Foreign Tax Credit

Introduction

Globalisation has significantly led to boost in trade activities, increased foreign direct investment and the development of economies. This has also led to countries being aware of the effect of a country's tax policies on its economy. Further, this has led to the need for continuously assessing the tax regimes of various countries and bringing about necessary reforms in one's country to be in line with the global tax practices.

The concept of Foreign Tax Credit (FTC) comes into picture whereby taxes paid in one country is allowed as credit against the tax payable in the other country. Some countries levy tax based on the country of residence of the person earning the income and some may levy on the basis of the source of such income. A country can prefer either of the above bases to charge tax on the income earned by the assessee. If the rules of both the countries are similar and applied simultaneously, it shall affect the income earned by the assessee due to double taxation of the same income as per the taxation rules of two countries. In order to eliminate the effect of such double taxation and provide relief, the Indian Income Tax Act, 1961 (hereinafter referred to as "the Act") contains provisions for double taxation relief.

Double Taxation Relief

As per the Indian Income Tax Act, 1961, double taxation relief are of two types:

1. Bilateral Relief (Section 90 and 90A)
2. Unilateral Relief (Section 91)

1. Bilateral Relief

Bilateral relief is applicable in the cases where the countries have entered into agreements for avoidance or elimination of double taxation. Such agreements are known as Double Taxation Avoidance Agreements (DTAAs). As the name suggests, bilateral relief is applicable where countries have mutually agreed to provide relief through a mechanism which is specified in the DTAA between the specified countries.

Section 90 of the Act aims at granting relief in respect of income tax chargeable under this Act and under the corresponding law in force in that country. It also provides that India and the other countries concerned may enter into agreements which facilitates exchange of information or for recovery of income tax under the Act and under the corresponding law in force.

While Section 90 deals with agreement with foreign countries or specified territories Section 90A provides for adoption by Central Government of agreement between specified associations for double taxation relief. India has entered into comprehensive double taxation avoidance agreement with 94 countries and Taipei is the only territory with which India has entered specified association agreement.

2. Unilateral Relief

Unilateral relief is applicable when there is no agreement existing between countries for elimination or avoidance of double taxation. Where the resident of a country earns income, which is accrued in another country and has paid tax on such income in the other country, the country of residence may decide to provide some relief to that person concerned in its country as a relief. Unilateral relief is covered under Section 91 of the Act. It provides as follows:

- where the assessee is the resident of India in the previous year and
- income arises or accrues outside India during the previous year and
- the assessee has paid tax on the income in the foreign country and
- there is no agreement under Section 90 for the relief or avoidance of double taxation,

such person shall be entitled to deduction from the Indian income-tax payable by him as mentioned below:

- average rate of Indian income tax (or)
- rate of tax in such foreign country

whichever is lower.

This relief shall be applied on the doubly taxed income in India.

Foreign Tax Credit

a) Definition of FTC (Rule 128)

The foreign tax shall mean,

- where DTAA exists, tax covered under the said agreement
- in the absence of DTAA, any excess profits tax or business profits tax charged by the Government or local authority in that country.

Foreign Tax Credit is available for both unilateral and bilateral relief. Foreign taxes are nothing but taxes which are eligible for relief under Section 90, 90A and 91. The assessee

shall claim FTC against the amount of tax, surcharge and cess payable. However, no credit shall be claimed in respect of sum payable by way of interest, fee or penalty.

b) Criteria for eligibility

- Assessee should be resident in India
- Tax should have been paid by the assessee in a country or specified territory outside India
- Income with respect to which such tax has been paid is subject to tax in India

If the above conditions are satisfied, FTC shall be allowed in the year in which such income is offered to tax in India. In the case where foreign tax has been paid or deducted, is offered to tax in more than one year, FTC shall be allowed across those years in the same proportion in which the income is offered to tax or assessed to tax in India.

c) Disputed FTC

According to the FTC rules, no credit shall be available to the assessee for foreign tax or part thereof which is disputed in any manner by the assessee. That is to say, where any appellate proceedings or any proceedings are pending with respect to the above tax in the foreign country, with respect to that tax, no credit shall be available in India.

However, such disputed tax shall be allowed in the year in which such income is offered to tax in India if the assessee within six months provide:

- evidence for settlement of disputes
- evidence for discharge of foreign tax
- an undertaking that no refund in respect of such amount is or shall be claimed in the future.

d) Calculation of FTC

The credit of foreign tax shall be the aggregate of the amount of credit computed separately for each source of income arising from a particular country. The credit shall be lower of the following:

- average tax rate in India
- tax rate in foreign country in respect of each income.

Further, in case the assessee has paid tax as per domestic laws which is more than the tax payable as per the DTAA between India and the foreign country, he/she shall be eligible to

claim credit only to the extent of tax payable as per the DTAA and any excess foreign tax paid shall not be eligible for FTC in the foreign country.

e) Applicability of FTC when there is AMT or MAT

According to the FTC rules, the foreign tax credit is allowable even against the Minimum Alternate Tax (MAT) payable under Section 115JB and Alternative Minimum Tax (AMT) under Section 115JC, as allowable against the normal income tax payable.

Further, where the amount of foreign tax credit available against MAT or AMT exceeds the amount of FTC available against the normal provisions, then while computing the amount of MAT or AMT credit, such excess shall be ignored.

f) Documents required to furnish

- Statement of income from other country offered for tax and of foreign tax deducted or paid in Form No. 67
- Certificate or statement specifying nature of income and tax deducted or paid from any one of the following:
  - Tax Authority of the other country
  - Person responsible for deduction of such tax
  - Assessee

  A certificate or statement signed by the assessee shall be valid only if
  - an acknowledgement of online payment or bank counterfoil or challan for payment of tax where the payment has been made by the assessee
  - proof of deduction where the tax has been deducted

  The above-mentioned documents shall be furnished on or before the due date specified for furnishing the return of income.

Issues in claiming FTC

FTC rules require filing of Form 67 before the due date of filing a tax return. One may face problems when the information or documentation concerning foreign income or taxes is available only after the due date of filing the return has passed. This may happen when the foreign jurisdiction adopts a taxable period different from the Indian financial year. For example, United States of America uses calendar year (January-December) as the financial year while India uses a different period for the same (April-March). Since Form 67 needs to

be filed on or before the due date of filing the tax return, this is likely to create difficulties for taxpayers who may not be in a position to do the same.

Conclusion

In the absence of FTC rules, it was difficult for taxpayers and tax authorities to agree on credit claims. This would have created a negative impact on the foreign companies having operations in India, which may lead to uncertainty as well as litigation. The FTC rules provides significant relief to resident taxpayers having foreign operations and income on which taxes are being parallelly paid in overseas. Thus, FTC facilitates foreign expansion and encourages foreign companies to conduct operations in India.