemed to be a resident only of the State in which the place of effective management is situated</u>.

"The reasonable man adapts himself to the world; the unreasonable one persists in trying to adapt the world to himself. Therefore all progress depends on the unreasonable man." –
George Bernard Shaw.

Questions and Answers

Thank you!