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Foreign Tax Credit

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Foreign Tax Credit – Concept and Law

Key Abbreviations:

COR	-	Country of Residence
COS	-	Country of Source
DTA	-	Double Tax Avoidance Agreement
FTC	-	Foreign Tax Credit
PE	-	Permanent Establishment

Foreign Tax Credit - The concept

- **The concept –** Foreign Tax Credit (FTC) is a mechanism to avoid double tax on income which is taxable in both countries.

- The Country where tax payer is a resident (e.g. India), gives credit for tax paid in the other country.

- **FTC is the responsibility of Country of Residence (COR)**. Country of Source (COS) has nothing to do with FTC.

Foreign Tax Credit in India - The Law

India is COR

- Foreign tax credit is available as under:

-Where DTA is available, for tax covered under the DTA (Section 90 and 90A).

-Where there is no DTA, for tax referred to in Section 91.

- **Foreign Tax Credit rules** have been recently notified – Rule 128. They will come into force from 1.4.2017.

Key requirements for FTC

- Income should have **arisen in COS**.
- If there is a DTA with COS, COS should have **charged tax as permitted by DTA**.

FTC will be allowed for taxes covered in the DTA.

- Where **there is no DTA,** FTC will be allowed for tax paid under COS law and as referred to in S.91.
- Tax paid in COS should be **considered as Income-tax**.
- Lower of foreign tax or Indian tax will be allowed as credit.

FTC– only for doubly taxed income

- Credit is available for **income which is doubly taxed**.

	<u>**Income**</u>	<u>**Tax**</u>
Software income in Country A … … … … …	1,000	200 (20%)
Income in India:		
Software income – 10AA **(NOT Doubly taxed)**	1,000	NIL
Other income	<u>200</u>	<u>60</u> (30%)
	1,200	60

Tax Credit - NIL

FTC– Some judicial decisions

- Some judicial precedents…

- Income to be considered is **ordinary commercial income** for the purpose of foreign tax credit. (Best & Crompton – 284 ITR 225 – Madras HC).
- Tax paid abroad has to be considered **country-wise** u/s. 91. (Bombay Burmah Trading – 259 ITR 423 – Bombay HC).

FTC– Some judicial decisions

- Tax Credit is on **proportionate basis – in proportion of income taxable / income earned**.

  K. L. Parekh (208 ITR 965).

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

- Tax credit is available on a source by source, country by country and proportionate basis.

Illustration – Source by Source FTC

- An Indian resident earns <u>income in UK</u> which is taxed in UK and India as under:

		UK	India
Source	**Amount**	**Tax**	**Tax**
Interest	1,000	200	300
Business	1,000	400	300
Total	2,000	600	600

Illustration – Source by Source FTC

FTC in India for UK tax :

On interest	200 (restricted to UK tax)
On Business	300 (restricted to Indian tax)
Net tax in India	**100**
Total tax	700 (600 in UK+ 100 in India)

- Higher of the rates in the two countries is the tax cost for each source of income.

Rule 128 – FTC

- FTC will be allowed **in the year in which such income is offered to tax / assessed to tax in India**.

  If foreign income is taxable in India spread over more than one year, proportionate FTC will be allowed over that many years.

Rule 128 – FTC

- FTC available against tax, surcharge and education cess. Not against interest, fee and penalty.

- FTC is available against each source of income from a particular country.

- FTC is available against MAT / AMT.

FTC exceeding "normal tax", but which is set off against MAT… See example in the next slide for implication on MAT credit…

MAT and FTC

Sr.	Particulars	Income	Rate of tax	Tax
1	Normal provisions	100	30%	30
2	As per MAT	190	18.5%	35
3	Tax to be paid (Higher of 1 and 2)			35
4	Normal MAT credit for subsequent years (1-2)			5
5	Less: FTC (assumed)			(32)
6	Tax to be paid in India (3-5)			3
7	MAT to be carried forward to subsequent years			3 (Not 5)

Disputed Tax in COS

- No credit for **tax disputed** abroad.
- When the dispute is settled, FTC will be given if within 6 months from the end of the month of settlement, following are furnished – i) evidence of settlement of dispute, ii) evidence of payment of foreign tax, iii) undertaking that no refund has been claimed or shall be claimed in any assessment year.

Credit will be given for the year in which the foreign income is taxed in India. [S.155(14A) proposed in Finance Bill 2017].

Documents required

- Documents to be furnished before due date of filing the tax return u/s. 139(1) –

- Form 67 (details of foreign income, tax etc.)
- Certificate stating the nature of income and amount of tax paid from:

a) foreign tax authority, OR

b) deductor of tax, OR

c) self-certification along with proof of payment of foreign tax.

Carry Back of losses

- In some countries, losses can be carried back.

Example:

<u>Year 1</u>

1)	Income in foreign country	1,000
2)	Tax paid in that country @ 25%	250
3)	Tax in India @ 30% on 1,000	300
4)	Less: FTC	<u>(-) 250</u>
5)	Tax paid in India	50

Carry Back of losses

Example contd…:

Year 2

6)	Loss in foreign country	(-)	400
7)	**Carry back in Year 1**		
	Thus income in Year 1 (1-6)		600
8)	Refund in foreign country @ 25%		100
9)	In India, pay tax for which FTC		
	has been claimed in Year 1	100	

Carry Back of losses

- Form 67 to be filed in case of carry back of losses.
- However it is not clear for which year should tax be paid in India – Year 1 or Year 2.

Foreign Tax Credit – Some Practical issues

Section 91 – No DTA

- Where there is no DTA, FTC will be available u/s. 91 for tax paid on income which accrues outside India, and which is not deemed to accrue in India.

- **Example** - Indian company earns commission from Tunisia for getting sales orders for Tunisian company. Indian company is liable to tax in Tunisia on gross basis. Will FTC be available for tax paid in Tunisia?

  No. Income does not accrue outside India.

Income sourced abroad

- **Example:**

Indian company has a branch (PE) abroad.

1) Total Profit of India company 100
2) Profit of foreign PE as per that country 20
3) Profit of foreign PE as per India 15

4) India will give FTC for tax on profit of 15

Income sourced abroad

- **Example contd…:**

What happens to the foreign tax on the difference of 5? It is lost – unless one goes through appellate process and gets relief if any.

BEPS measures, POEM, GAAR will be increase such issues.

Further reference on BEPS, please visit –

https://www.youtube.com/watch?v=ZjtwH7tW1sI.

FTC and filing of tax return

Example - Indian company has a US PE:

- Indian company has to file its tax return for the year 1st April 2017 to 31st March 2018. US Tax year is Calendar year (January to December).

- US income is taxable in India and US.

US income for 2017 has to be considered from 1.4.2017 to 31.12.2017.

US income for 2018 has to be considered from 1.1.2018 to 31.3.2018.

FTC and filing of tax return

- In India, return has to be filed by 30.11.18.

  Revised return can be filed upto 31st March 2019 (with effect from AY 2018-19).

  Final U.S. tax will be known after Dec. '18 – probably by April / May 2019.

- **Jan. '18 – Mar. '18 – How much credit should be claimed for US tax?**

FTC and filing of tax return

- Practically, make proper accounts for Jan to Mar. 2018, pay advance tax, file the Indian return on the basis of taxes paid upto March. '18.

- Is there is a scrutiny assessment, make a revised claim for correct FTC after filing US tax return.

- If there is no scrutiny assessment, there will be difficulties – especially if more FTC has to be claimed.

FTC and filing of tax return

- U.S. taxes – Will **State & City tax** be available as credit?

  U.S. – India DTA applies only to Federal tax.

  Section 91 – credit is available for foreign taxes, <u>only where there is no DTA</u>.

- Tata Sons – 10 Taxmann.com 87 (Mumbai ITAT) – Credit will be available for State income-tax.

Non-residents returning to India

- An NRI aged 40 years returns to India after working in USA.
- He retains his 401-K account (akin to Provident Fund). Income is credited every year.
- No tax is levied in USA on 401-K accounts. At the age of 59, the amount can be withdrawn. Tax is levied in USA on withdrawal.

Non-residents returning to India

- Is income credited in 401-K account every year taxable in India? Yes.

- Will FTC be available for tax paid on withdrawal? Yes, but how?

FTC has to be spread over the years in which income is offered. Assessments would have been over for past years.

Total tax paid on withdrawal cannot be fully available against income of last year.

To summarise

- FTC rules are good and provide a formal clarity on some issues.
- There are many practical issues which one will come across for which there will be no solutions.

Thank you.

Questions and comments are welcome.

For more discussion on various subjects, visit our website – www.rashminsanghvi.com

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