International Taxation
Foreign Tax Relief

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Foreign Tax Credit (FTC)

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Section 90 / 90A of IT Act 1961

- Provisions granting foreign tax credit under the Act

- Section 90 / 90A: Agreement with foreign countries / specified territories / specified associations
  - Govt may enter into agreement with 'foreign countries' or 'specified territories'
    - for granting relief in respect of income which has been doubly taxed
    - for avoidance of double tax etc…
- Sec.90(2) provides that more beneficial provisions can be invoked by a non resident – DTAA or IT Act 1961
- Tax Residency certificate (TRC) must for an NR to claim treaty benefits in India [w.e.f. 1.4.2013]

Section 295(2)(ha)–Amendment by F.Act, 2015

- Section 295(2)(ha) of the Income-tax Act, 1961 (the Act) provides that the CBDT may prescribe rules specifying the procedure for the granting of relief or deduction, as the case may be, of any income-tax paid in any country or specified territory outside India, under section 90 or section 90A or section 91, against the income-tax payable under the Act.

- Purpose of Amendment in Section 295 :

  The Income-tax Act did not provide the manner for granting credit of taxes paid in any country outside India.

OECD Model Article 23A

- Where a resident of a Contracting State derives income or owns capital which, in accordance with the provisions of this Convention, may be taxed in the other Contracting State, the first – mentioned State shall, subject to the provisions of paragraphs 2 and 3, exempt such income or capital from tax.

- Where a resident of a Contracting State derives items of income which, in accordance with the provisions of Article 10 and 11, may be taxed in the other Contracting State, the first - mentioned State shall allow as a deduction from the tax on the income of that resident an amount equal to the tax paid in that other State. Such deduction shall not, however, exceed that part of the tax, as computed before the deduction is given, which is attributable to such items of income derived from the that other State.

OECD Model Article 23A

- Where in accordance with any provision of the convention income derived or capital owned by a resident of a Contracting State is exempt from tax in that State, such State may nevertheless, in calculating the amount of tax on the remaining income or capital of such resident, take into account the exempted income or capital.

- The provisions of paragraph 1 shall not apply to income derived or capital owned by a resident of a Contracting State where the other Contracting State applies the provisions of this convention to exempt such income or capital from tax or applies the provisions of paragraph 2 of Article 10 or 11 to such income.

OECD Model Article 23A

- Where a resident of a Contracting State derives income or owns capital which, in accordance with the provisions of this Convention, may be taxed in the other Contracting State, the first-mentioned State shall allow:
  - a) as a deduction from the tax on the income of that resident, an amount equal to the income tax paid in that other State
  - b)as a deduction from the tax on the capital of that resident, an amount equal to the capital tax paid in that other State

OECD Model Article 23B

- Such deduction in either case shall not, however, exceed that part of the income tax or capital tax, as computed before the deduction is given, which is attributable, as the case may be, to the income or capital which may be taxed in that other State.
- Where in accordance with any provision of the Convention income derived or capital owned by a resident of a Contracting State is exempt from tax in that State, such State may nevertheless, in calculating the amount of tax on the remaining income or capital of such resident, take into account the exempted income or capital.

UN MODEL ARTICLE 23A

EXEMPTION METHOD:

1. Where a resident of a Contracting State derives income or owns capital which, in accordance with the provisions of this Convention, may be taxed in the other Contracting State, the first mentioned State shall, subject to the provisions of paragraphs 2 and 3, exempt such income or capital from tax.
2. Where a resident of a Contracting State derives items of income which, in accordance with the provisions of Articles 10, 11 and 12, may be taxed in the other Contracting State, the first-mentioned State shall allow as a deduction from the tax on the income of that resident an amount equal to the tax paid in that other State. Such deduction shall not, however, exceed that part of the tax, as computed before the deduction is given, which is attributable to such items of income derived from that other State.

UN MODEL ARTICLE 23A

EXEMPTION METHOD:

3. Where in accordance with any provision of this Convention income derived or capital owned by a resident of a Contracting State is exempt from tax in that State, such State may nevertheless, in calculating the amount of tax on the remaining income or capital of such resident, take into account the exempted income or capital.

UN MODEL ARTICLE 23A

CREDIT METHOD:

1. Where a resident of a Contracting State derives income or owns capital which, in accordance with the provisions of this Convention, may be taxed in the other Contracting State, the first mentioned State shall allow as a deduction from the tax on the income of that resident an amount equal to the income tax paid in that other State; and as a deduction from the tax on the capital of that resident, an amount equal to the capital tax paid in that other State. Such deduction in either case shall not, however, exceed that part of the income tax or capital tax, as computed before the deduction is given, which is attributable, as the case may be, to the income or the capital which may be taxed in that other State.

UN MODEL ARTICLE 23A

<u>CREDIT METHOD:</u>

2. Where, in accordance with any provision of this Convention, income derived or capital owned by a resident of a Contracting State is exempt from tax in that State, such State may nevertheless, in calculating the amount of tax on the remaining income or capital of such resident, take into account the exempted income or capital.

Source - residence conflict

- Methods of elimination of Double Taxation

  (i) Exemption method

  (ii) Credit method

  (iii) Deduction method –

  The deduction method allows residents/citizens to deduct foreign taxes paid treating them as a current expense so it becomes the effective means of providing relief when there is no Tax treaty.

  - This method will not result in total relief.
  - This method is very rarely used.

EXEMPTION METHOD

- Full exemption –

  In this method income taxed in source country is totally excluded in resident country for tax purposes.

- Exemption with progression method –

  Rate of tax is calculated by COR by including income taxed in COS. Then such rate is applied on income excluding income taxed in COS.

- <u>In the following treaties with India, exemption method has been followed:</u>

  → By both the CS:

  Bulgaria, Poland and Egypt (United Arab Republic)

  → By the other CS *(i.e. the other CS adopts exemption method and India adopts Tax Credit method):*

  Austria, Belgium, Turkey

EXAMPLES

- A ltd resident of a Contracting State, has earned a total income of Rs. 2,00,000. Of its total income, Rs. 40,000 is derived from State S. State R imposes tax of 35% on income of Rs.2,00,000 or more and a tax of 30% on income below Rs. 2,00,000. State S imposes a tax of 20%. In this case, the tax costs would be computed as follows:

Particulars	Situation where Full exemption mechanism exists	Situation where exemption (with progression) mechanism exists
Amount of income earned	2,00,000	2,00,000
State R tax	48,000 @	56,000#
State S tax @ 20%	8,000	8,000
Total tax costs	56,000	64,000

@ 1,60,000*30%
# 1,60,000*35%

CREDIT METHOD

- Full credit method –

  Under this method COR allows foreign taxes from total tax liability irrespective of different tax rates in COR and COS.

- Ordinary credit method –

  COR allows tax credit by restricting it to the rate of tax in COR against income taxed in COS.

  - Dividend and interest always follow tax credit method

  - Tax credit method-Resident state retains the right to tax.

EXAMPLES

- A ltd resident of a Contracting State, has earned a total income of Rs. 2,00,000. Of its total income, Rs. 40,000 is derived from State S. State R imposes a tax of 35% on income of Rs.2,00,000 or more and a tax of 30% on income below Rs. 2,00,000. State S imposes a tax of 40%. In this case, the tax costs would be computed as follows:

Particulars	Situation where Full Credit mechanism exists	Situation where Ordinary Credit mechanism exists
Amount of income earned	2,00,000	2,00,000
State R tax	70,000	70,000
State S tax @ 40%	16,000	16,000
Less: Tax credit	16,000	14,000#
Taxes due in State R	54,000	56,000
Total tax costs	70,000	72,000

#40,000 * 35%

OTHER CONCEPTS – FOREIGN TAX CREDIT (FTC)

- **Underlying tax credit (UTC)** –

  - Shareholder of COR receiving dividend from a company in COS is allowed tax credit in respect of taxes paid by the company in COS against its profits from which dividends are declared. Tax on underlying profits of company from which dividend is declared is allowed as credit in the hands of shareholder in COR.

- DTAAs with USA, UK, Australia, Japan, Mauritius, Singapore and China.

OTHER CONCEPTS – FOREIGN TAX CREDIT (FTC)

UTC

- **Important treaties having UTC clause**
  - Both CS granting UTC Mauritius, Singapore
- Only other CS granting UTC
  - Canada, China, Germany, Japan, UK, US
- Only India granting UTC
  - None!!
- Will DDT be covered by UTC?

OTHER CONCEPTS – FOREIGN TAX CREDIT (FTC)

Participation threshold for exemption			
Country	**% holding**	**% holding of-**	**Benefit available**
China*	10	Shares	UTC
Germany*	10	Voting	Dividend exemption
Japan*	25	Total shares issued or voting power	UTC
Mauritius	10	Shares paying dividend	UTC
Singapore	10	Share Capital	UTC
UK*	10	Voting power	UTC
US*	10	Voting power	UTC

UTC : Underlying tax credit
*Not for Indian resident

OTHER CONCEPTS – FOREIGN TAX CREDIT (FTC)

- **Tax sparing –**
  - If COS exempts particular stream of income, tax that would have been payable on such income in COS will be given credit by COR. This ensures objective of COS to exempt such income, lest it would result in such income getting taxed in COR. Waiver of taxing rights by COS continues in COR also.

- DTAAs with Cyprus, Mauritius, Singapore, Kenya, Korea, Malaysia, Nepal, Philippines etc,.

Section 91 – Unilateral tax credit

- Section 91 of the Act grants unilateral Tax Credit in case where no DTAA exists.
- ***S. 91.(1) 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.***
- Conditions:
  - Applies only to Resident
  - In respect of income accruing outside India
  - For taxes paid in any country with which there is no DTAA

SECTION 91 – UNILATERAL TAX CREDIT

Example 1

- Mr. A resident of India
- Income Earned is Rs.10,000/- from USA
- Tax Rate in India – 30%
- Tax Rate in USA – 40%
- Tax paid in USA (a) = (10000*40%) = 4000/-
- Tax to be paid in India (b) = (10000*30%) = 3000/-
- Doubly Taxed Income is Rs.10,000/- which is taxed in India as well as in USA
- FTC available (lower of (a) or (b)) = 3000/-
- <u>Tax Payable in India will be Rs. NIL </u>(Tax of Rs.3000 – FTC Rs. 3000)

Section 91 – Unilateral tax credit

Example 2

- Mr. A resident of India
- Income Earned is Rs.10,000/- from Foreign Country X
- Tax Rate in India – 30%
- Tax Rate in Country X – 15%
- Tax paid in Country X (a) = (10000*15%) = 1500/-
- Tax to be paid in India (b) = (10000*30%) = 3000/-
- Doubly Taxed Income is Rs.10,000/- which is taxed in India as well as in Country X
- FTC available (lower of (a) or (b)) = 1500/-
- <u>Tax Payable in India will be Rs. 1500 </u>(Tax of Rs.3000 – FTC Rs. 1500)

ISSUES - FTC

- Taxes covered – Article 2
  - In USA only federal taxes are covered.
  - ***Tata Sons (2011)10 taxmann.com 87(Mum)*** State taxes allowed u/s 91
- Characterisation of Income
  - Para 32.3 OECD MCC provides for tax credit even in qualification conflicts.
- Different assessment periods
- Triangular cases

ISSUES - FTC

- Different income base
  - Disallowance under the domestic law to be ignored for PE profits.
  - ***State Bank of India ITA 2254/Mum/2005 (2012) 25 taxmann.com 555***
  - *No relief qua income exempt in foreign jurisdiction* ***[Refer CIT V/s. United Commercial Bank [206 ITR 641](Cal)]***
  - *Relief w.r.t income net of deductions in India – Say, Section 80RRA.* ***[Refer CIT V/s. Dr. K.L. Parekh (208 ITR 965)(Raj)]***
  - *Foreign income to be recomputed for Indian assessment* ***[ACC Ltd. V/s. CIT (141 ITR 318)(Bom)]***

ISSUES - FTC

- ***(K.V. AL.M. Ramanathan Chettiar – 88 ITR 169). (Dissenting judgement.)***

- ***(Mois (M.A.) - 210 ITR 284).***

- Income to be considered is ordinary commercial income for the purpose of foreign tax credit.

  (Best & Crompton Engg. Ltd. – 284 ITR 225).

ISSUES - FTC

- 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; 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 – ***Wipro Ltd.[2015] 62 taxmann.com 26 (Karnataka)(HC)***

ISSUES - FTC

- Relief under section 91 would only be available when amount of tax paid under foreign income is again included in taxable income earned in India i.e. the same income must be taxed. Thus, where income earned by assessee in Saudi Arabia had been subjected to tax in Saudi Arabia and while determining tax payable under Indian Law, assessee claimed benefit of double taxation relief on deductions claimed under section 80HHB and section 35B, same was to be disallowed as it did not bear any tax in India. ***Reliance Infrastructure Ltd. [2016] 76 taxmann.com 257 (Bombay)(HC)***

FTC RULES - NEW INCOME TAX RULE 128

Effective date: 1 April 2017

Basic Provision [Rule 128(1)]

- Assessee being a resident shall be allowed a credit for the amount of any foreign tax paid by him in a country or specified territory outside India
- By way of deduction or otherwise
- Year of credit
  - In the year in which income corresponding to such tax has been offered to tax / assessed to tax in India
  - Where income has been offered to tax in more than one year, foreign tax credit shall be allowed across those years proportionately

FTC RULES - NEW INCOME TAX RULE 128

Meaning of "Foreign Tax" [Rule 128(2)]

- Country or specified territory with which India has DTAA (Covered under section 90/90A of the IT Act)
  - Taxes covered under the said DTAA

- No DTAA with India (Section 91 of IT Act)
  - Tax payable under the law in force in that country (*as referred to in clause (iv) of Explanation to section 91)*

FTC RULES - NEW INCOME TAX RULE 128

Foreign Tax Credit available against [Rule 128(3)]:

- The amount of tax, surcharge and cess payable under the Act
- But not against any sum payable by way of :
  - Interest
  - Fee or
  - Penalty

FTC RULES - NEW INCOME TAX RULE 128

Disputed Foreign T ax Credit [Rule 128 (4)]

- No credit of foreign tax (part or full) which is disputed in any manner shall be available.

- However, credit for disputed tax shall be allowed in year in which such income is offered / assessed to tax in India, provided:
  - Evidence towards settlement of dispute and payment of foreign tax to be furnished within 6 months from end of the month in which dispute is finally settled
  - Undertaking that no refund of foreign tax paid, has directly or indirectly, been claimed or shall be claimed

FTC RULES - NEW INCOME TAX RULE 128

Manner of availment of Foreign T ax Credit [Rule 128 (5)].

- Credit of foreign tax shall be the aggregate of amounts of credit computed separately for each source of income arising from a particular country or specified territory
- Amount of Credit, lower of the two:
  - tax payable under the Act on such income or
  - the foreign tax paid on such income

  Excess of foreign tax paid over and above tax payable in accordance with DTAA shall be ignored
- <u>Conversion rate to be applied</u>
  - Credit shall be determined by conversion of the currency of payment of foreign tax at the telegraphic transfer buying rate on the last date of the month immediately preceding the month in which such tax has been paid/ deducted

FTC RULES - NEW INCOME TAX RULE 128

Foreign T ax Credit available also against MAT /AMT* [Rule 128 (6)& (7)

- FTC available against MAT / AMT**
- No impact on MAT/AMT credit
  - Where the amount of foreign tax credit available against the tax payable under the provisions of section 115JB or 115JC exceeds the amount of tax credit available against the normal provisions, then while computing the amount of credit under section 115JAA or section 115JD in respect of the taxes paid under section 115JB or section 115JC, as the case may be, such excess shall be ignored

FTC RULES - NEW INCOME TAX RULE 128

Documentation Requirement [Rule 128 (8)]

- FTC allowed on furnishing following documentation :
  - Statement of income from the country outside India offered for tax for the previous year and of foreign tax deducted/paid in new Form 67
  - Certificate/statement specifying the nature of income and tax deducted/paid from any of the following:
    - Tax authority of a country or specified territory outside India
    - Person responsible for deduction of such tax
    - Self declaration by assessee*

*Self declaration signed by the assessee shall be valid only if it is accompanied by an acknowledgement of online tax payment or bank counter foil or slip or challan for tax payment where the payment of foreign tax has been made by the assessee and proof of deduction where tax has been deducted.

FTC RULES - NEW INCOME TAX RULE 128

Furnishing of Form 67 [Rule 128 (9) & (10)]

- These documents required to be provided by due date of filing of return of income under section 139(1).
- Form 67 would also be required in a case where the carry backward of loss of the current year results in refund of foreign tax for which credit has been claimed in any earlier years.
- Form 67 is divided into Part A and Part B. Part A requires details such as name, PAN, address , source of income, taxes paid abroad, foreign tax credit claimed country-wise and source of income wise. Part B requires details of refund of foreign tax credit arising out of carry backward of losses and details of disputed foreign tax credit

FTC RULES - ISSUES NOT ADDRESSED

- Tax Payers expectation to provide an option to claim credit for all foreign taxes paid on an aggregate basis has not been considered.

- Source by source approach prescribed may increase compliance burden and effectively reduce availability of tax credit.

- Characterization of income conflicts and tax credit have not been addressed.

- No clarity on availability of tax credit for state taxes paid in foreign country

FTC RULES - ISSUES NOT ADDRESSED

- Whether restriction of FTC available in case of MAT or AMT payments in India would amount to a conflict between treaty provisions and domestic law provisions.
- Tax Sparing credits allowed under some treaties is a subject not dealt with by FTC rules
- Option to carry forward or carry back excess FTC has not been provided in the rules
- Deemed tax credits allowed in source jurisdiction must be allowed in resident jurisdiction i.e., India
- No clarity on Branch Profit tax paid in foreign jurisdiction is provided by the rules.

"Try not to become a man of success. Rather become a man of value."

– Albert Einstein

THANK YOU