REFUND AND DEDUCTION OF FOREIGN TAXES IN INDIA

Recently, Mumbai bench of the Income-tax Appellate Tribunal ("**the Tribunal**") in the case of Bank of India vs ACIT (ITA No.869/Mum/2018) vide order dated 04.03.2021 examined the claim of credit/ refund of taxes paid on income earned outside India ("**foreign taxes**") by the taxpayer, a major Indian bank with several branches abroad when it did not have tax liability in India on such foreign income, as the aggregate income of the taxpayer was a loss. The taxpayer had made an alternate claim of deduction of such foreign taxes, as business expenditure, should the claim of credit/ refund of foreign taxes fail.

The taxpayer, in this case, claimed credit of foreign taxes paid in the UK, Singapore, USA, Japan, Belgium, Kenya, China and France, in terms of the mechanism provided in the tax treaties entered into by the Indian Government with those countries under section 90 of the Income-tax Act, 1961 ("**the Act**"). Credit was also claimed in respect of foreign taxes paid in Hong Kong, Cambodia and Jersey, jurisdictions with which no tax treaty was entered into for the relevant assessment year.

While tax treaty with the UK provides the condition of income being 'subjected to tax' in both jurisdictions, in addition to the stipulation that only so much of the foreign taxes will be allowed as credit which do not exceed that proportion of Indian tax which such income bears to the entire income chargeable to Indian tax; the tax treaties with USA, Singapore, Japan, etc., only contain the latter restrictive condition, and allow credit of so much of the foreign taxes which do not exceed that proportion of Indian tax which such income bears to the entire income chargeable to Indian tax.

The claim of the taxpayer for refund of foreign taxes was rejected by the assessing officer and the CIT(A) holding that section 90 of the Act is for providing relief of taxes paid in foreign jurisdictions against the income-tax chargeable under the Act, and the same cannot be interpreted to mean that refund of foreign taxes would be granted in India in case no tax is payable by the taxpayer in India. The lower authorities also rejected the alternate claim of business deduction in respect of foreign taxes.

Taxpayer's contentions:

The taxpayer, relying upon the decision of the Karnataka High Court in the case of Wipro Ltd. vs DCIT: [2015] 382 ITR 179 (Kar), contended before the Tribunal that income of the foreign branches was 'subjected to tax' in both the countries, inasmuch as it reduced the entitlement for losses carried forward. The taxpayer also contended that the actual payment of tax is not the condition precedent for being entitled to tax credit in terms of article 24 of the tax treaty with UK. Regarding the alternate claim for business deduction, reliance was placed on the

decision of the jurisdictional Bombay High Court in the case of Reliance Infrastructure Ltd. vs CIT: [2016] 390 ITR 271 (Bom), wherein similar relief was allowed.

Department's contentions:

Revenue, on the other hand, urged that refund cannot be granted for taxes paid abroad and foreign tax credit can be claimed only when there is tax payable in India, in as much as, the foreign tax credit can never exceed the actual tax liability in the residence jurisdiction. Revenue urged that the decision in the case of Wipro *(supra)* was rendered in the context of an income that was taxable in the hands of the assessee but exempt for the reason of an incentive provision and the same was not applicable. Revenue also argued that the said decision, being a non-jurisdictional High Court decision, was not binding on this Tribunal.

For the alternate contention of the taxpayer of business deduction of foreign taxes, the Revenue relied upon the decision of the Ahmedabad bench of the Tribunal in the case of DCIT vs Elitecore Technologies Pvt Ltd: [2017] 80 taxmann.com 6 (Ahmd Trib.), wherein the claim of the taxpayer seeking deduction of the amount of foreign taxes as deductible expenditure was denied, not following the decision of the Bombay High Court in the case of Reliance Infrastructure *(supra)*, on the basis that the said decision was rendered by a non-jurisdictional High Court and hence, was not binding on the Tribunal at Ahmedabad.

Decision of the Tribunal:

The scheme of foreign tax credit in India as per Article 24(2) of the India-UK tax treaty was interpreted by the Tribunal holding that (i) tax credits are subject to the provisions of the domestic law *(however, since Rule 128 was introduced w.e.f. 01.04.2017, no discussion qua the same was required in the present case)*; (ii) income in respect of which tax credit is to be given must have been "subjected to tax" in both jurisdictions; (iii) tax credit is to be allowed proportionate to the income doubly taxed *vis-à-vis* entire income chargeable to tax in India.

Subjected to tax

Referring to various decisions, including the decision of the UK First Tier Tribunal, as well as the OECD commentary on the OECD Model Convention, the Tribunal distinguished "subjected to tax" from the expression "liable to tax" and held that while, indeed the income suffered taxation in the UK, since the said income was offset against losses incurred by the assessee outside UK, the income so earned in the UK was never subjected to tax in India, which is *sine qua non* for the availability of tax credit under the tax treaty.

Tax credit to the extent of tax paid in India on income doubly taxed

Referring to various international tax literature, including the interpretation of the noted author, Professor Klaus Vogel, it was held that the India-UK tax treaty provided for "ordinary tax credit" as against "full tax credit" available under the India-Namibia tax treaty; ergo, foreign tax credit could be allowed only to the extent of tax payable in India on the doubly taxed income, which in the present case, was Nil.

Double jeopardy

Regarding assessee's argument of double jeopardy, the Tribunal held that, at best, such issue would arise in the year in which brought forward losses will be eligible for set off against taxable income arising in the year; thus, rejected the same on the ground of the claim being in the realm of a contingent event and secondly, not arising in the present assessment year in which loss was carried forward.

Decision of the Karnataka High Court in Wipro Ltd.

Distinguishing the judgment in the case of Wipro *(supra)*, the Tribunal held that the same was rendered on peculiar facts arising in that case and, at best, can be seen as an authority for "full tax credit", like in the case of India-Namibia tax treaty, rather than an "ordinary tax credit" and cannot be relied upon to grant foreign tax credit exceeding the domestic tax liability/ refund of foreign taxes in a situation in which the income has suffered tax abroad but has not been subjected to tax in India.

The Tribunal held that the Wipro judgment *(supra)*, rendered by a non-jurisdictional High Court does not bind Mumbai bench of the Tribunal and was not required to be followed. The Tribunal also considered the judicial position on interpretation of the treaties, viz. *"… a literal or legalistic interpretation must be avoided when the basic object of the treaty might be defeated or frustrated …"* and held that the interpretation being assigned to the provisions of the tax treaty, relying on the Karnataka High Court ruling, thereby seeking refund of taxes paid in UK from Indian tax authorities could not be said to be tenable and correct in the light of context of the tax treaty and in light of object and purpose of the tax treaty; and would also not be a 'good faith' interpretation of the treaty.

Similar view was taken by the Tribunal rejecting the claim for refund in India in respect of taxes paid in Singapore, USA, Japan, Belgium, Kenya, China and France.

Refund of taxes paid abroad in non-tax treaty partner jurisdictions

In respect of taxes paid abroad in non-tax treaty partner jurisdictions, the Tribunal held that section 91 does not provide for tax credit when no part of income earned abroad had actually suffered tax in India.

Deduction of foreign taxes paid

The Tribunal allowed the alternate claim of the assessee for deduction of foreign taxes paid, relying on the judgment in Reliance Infrastructure *(supra)*, wherein it was held that taxes have been paid by the assessee in foreign jurisdiction for the purpose of earning global income on which tax is payable in India, therefore, such foreign taxes paid shall be allowed as expenditure [not hit by section 40(a)(ii) of the Act], to the extent credit for the same is not granted to the assessee. The said judgment, being rendered by the jurisdictional Bombay High Court, was

held to be binding. Revenue's reliance on the decision in the case of Elitecore Technologies *(supra)* wherein it was held that taxes on profits and gains paid outside India would be hit by rigours of section 40(a)(ii), even though benefit in respect of the same was not available under sections 90/ 91 of the Act; was therefore, not followed by the Tribunal.

VA Comments:

The well-reasoned and comprehensive decision of the Tribunal extensively analyses the credit mechanism provided under the tax treaties and conclusively deliberates upon the eligibility to claim refund of foreign taxes in absence of tax payable on foreign sourced income in India.

The Tribunal has made some bold and interesting observations regarding the judgment of the Karnataka High Court in the case of Wipro *(supra)*, a decision which hitherto had been followed by benches of the Tribunal[1] across the country, albeit not in the context of refund of foreign taxes.

The findings of the Tribunal qua deduction of foreign taxes would be welcomed by the taxpayers and adds to the gradually growing list of decisions[2] allowing such claim.

Further, elucidating on the concept of "ordinary tax credit" *vis-à-vis* "full tax credit", the Tribunal has also touched upon the computation of foreign tax credit allowable by holding that the same is capped to the extent of tax payable in India on the doubly taxed income. Interestingly, benches of the Tribunal[3] have held that only income embedded in the "Gross receipt" and foreign tax paid corresponding to such income shall be considered as eligible foreign tax paid for the purpose of credit.

For any further information/ clarification, please feel free to write to:
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[1] Tata Consultancy Service Ltd vs ACIT: [2019] 111 taxmann.com 42 (Mumbai Trib.); HCL Comnet SSL Ltd vs DCIT: [2020] ITA No. 835/Del/2014 (Del Trib.)
[2] Virmati Software and Telecommunication Ltd vs DCIT: ITA No.1135/Ahd/2017 (Ahmd Trib. dated 05.03.2020); Tata Consultancy Services Ltd vs ACIT: [2019] 111 taxmann.com 42 (Mum Trib.); Tata Motors Ltd vs CIT: [2019] ITA No.3802/Mum/2018 (Mum Trib.); Mastek Ltd vs DCIT: 146 ITD 642 (Ahmd)
[3] Elitecore Technologies (P) Ltd vs DCIT: [2017] 184 TTJ 166 (Ahmd); DCIT vs iGate Global Solutions Ltd: 342/Pun/2014; Manpreet Singh Gambhir vs DCIT: 26 SOT 208 (Del)