

Analysis of Rules for grant of Foreign Tax Credit

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Computation of Foreign Tax Credit ('FTC') in case of assessee's with cross border payments has been a major hassle for tax professionals. Absence of well-defined set of rules, coupled with few judicial precedents had resulted in diversified practices. The Central Board of Direct Taxes ('CBDT') by Income-tax (18th Amendment) Rules, 2016 have inserted Rule 128 to the Income-tax Rules, 1962 ('Rules') providing the rules for grant of Foreign Tax Credit. The said rules, applicable from April 1, 2017, will help provide much needed clarity in an area which was until now marked by diverse interpretations. This will help reduce the hassle in claiming credit on tax paid in foreign countries and help achieve the Government's vision for non-adversarial tax regime.

1. Eligibility to claim FTC

Sub-rule 1 of the Rules provide that a resident assessee will be eligible to claim FTC if any tax has been paid by him in a country or specified territory outside India. Grant of FTC shall be allowed only in the year in which the income corresponding to such tax has been offered to tax or assessed to tax in India.

The rule further provides that where income on which foreign tax has been paid or deducted, is offered to tax in more than one year, credit of foreign tax shall be allowed across those years in the same proportion in which the income is offered to tax or assessed to tax in India.

This rule may create certain complications where there is a mismatch in timing of taxation of a particular stream of income in India and foreign country in accordance with their respective tax laws.

For example: Income X is chargeable to tax in India in FY 2016-17 and in foreign country in FY 2017-18. Here, since the income is taxable in FY 2017-18 in foreign country, there may be cases where foreign tax is paid by the end of FY 2017-18. Since, the rules provide for grant of FTC in the year in which income was offered to tax in India, taking credit of foreign tax in India in FY 2016-17 may prove to be a challenge since the basic condition for grant of FTC (payment of foreign tax) has not materialised up to the date of filing of return in India for FY 2016-17.

2. Eligible Foreign Taxes on which relief is allowed

Sub-rule 2 of the Rules provide that where a Double Taxation Avoidance Agreement ('DTAA') has been entered between India and the foreign country, eligible foreign tax shall be the taxes covered under the respective DTAA.

However, where no DTAA has been entered between India and the foreign country, eligible foreign tax shall mean the tax payable under the law in force in that country in the nature of income-tax referred to in clause (iv) of the Explanation to section 91 of the Act.

3. Grant of FTC

Sub-rule 3 of the Rules provide that an assessee would be allowed to claim FTC against the amount of tax, surcharge and cess payable by such assessee in India under the Act. However, it has been clarified that claim of FTC will not be allowed in respect of any sum payable by way of interest or penalty.

Sub-rule 4 of the Rules provide that no credit shall be available in respect of any amount of foreign tax or part

thereof which is disputed in any manner by the assessee.

However, proviso to sub-rule 4 takes into consideration situation where the dispute in relation to foreign tax credit has settled. Proviso to sub-rule 4 provides that credit of such disputed tax shall be allowed for the year in which such income is offered to tax or assessed to tax in India if the assessee within six months from the end of the month in which the dispute is finally settled, furnishes the following:

- a. evidence of settlement of dispute,
- b. evidence of discharge of such disputed foreign tax, and
- c. an undertaking that no refund in respect of such amount has directly or indirectly been claimed or shall be claimed.

The rules notified mark a change in position CBDT had taken in the draft rules which created an embargo on grant of credit of foreign tax which was disputed by the assessee by way of an appeal and such appeal was subsequently settled.

Further, the rules notified provide that credit of disputed tax shall be allowed for the year in which such income is offered to tax or assessed to tax in India on settlement of such dispute. However, ambiguity still exists on how the assessee would claim credit of such foreign taxes on settlement of dispute.

For example: A Ltd., a resident company, is in receipt of income in the nature of FTS from UK in FY 2016-17. A Ltd. is of the opinion that no tax is payable on this FTS arising from UK as per beneficial definition of FTS under Article 13 of India-UK DTAA. However, the tax authorities of UK are of the opinion that A Ltd. is liable to pay tax in UK. A Ltd. has disputed such claim of UK tax authorities by way of an appeal which is pending for disposal. A Ltd., being Indian company is liable to file its Indian Income Tax Return for FY 2016-17 by September 30, 2017. As on the date of filing of Indian Income Tax Return, the dispute in relation to tax on FTS income from UK is pending. As per rule 4, A Ltd. shall not be eligible to claim credit of such disputed tax on

the date of filing of return for FY 2016-17. Presume, the dispute gets settled in the favour of UK tax authorities by order of Supreme Court of UK on June 30, 2020 and A Ltd. deposits such disputed tax with UK authorities on July 15, 2020. Here, an ambiguous situation shall arise for A Ltd. on how the credit of such disputed foreign tax paid on July 15, 2020 would be availed in India's tax return for FY 2016-17. (Please note that proviso to sub-rule 4 categorically provides that credit for such foreign tax on settlement of dispute shall be available for the year in which such income is offered to tax or assessed to tax in India)

4. Manner of calculating FTC

Sub-rule 5 of the Rules provide that credit of foreign tax shall be the aggregate of the amounts of credit computed separately for each source of income arising from a particular country. Further, the credit allowable shall be the lower of the tax payable under the Act on such income and the foreign tax paid on such income.

Proviso to clause (i) of sub-rule 5 clarifies that where foreign tax paid exceeds tax payable in accordance with DTAA, such excess shall be ignored.

In simpler words, a separate calculation would be required to be made on each and every stream of income arising from each and every foreign country individually in accordance with the manner prescribed in next paragraph. The aggregate of such different FTCs computed from each and every stream of income above from different foreign countries shall be the credit of foreign tax paid allowable from the tax payable in India.

For the above purpose, FTC from each and every stream of income arising from each and every foreign country shall be lower of:

- i. the tax payable under the Act on each and every such stream of income, or
- ii. the foreign tax paid on each and every such stream of income

Further, the credit shall be determined by conversion of the currency of payment of foreign tax at the

telegraphic transfer buying rate on the last day of the month immediately preceding the month in which such tax has been paid or deducted.

The above rule throws light in an area which was until now marked by divergent practices due to absence of any specific law. Having said that, the requirement of calculating the FTC separately on each and every stream of income from a foreign country would make the entire calculation process complex and convoluted.

5. FTC where MAT/AMT is payable

One of the most welcome proposal in the rules notified is regarding grant of FTC where tax is payable under the provisions of section 115JB or 115JC of the Act. Sub-rule 6 of the Rules provide that the credit of foreign tax shall be allowed against MAT/AMT in the same manner as is allowable against tax payable under the normal provisions of the Act.

However, sub-rule 7 of the Rules come as a rider on sub-rule 6 and provides where the amount of FTC 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. The said rule is clarificatory and will obviate taking claim of excess FTC twice, first, directly upon payment of taxes when being paid under MAT and second, indirectly by means of MAT credit against future tax liabilities.

6. Documents required to be furnished

For claiming FTC, assessee shall be required to furnish following documents :-

- i. a statement in Form No.67
- ii. certificate or statement specifying the nature of income and the amount of tax deducted therefrom or paid by the assessee,-
 - a. from the tax authority of foreign country; or
 - b. from the person responsible for deduction of such tax; or

c. a statement signed by the assessee if it is accompanied by :

1. an acknowledgment of online payment or bank counter foil or challan for payment of tax where the payment has been made by the assessee;
2. proof of deduction where the tax has been deducted.

Such documents shall be furnished on or before the due date return of income under section 139(1) of the Act.

Form No.67 shall also be furnished 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 previous year or years.

Controversy on vires of Substantive Provisions

The Finance Act, 2015 by insertion of clause (ha) in section 295 of the Act empowered CBDT to frame rules regarding 'procedure for granting relief or deduction of any foreign tax paid against the Indian tax payable'. However, CBDT while framing such rules in Rule 128 has extended its brief and has acted outside the authority conferred to it by the Act.

The authority conferred to CBDT was restricted to framing procedural rules for grant of foreign tax credit. However, CBDT has provided entire substantive law regarding grant of foreign tax credit. An illustration of this is found in sub-rule 5 of the Rules which puts a cap of maximum FTC that could be claimed. The vires of such provisions if tested through judicial scrutiny may lead to reading down of such substantive provisions.

Conclusion

The rules notified are a welcome step towards providing clarity on various issues related to grant of credit of taxes paid outside India. Various issues requiring clarification or creating unnecessary hardships on assessee in the draft rules have been well addressed in the rules notified. However, litigation on various other aspects can not be completely ruled out.