Methods for Elimination of Double Taxation (including relevant Articles of MLI) Articles 23A and 23B

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Double Taxation Overview

Distributive Rules

Distributive rules determine taxing rights for different classes of income to Country of Source (CoS) or Country of Residence (CoR). For example:

- Exclusive taxing rights - generally allocated to CoR : "… shall be taxable only" and
- "Shall not be taxed" – clear mandate against taxation by one state, usually CoR.

- Allocation of primary taxing rights - allocated to CoS: "may be taxed in.."

- Shared taxing rights: "… may be taxed in … the tax so charged shall not exceed …" or
- "May also be taxed..".

Where CoS is allocated taxing rights, CoR must allow relief for double taxation.

Meaning of 'may be taxed'

- Many judicial decisions interpreting the expression "may be taxed" and concluding that said expression permitted only **CoS to tax the income and precluding the CoR from taxing same income**. The relevant cases are:
  - CIT v. P.V.A.L. Kulandagan Chettiar [2004] 137 Taxman 460 (SC).
  - CIT v. S.R.M. Firm & Others TS-5202-HC-1994 (Madras)-O.
  - CIT v. R.M. Muthiah TS-5829-HC-1992 (Karnataka)-O.
  - DCIT v. Turquoise Investment & Finance Ltd. [2006] 154 Taxman 80 (Madhya Pradesh) / [2008] 168 Taxman 107 (SC).
- Section 90(3) and Explanation 3 of the Income-tax Act, 1961 [the Act].
- The relevant **notification no. 91/2008 dated 28-08-2008 issued under section 90(3)** reads as:

  In exercise of the powers conferred by sub-section (3) of section 90 of the Income-tax Act, 1961 (43 of 1961), the Central Government hereby notifies that where an agreement entered into by the Central Government with the Government of any country outside India for granting relief of tax, or as the case may be, avoidance of double taxation, provides that any income of a resident of India "may be taxed" in the other country, such income shall be included in his total income chargeable to tax in India in accordance with the provisions of the Income-tax Act, 1961 (43 of 1961), and relief shall be granted in accordance with the method for elimination or avoidance of double taxation provided in such agreement.

Meaning of ‘may be taxed’

- **Essar Oil Ltd v. ACIT [2014] 42 taxmann.com 21 (Mumbai - Trib.)**

Now, it is necessary to analyse the important phrases / expressions used in the various Articles, which is the subject-matter of dispute viz. "may be taxed", "may also be taxed" and "shall be taxed only". Under the model convention, wherever the phrase "shall be taxed only" is used, it connotes that one contracting State has the right to tax to the exclusion of the other contracting State. This expression is used in an Article where income is to be taxed only by the State of resident and the same income has to be exempt from taxation by the country of source. Some of the examples which can be cited here are Articles (of model convention) 8(1), 8(2), 12(1), 13(3), 13(5), 15(2), 18, 19(1), 19(2), 21(1), 22(3), 22(4), etc.

In some situation, a secondary right is given to a State of source generally to tax the income at a lower tax rate but on a gross basis, here the expression used generally is 'may also be taxed', for e.g., Articles 10(2), 11(2), etc. There are certain incomes which are "shall be taxable only in the contracting State unless". This expression provides that exclusive taxing rights are given to the first State, however, if certain conditions are fulfilled, the same income may be taxed in the second State. Here the classical example is Articles-7(1), 14(1) and 15(1).

Likewise, the phrase 'may be taxed' gives non-exclusive taxing right which enables both the States to have option to exercise the right with or without limitations. The phrase 'may also be taxed' also gives both the States the option to right to tax. Under both the situations, the credit of taxes is given under the treaty.

If the phrase 'may be taxed' is to be interpreted in the manner that country of source has the exclusive right to tax to the exclusion of the country of resident then probably phrase used in such a situation would have been 'shall be taxable only in the other contracting State' i.e., the country of source.

Meaning of ‘may be taxed’

- **Essar Oil Ltd v. ACIT [2014] 42 taxmann.com 21 (Mumbai - Trib.) Cont’d**

If phrase is used in a statute, then any interpretation given by the High Court or the Supreme Court is binding on all the subordinate Courts and has to be reckoned as law of the land. However, the meaning assigned by Government of India for a phrase or term used in the agreement through notification will prevail atleast from the assessment year 2004-05. Because, while interpreting the treaty, the intention of the parties to the agreement has to be given primacy and has to be understood in that manner only.

Para 3 of the protocol to New India – Malaysia DTAA wef 1-4-2013

> *3. It is understood that the term “may be taxed in the other State” wherever appearing in the Agreement should not be construed as preventing the country of residence from taxing the income.”*

Issues:

- Whether a unilateral amendment can be read in to a DTAA?
- Clarification similar to para 3 of the Protocol to India Malaysia DTAA not incorporated in other DTAAs.
- In case of non inclusion of income which ‘may be taxed’ in CoS only, claim of foreign tax credit may be lost.

Purpose of DTAAs

- Main Purpose of DTAAs:
  - Exclusivity of taxation not possible based on independent local laws of two countries;
  - Both States insist upon exercising their right to tax the income;
  - Article 23 provides a mechanism to resolve Double Taxation.
- Article 23 of the DTAAs:
- On the basis of following Conventions, Countries negotiate treaties
  1. **OECD Convention:**
     - Taxation rights provided based on Residential Status.
     - Regarded as furthering interest of developed countries.
  2. **U.N. Model Convention:**
     - Formulated based on OECD Principle but emphasis provided on source principle.
- Generally the CoR provides mechanism for providing relief.

Juridical Double Taxation and Economic Double Taxation

Juridical Double Taxation

- The same person is taxed on the same income in more than one state.
- This may happen on account of:
  - Residence in one state and source in another state
  - Triangular taxation

Economic Double Taxation

- Two persons are taxed on the same income in more than one state
- This may happen on account of:
  - Dividend taxed in the hands of shareholder, despite the company being taxed on the profits
  - Taxation in CoS of partnership entity, whereas in the CoR, partners being subject to tax

Possible situations of Double Taxation

1	Resident of two states based on domestic laws of both the states • World wide income taxable in both the states; • DTAA – Article 4 – Tie Breaker Test
2	Resident of one state and income derived from Other State • Income tax based on Residential status in one state; • Income tax based on Source Rule in other state • DTAA- Article 6 to 23
3	A non resident has a Permanent Establishment in State 1 and that PE derives income from another State • Income tax in both the CoS.
4	Same Income taxed by different states in the hands of different persons.

Double Taxation - Elimination

- Whether juridical and economic double taxation can be eliminated by DTAAs?
- Foreign Tax Credit [FTC] is a method for elimination of double taxation.
- Countries often provide their residents with relief from double taxation through their domestic tax laws
- DTAAs also contain Articles for the elimination of double taxation.

  Relief provided by CoR in respect of tax paid in CoS.
- DTAAs generally cover cases of juridical double taxation and not economic double taxation

  Exception: Protocol to India-Hungary DTAA:

  With reference to Article 10:

  When the company paying the dividends is a resident of India the tax on distributed profits shall be deemed to be taxed in the hands of the shareholders and it shall not exceed 10 per cent of the gross amount of dividend.

Methods for Elimination of Double Taxation

Double taxation relief under Tax Treaties

OECD / UN Model		US Model
OECD – Model treaty between two developed countries Emphasis on taxing right to CoR	UN – Model treaty between developed and developing countries Emphasis on taxing right to CoS	Served as a basis of US Treaty negotiations
Exemption method: Generally, exemption with progression Example: Income taxable in CoS is exempt from taxation in CoR but can be taken into account in determining rate for other income.		Limitation computed separately for 'passive category income' and other income to prevent credit pooling (high-tax foreign-source income and low-tax foreign-source income).
Credit method: Income subject to tax, but credit allowed for tax suffered in CoS. Credit may not exceed CoR taxation on the foreign-source income.		Applies credit method Credits foreign tax paid on foreign-source income against the US tax imposed on that foreign-source income.
No relief from the economic double taxation of dividends (i.e. exemption or an underlying foreign tax credit).		Allows for an underlying tax credit on dividends from >=10% voting stock investee Co.

Methods for Elimination of Double Taxation

	Unilateral Relief [u/s 91 of the Act]	Bilateral Relief [u/s 90 of the Act]
1.	When the domestic tax system of a state provides relief for double taxation, irrespective of whether the other state's tax system provides corresponding relief or not	Two states negotiate an agreement for providing double taxation relief.
2.	Applicable where DTAA does not exist.	Applicable where DTAA exists.
3.	Tax credit available on the basis of provisions contained in the domestic tax law.	Tax credit available on the basis of Articles in the DTAA.
4.	CoR allows credit for taxes paid in CoS unilaterally.	Model conventions provide for options for contracting States to agree on a methodology to avoid / relieve from double taxation.
5.	Credit for taxes cannot exceed the tax imposed by CoR on foreign income.	Generally countries adopt a particular approach as a principle and apply that to most / all of their tax treaties –for instance, India applies the credit method rather than the exemption method.

Unilateral Tax Credit

India - Unilateral Tax Credit

Section 91 - Countries with which no agreement exists

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.

(2)…

(3)…

Unilateral Tax Credit

Explanation – In this section,–

i. *the expression "Indian income-tax" means income-tax charged in accordance with the provisions of this Act;*

ii. *the expression "Indian rate of tax" means the rate determined by dividing the amount of Indian income-tax after deduction of any relief due under the provisions of this Act but before deduction of any relief due under this Chapter, by the total income;*

iii. *the expression "rate of tax of the said country" means income-tax and super-tax actually paid in the said country in accordance with the corresponding laws in force in the said country after deduction of all relief due, but before deduction of any relief due in the said country in respect of double taxation, divided by the whole amount of the income as assessed in the said country;*

iv. *the expression "income-tax" in relation to any country includes any excess profits tax or business profits tax charged on the profits by the Government of any part of that country or a local authority in that country.*

Unilateral Tax Credit

Key features of section 91

1. Unilateral Tax Credit available to a Resident of India. (includes NOR {Aditya Khanna v. ITO (International Tax), Ward 3(2), New Delhi [TS-285-ITAT-2019(Del)]}
2. Some income should
   - have accrued or arisen outside India and
   - such income is not deemed to accrue or arise in India.
3. Credit for taxes paid in a foreign country on such income either by way of deduction or otherwise.
4. India should not have entered into DTAA with such foreign country.
5. Taxpayer proves that he has paid taxes on such income in such foreign country.
6. Income tax includes any business profits tax charged by the Government of any part of that country or a local authority in that country.
7. Taxpayer shall be entitled to deduction of such foreign tax from Indian income-tax payable and amount of deduction shall be calculated on 'doubly taxed income'.
8. Indian rate of tax = Indian income-tax (after deduction of any relief under the Act except u/s 90, 90A & 91) / Total Income.
9. Foreign country's rate of tax = Income-tax paid in foreign country (after deduction of all relief due, except relief in respect of double taxation) / Total Income as assessed in foreign country.
10. Credit claimed cannot be greater than the amount of tax payable on such income as per Indian rate of tax i.e.
    - Tax on foreign income as per Indian rate of tax; or
    - Tax on foreign income as per Foreign country's rate of tax, whichever is lower.

Unilateral Tax Credit - Illustration

Amt in Rs.

Sr. No.	Particulars	Country A	Country B
1.	Income in CoS	2,00,000	2,00,000
2.	Income in India	4,00,000	4,00,000
3.	Global Income (1 + 2)	6,00,000	6,00,000
4.	Rate of tax in India	25%	25%
5.	Rate of tax in CoS	20%	30%
6.	Indian Income tax on Global Income (3 * 4)	1,50,000	1,50,000
7.	Indian Income tax on Foreign Income (1 * 4)	50,000	50,000
8.	CoS tax on Foreign Income (1 * 5)	40,000	60,000
9.	Unilateral Tax Credit (Lower of 7 & 8)	40,000	50,000
10.	Tax Payable in India (6 – 9)	1,10,000	1,00,000
11.	Total tax outflow (8 + 10)	1,50,000	1,60,000
12.	Effective tax rate (11 / 3)	25%	26.67%

Unilateral Tax Credit - Doubly taxed income

Assumed conversion rate 1 USD = Rs. 72

Sr. No.	Particulars	USD	Rs.
1.	Income earned in USA by a resident of India	600	
2.	Taxable income in USA after all deductions and reliefs under its domestic laws	500	
3.	Tax rate in USA	37%	
4.	Tax paid in USA (2 * 3) Tax paid in USA in Rs. (185 * 72)	185	13,320
5.	Assuming income earned from USA is the only income Total Income as per the Act, after claiming deductions of Rs. 3,200 (assumed) [Rs. 43,200 (600*72) – Rs. 3,200]		40,000
6.	Tax in India on total income of Rs. 40,000 @ 30%		12,000
7.	Doubly taxed income [lower of INR 36,000 (500*72) and Rs. 40,000]		36,000
8.	Unilateral Tax Credit – 30% of Rs. 36,000		10,800

UTC Issues relating to Section 91

- **CIT vs Bombay Burmah Trading Corporation Ltd. [2003] 259 ITR 423 (Bom)**
  UTC to be computed country wise, and not on aggregation. Hence loss of Tanzania branch to be ignored while computing UTC for Thailand branch profits

- **Tata Sons ltd. vs DCIT [2011] 10 taxmann.com 87 (Mum)**

  US State Tax to be eligible as credit under Section 91 inspite of India-US DTAA providing only for Federal Tax Credit.

- **Vijay Electricals [2015] 54 taxmann.com 19 (Hyd AT)**

  Eligible to claim entire TDS credit even if the payer has not deposited the same with overseas Government in the year of taxability

- **Hindustan Construction [2013] 29 taxmann.com 82 (Mum AT)**

  Entitled to relief under Section 91 at average rate of tax paid (i.e. tax paid divided by book profits from operations in Bhutan) which is subject to tax in both countries

- **Petroleum India [2013] 29 taxmann.com 250 (Bom HC)**

  Entitle to relief under Section 91 for taxes paid outside India and the relief is not dependent upon payment being made in relevant previous year

- **Best & Crompton [2006] 156 Taxman 216 (Mad HC)**

  Eligible to claim unilateral relief under section 91 without taking into account weighted deduction allowed under Section 35B (now deleted) in respect of Iranian income

Allowance of FTC under section 37

Section 40 - Amounts not deductible.

(a) …

(*ii*) any sum paid on account of any rate or tax levied on the profits or gains of any business or profession or assessed at a proportion of, or otherwise on the basis of, any such profits or gains.

Explanation 1.—For the removal of doubts, it is hereby declared that for the purposes of this sub-clause, any sum paid on account of any rate or tax levied includes and shall be deemed always to have included any sum eligible for relief of tax under section 90 or, as the case may be, deductionfrom the Indian income-tax payable under section 91.

Section 2 (43)

"tax" in relation to the assessment year commencing on the 1st day of April, 1965, and any subsequent assessment year means income-tax chargeable under the provisions of this Act, and in relation to any other assessment year income-tax and super-tax chargeable under the provisions of this Act prior to the aforesaid date and in relation to the assessment year commencing on the 1st day of April, 2006, and any subsequent assessment year includes the fringe benefit tax payable under section 115WA;

Favourable

Reliance Infrastructure Ltd. vs CIT [2016] 76 taxmann.com 257 (Bom).

Tata Consultancy Service Ltd. vs ACIT [2019] 111 taxmann.com 42 (Mumbai-Trib)

Against

DCIT vs Elitecore Technologies (P.) Ltd. [2017] 80 taxmann.com 6 (Ahmedabad-Trib)

Lubrizol India Ltd. vs CIT [1991] 187 ITR 25 (Bom).

Article 23 Comparison – OECD & UN Model

Article 23A – Exemption Method

Article 23	OECD Model	UN Model
23A(1) – Exemption Method	Where a resident of a Contracting State derives income or owns capital which may be taxed in the other Contracting State in accordance with the provisions of this Convention (except to the extent that these provisions allow taxation by that other State solely because the income is also income derived by a resident of that State or because the capital is also capital owned by a resident of that 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 income or owns capital which may be taxed in the other Contracting State, in accordance with the provisions of this Convention (except to the extent that these provisions allow taxation by that other State solely because the income is also income derived by a resident of that State or because the capital is also capital owned by a resident of that State), the first mentioned State shall, subject to the provisions of paragraphs 2 and 3, exempt such income or capital from tax.

Article 23A – Exemption Method

Article 23	OECD Model	UN Model
23A(2) – Exemption Method	Where a resident of a Contracting State derives items of income which may be taxed in the other Contracting State in accordance with the provisions of Articles 10 and 11 (except to the extent that these provisions allow taxation by that other State solely because the income is also income derived by a resident of that 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.	Where a resident of a Contracting State derives items of income which, in accordance with the provisions of Articles 10, 11 12, and 12A 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 which may be taxed in that other State.

Article 23A – Exemption Method

Article 23	OECD Model	UN Model
23A(3) – Exemption Method	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.	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.

Article 23A – Exemption Method

Article 23	OECD Model	UN Model
23A(4) – Exemption Method	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.	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, 11, 12 or 12A to such income; in the latter case, the first-mentioned State shall allow the deduction of tax provided for by paragraph 2.

Article 23B – Credit Method

Article	OECD Model	UN Model
23B(1) – Credit Method	Where a resident of a Contracting State derives income or owns capital which may be taxed in the other Contracting State in accordance with the provisions of this Convention (except to the extent that these provisions allow taxation by that other State solely because the income is also income derived by a resident of that State or because the capital is also capital owned by a resident of that 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. 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.	Where a resident of a Contracting State derives income or owns capital which may be taxed in the other Contracting State, in accordance with the provisions of this Convention (except to the extent that these provisions allow taxation by that other State solely because the income is also income derived by a resident of that State or because the capital is also capital owned by a resident of that 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. 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.

Article 23B – Credit Method

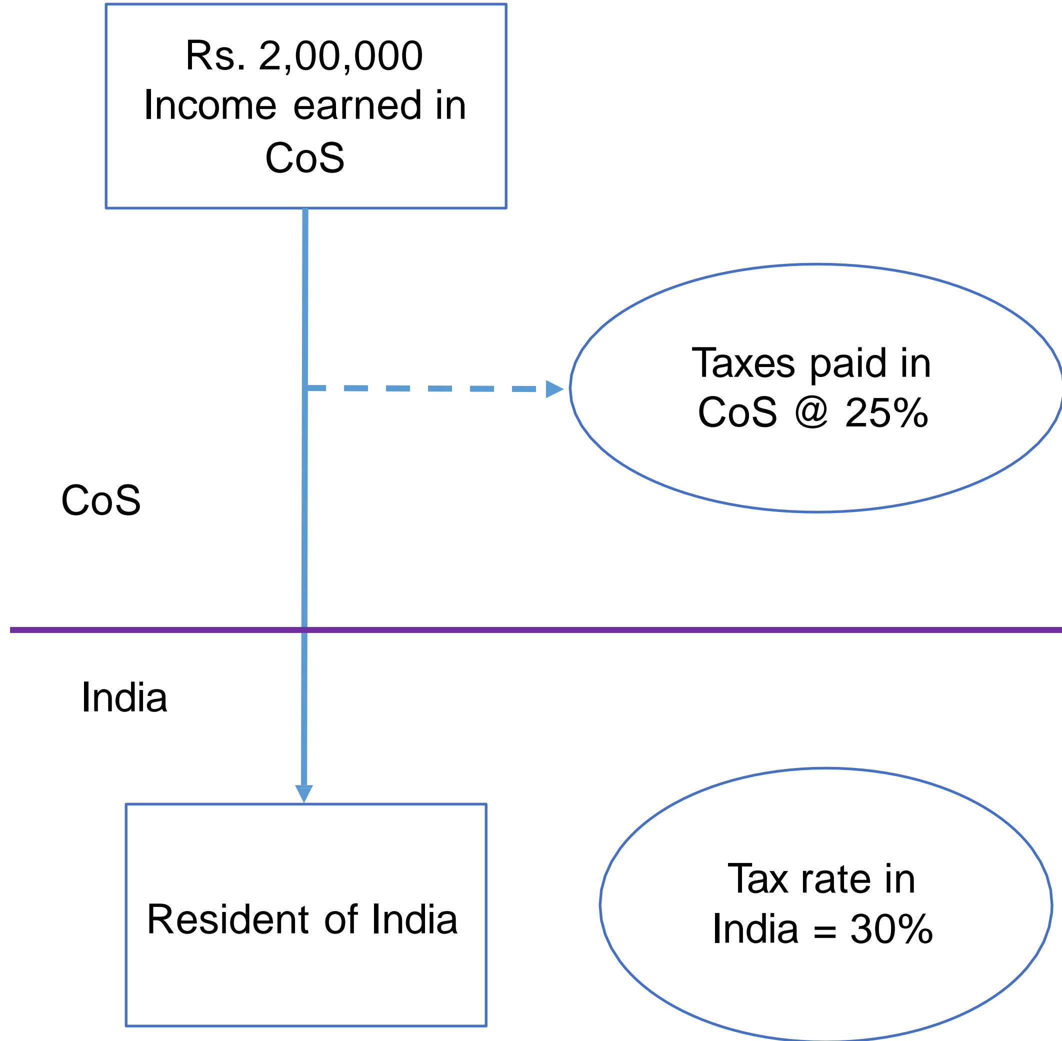
Article	OECD Model	UN Model
23B(2) – Credit Method	Where in accordance with any provision of the Convention income derived or capital owned by a resident of a Contracting State is exempt from tax in that State, such State may nevertheless, in calculating the amount of tax on the remaining income or capital of such resident, take into account the exempted income or capital.	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

Bilateral Tax Relief Methods

Bilateral Tax Relief Methods

Exemption Method		Credit Method	
Full Exemption	Under full exemption, the whole income earned in CoS is exempt for taxation purposes in CoR	Full Credit	CoR allows deduction of total amount of tax paid in CoS.
		Ordinary Credit	CoR allows credit of tax paid in the CoS restricted to that part of income tax which is attributable to the income taxable in the CoR.
Exemption with Progression	Under exemption with progression the CoR fully exempts the income earned by the resident in the CoS but the exempt income is considered for determining the tax rate on non exempt income.	Underlying Tax Credit	It relieves economic double taxation on same income, which has already suffered tax in form of corporate profits tax (relevant to dividend income).
		Tax Sparing Credit	Under tax sparing credit, CoR provides deemed credit for tax waived under special incentive schemes in CoS.

Exemption vs Credit Method – Illustration



Tax calculation in the CoR (India)

Exemption Method:

Sr. No.	Particulars	Amount (Rs.)
1.	Taxable Income in CoR	Nil
2.	Net Income from CoS	1,50,000*
*Rs. 2,00,000 – 25% tax of CoS		

Credit Method:

Sr. No.	Particulars	Amount (Rs.)
1.	Taxable Income	2,00,000
2.	Indian Income-tax	60,000
3.	CoS Income-tax	50,000
4.	Foreign tax credit (Lower of 2 and 3)	50,000
5.	Net Income tax payable (2 – 4)	10,000
6.	Net Income (1 – 4 – 5)	1,40,000*
*Rs. 2,00,000 – (25% tax of CoS + Tax payable in India)		

Net Income – Income in the hands of the assessee after deduction of all the taxes.

Exemption Method

Exemption Method

- The exemption method adopts the "income approach", whereby the right of taxation is given to either the CoS or the CoR with the right to tax the income according to its own tax rules and rates.
- In most cases the right of taxation is given solely to CoS, leading to taxation of income only in CoS
- Hence, the CoR exempts from tax the income earned in the CoS.
- Generally preferred in DTAAs between a developed country and developing country.
- Key aspects of Exemption Method
  - Reduces the tax share of CoR.
  - Encourages use of low-tax countries as CoS.
  - May result in Double non-taxation where CoS also exempts such income notwithstanding its right to tax.

Exemption Method

There are two variants of Exemption Method

Full Exemption –

- The whole income earned in CoS is exempt for taxation purposes in CoR.
- In determining the tax on the rest of the income in the CoR, the income taxable in the CoS is not considered.

Example: Article 23 of India - Brazil DTAA

Exemption with Progression –

- The CoR fully exempts the income earned by the resident in the CoS.
- However, the exempt income is considered for determining the tax rate on non exempt income.

Illustration – Bilateral Relief Exemption Methods comparison

Amt in Rs.

Particulars	Full Exemption	Exemption with Progression
Income in CoS	50,000	50,000
Income in CoR	75,000	75,000
Total Income	1,25,000	1,25,000
Rate of tax in CoR - Income up to Rs. 1,00,000 - Income more than Rs. 1,00,000 (on entire income)	 30% 35%	 30% 35%
Rate of tax in CoS	20%	20%
Tax Calculation:		
Income considered for deciding tax rate in CoR	75,000	1,25,000
Tax in CoR	75,000*30%= 22,500	75,000*35%= 26,250
Tax in CoS	50,000*20%= 10,000	50,000*20%= 10,000
Total Tax	32,500	36,250

Exemption Method

- Relevant extracts of Articles where exemption method is followed:

- **India Brazil DTAA: Article 23(4)**

  4. Where a resident of India derives profits which, in accordance with the provisions of paragraph 5 of Article 10 may be taxed in Brazil, India shall exempt such profits from tax.

- **India Mauritius DTAA: Article 23(6)**

  6. Where under this Convention a resident of a Contracting State is exempt from tax in that Contracting State in respect of income derived from the other Contracting State, then the first-mentioned Contracting State may, in calculating tax on the remaining income of that person, apply the rate of tax which would have been applicable if the income exempted from tax in accordance with this Convention had not been so exempted.

- **India Austria DTAA: Article 23(3)(b)**

  3.(b) Where, in accordance with any provision of this Convention, income derived by a resident of India is exempt from tax in India, India may nevertheless, in calculating the amount of tax on the remaining income of such resident, take into account the exempted income.

Credit Method

Credit Method

- Under Credit method, the CoR grants credit for the taxes paid in the CoS.
- For the CoR, the loss of revenue is generally lower in credit method as compared to exemption method, therefore generally most DTAAs relieve double taxation through credit method.
- Non-refundable tax credit – In case the tax payable in CoR on the income earned in CoS is less than the credit available or the relevant income is exempt in CoR, the resident is not entitled to refund of the excess credit for the taxes paid in CoS.
- Variants of Credit Method
  - **Full credit** – CoR grants credit for the taxes paid in the CoS without any restriction.
  - **Ordinary credit** – Tax credit is restricted to lower of
    - Taxes to be paid in CoR on income earned in CoS
    - Actual taxes discharged in CoS.
  - **Underlying Tax credit** – Credit is granted by CoR not only for taxes withheld on dividend by CoS, but also for the corporate taxes paid on the underlying profits, out of which dividend is paid.
  - **Tax Sparing credit** – Tax Sparing is the allowing of relief by CoR of those foreign taxes which have been spared under the incentive program of the CoS.

Credit Method – Full Credit

- CoR grants credit for taxes paid in CoS without any restriction (i.e. Credit for whole of the taxes paid).
- **Article 23(2) of India Namibia DTAA**

  2. In India, double taxation shall be eliminated as follows:

  Where a resident of India derives income or capital gains from Namibia, which, in accordance with the provisions of this Convention may be taxed in Namibia, then India shall allow as a deduction from the tax on the income of that resident an amount equal to the tax on income or capital gains paid in Namibia, whether directly or by deduction.

- **Article 25(1) of India USA DTAA**

  1.In accordance with the provisions and subject to the limitations of the law of the United States (as it may be amended from time to time without changing the general principle hereof), the United States shall allow to a resident or citizen of the United States as a credit against the United States tax on income—

  (a) the income-tax paid to India by or on behalf of such citizen or resident; and

  (b)in the case of a United States company owning at least 10 per cent of the voting stock of a company which is a resident of India and from which the United States company receives dividends, the income-tax paid to India by or on behalf of the distributing company with respect to the profits out of which the dividends are paid.

  For the purposes of this paragraph, the taxes referred to in paragraphs 1(b) and 2 of Article 2 (Taxes Covered) shall be considered as income taxes.

Illustration – Credit Method – Full Credit

Amt in Rs.

Sr. No.	Particulars	Country A	Country B
1	Income in CoS	1,00,000	1,00,000
2	Income in CoR	2,00,000	2,00,000
3	Total Income taxable in CoR (1 + 2)	3,00,000	3,00,000
4	Tax Rate in CoR	30%	30%
5	Tax Rate in CoS	25%	35%
	Tax Calculation:		
6	Tax payable in CoR (3 * 4)	90,000	90,000
7	Tax paid in CoS (1 * 5)	25,000	35,000
8	Tax Credit available in CoR (same as 7)	25,000	35,000
9	Tax in CoR after Full tax credit (6 – 8)	65,000	55,000
10	Total Tax Outflow (7+ 9)	90,000	90,000

Credit Method – Ordinary Credit

- Tax credit is restricted to lower of the tax payable in CoR on the income earned in CoS and the tax paid in CoS.
- **Article 24(2) of India UK DTAA**

  2.Subject to the provisions of the law of India regarding the allowance as a credit against Indian tax of tax paid in a territory outside India (which shall not affect the general principle hereof), the amount of the United Kingdom tax paid, under the laws of the United Kingdom and in accordance with the provisions of this Convention, whether directly or by deduction, by a resident of India, in respect of income from sources within the United Kingdom which has been subjected to tax both in India and the United Kingdom shall be allowed as a credit against the Indian tax payable in respect of such income but in an amount not exceeding that proportion of Indian tax which such income bears to the entire income chargeable to Indian tax.

- **Article 23(2) of India Germany DTAA**

  2. Tax shall be determined in the case of a resident of the Republic of India as follows:

  Where a resident of the Republic of India derives income or owns capital which, in accordance with the provisions of this Agreement, may be taxed in the Federal Republic of Germany, the Republic of India shall allow as a deduction from the tax on such income of that resident an amount equal to the income-tax paid in the Federal Republic of Germany, whether directly or by deduction, and as a deduction from the tax on such capital of that resident an amount equal to the capital tax paid in the Federal Republic of Germany. 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 the Federal Republic of Germany.

Illustration – Credit Method – Ordinary Credit

Amt in Rs.

Sr. No.	Particulars	Country A	Country B
1.	Income in CoS	1,00,000	1,00,000
2.	Income in CoR	2,00,000	2,00,000
3.	Total Income taxable in CoR (1 + 2)	3,00,000	3,00,000
4.	Rate of tax in CoR	30%	30%
5.	Rate of tax in CoS	25%	35%
6.	Tax on total Income in CoR (3 * 4)	90,000	90,000
7.	Tax in CoR on Income from CoS (1 * 4)	30,000	30,000
8.	Tax paid in CoS (1 * 5)	25,000	35,000
9.	Ordinary Tax Credit (Lower of 7 & 8)	25,000	30,000
10.	Tax Payable in CoR after Credit (6 – 9)	65,000	60,000
11.	Total Taxes (8 + 10)	90,000	95,000

Methods of FTC under exemption

	Country S1	Country S2	Country S3	Country R	Worldwide
Income	1,00,000	1,00,000	1,00,000	1,00,000	4,00,000
Rate of taxation	30%	42%	20%		30%
Tax Amount	30,000	42,000	20,000	-	1,20,000
Total Foreign Sourced income	3,00,000				
Total Foreign Tax Paid	92,000				
Foreign Tax Credit					
A- Country -by-Country Method	30,000	30,000	20,000		80,000
B-Full Credit Method					92,000
C-Aggregation or Overall Method (with limitation)					
FTC = Resident Income Tax X Foreign Source Income/Worldwide taxable income					90,000
1,20,000x 3,00,000/4,00,000					
Carry forward /carry backward / Lapse??					2,000

Credit Method – Tax Sparing

- CoS generally grant incentives to foreign investors for the purpose of attracting foreign investments which get neutralized if the CoR taxes them fully on the basis of no taxation in CoS.
- 'Tax Sparing' is the allowing of relief by CoR of those foreign taxes which have been 'spared' under the incentive program(s) of CoS.
- Income exempt in CoS but taxable in CoR for which deemed tax credit provided by CoR.
- Types of Tax Sparing
  - Deduction / credit for taxes not levied / spared by the CoS.
  - Deemed Higher tax credit to the extent of tax reduction by the CoS.
  - Exemption of income which has benefitted from the tax incentives.
- Tax Sparing relevant to income such as interest, royalties, foreign branch / permanent establishment income etc.
- Tax sparing may lead to double non-taxation.
- Many Indian Tax Treaties contain tax sparing clauses.

Credit Method – Tax Sparing

- Limitation of other tax credit methods – They are based on the actual taxes paid.
- Tax Sparing – Benefit even if actual taxes not paid in CoS.
- Variants of Tax sparing in India's DTAAs
  - Tax sparing wrt general tax incentives designed to promote economic development (e.g. DTAA with Czech Republic, Oman)
  - Tax sparing without reference to any specific tax exemption provision (e.g. DTAA with Bulgaria, China)
  - Tax sparing only in respect of certain specified exemption provisions (e.g. DTAA with Australia, Belgium, Canada).
  - Tax sparing only in respect of specified incomes (e.g. DTAA with Spain)
- **Article 25(4) of India Oman DTAA**

4. The tax payable in a Contracting State mentioned in paragraph 2 and paragraph 3 of this Article shall be deemed to include the tax which would have been payable but for the tax incentives granted under the laws of the Contracting State and which are designed to promote economic development.

PCIT vs Krishak Bharati Cooperative Ltd. [2017] 80 taxmann.com 326 (Delhi)

Assessee-society received dividend income from a Omani company on which it was not liable to pay any tax in Oman by virtue of exemption granted as per Omani tax laws, purpose of exemption being to promote economic development, assessee-society was entitled for getting credit for deemed dividend tax by virtue of provisions of DTAA read with section 90 together with clarifications issued by Sultanate of Oman

Also : Polyplex Corporation – Delhi ITAT and Kenwell P Ltd – Bangalore ITAT

Credit Method – Tax Sparing

- **Article 23(3) of India China DTAA**

3. The tax paid in a Contracting State mentioned in paragraphs 1 and 2 of this Article shall be deemed to include the tax which would have been payable but for the legal provisions concerning tax reduction exemption or other tax incentives of the Contracting States for the promotion of economic development.

- **Article 23 (4) of India Canada DTAA**

4. For the purposes of paragraph 2(a), the term 'tax payable in India' shall, with respect to a company which is a resident of Canada, be deemed to include any amount which would have been payable as Indian tax but for a deduction allowed in computing the taxable income or an exemption or reduction of tax granted for that year under:

(a) sections 10 (15)(iv), 10A, 32A (but not the part dealing with ships and aircraft), 80HH, 80HHD and 80-IA (but not the part dealing with ships) of the Income-tax Act, 1961, as amended, so far as they were in force on and have not been modified since the date of signature of the Agreement, or have been modified only in minor respects so as not to affect their general character.

(b) any other provision which may subsequently be made granting an exemption or reduction from tax which is agreed by the competent authorities of the Contracting States to be of a substantially similar character, if it has not been modified thereafter or has been modified only in minor respects so as not to affect its general character:

Provided that relief from Canadian tax shall not be given by virtue of this paragraph in respect of income from any source if the income relates to a period starting more than ten fiscal years after the exemption from, or reduction of, Indian tax is first granted to the resident of Canada, in respect of that source.

Credit Method – Tax Sparing

- **Article 25(4) of India Spain DTAA**

4. For the purposes of deduction referred to in paragraph 3, the term "income-tax paid in India" shall be deemed to include any amount which would have been payable as Indian tax under the laws of India and in accordance with this Convention for any year but for an exemption from, or reduction of, tax granted for that year under:

i. Sections 10(4), 10(15)(iv), 10A, 10B, 32A, 32AB, 80HH, 80HHC and 80-I of the Income-tax Act, 1961 (43 of 1961) so far as they were in force on, and have not been modified since, the date of the signature of this Convention, or have been modified only in minor respects so as not to affect their general character; or

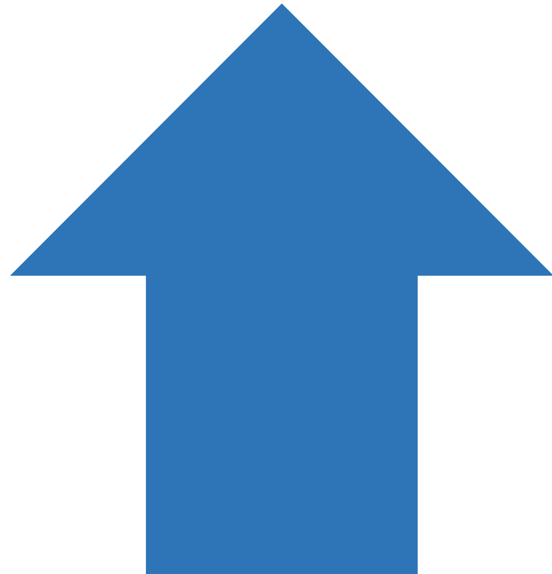
ii. any other provisions which may be enacted hereafter granting a deduction in computing the taxable income or an exemption or reduction from tax which the competent authorities of the Contracting States agree to be of a substantially similar character if it has not been modified thereafter or has been modified only in minor respects so as not to affect its general character.

Illustration – Credit Method – Tax Sparing

Amt in Rs.

Sr. No.	Particulars	Tax Sparing – Absent	Tax Sparing – Present
1.	Income in CoS	1,00,000	1,00,000
2.	Income in CoR	2,00,000	2,00,000
3.	Total Income taxable in CoR (1 + 2)	3,00,000	3,00,000
4.	Rate of tax in CoR	30%	30%
5.	Rate of tax in CoS (a) Normal rate (b) Special rate (exemption / incentive)	 25% 0%	 25% 0%
	Tax calculation		
6.	Tax payable in CoR (3 * 4)	90,000	90,000
7.	Tax payable in CoS [1 * 5(b)]	0	0
8.	Tax credit in CoR [Tax exempted in CoS 1 * 5(a)]	NA	25,000
9.	Total tax after relief (6 – 8)	90,000	65,000

Credit Method – Tax Sparing



Pros

- Benefit to Developing Country
- Real benefit to taxpayer - Investment Abroad Horizon

Cons

- Transfer Pricing Abuse
- Government Abuse
- Double Non taxation

OECD Commentary (Para 72 to 78)

Tax Sparing properly explained (Para 72)

Credit for Local activities

Guidance in Tax Sparing Report 1988

Credit Method – Underlying Tax Credit (UTC)

- The concept of Underlying Tax Credit is relevant to Dividend income and is available only to a Company.
- It eliminates 'economic double taxation' i.e. same income taxed twice in the hands of two or more persons (corporate profits, which are taxed firstly in the hands of the company and secondly in the hands of the shareholders in the form of dividends)
- Meaning of Underlying Tax Credit - Credit is granted by CoR for

  - the taxes withheld on dividends; and

  - the corporate taxes paid on the underlying profits out of which dividends has been paid.
- Underlying Tax Credit relief may only apply / be eligible on satisfaction of **substantial shareholding requirements**.
- Intended to mitigate the double taxation of corporate profits, which are taxed firstly in the hands of the company and secondly in the hands of the shareholders (on the dividend)
- Example of Indian Tax DTAAs with Underlying Tax Credit:
  - Article 24 of India – UK DTAA, Article 23 of India – Mauritius DTAA, Article 23 of India – Japan DTAA
  - Article 25 of India – Singapore DTAA, Article 25 of India – USA DTAA

Credit Method – Underlying Tax Credit (UTC)

Article 24(1) of India UK DTAA

1. *Subject to the provisions of the law of the United Kingdom regarding the allowance as a credit against United Kingdom tax of tax payable in a territory outside the United Kingdom (which shall not affect the general principle hereof):*

   (a) Indian tax payable under the laws of India and in accordance with the provisions of this Convention, whether directly or by deduction, on profits, income or chargeable gains from sources within India (excluding, in the case of a dividend, tax payable in respect of the profits out of which the dividend is paid) shall be allowed as a credit against any United Kingdom tax computed by reference to the same profits, income or chargeable gains by reference to which the Indian tax is computed.

   (b) In the case of a dividend paid by a company which is a resident of India to a company which is a resident of the United Kingdom and which controls directly or indirectly at least 10 per cent of the voting power in the company paying the dividend, the credit shall take into account (in addition to any Indian tax for which credit may be allowed under the provisions of sub-paragraph (a) of this paragraph) the Indian tax payable by the company in respect of the profits out of which such dividend is paid.

- **Article 23(3) of India Japan DTAA**

3. Subject to the laws of Japan regarding the allowance as a credit against Japanese tax of tax payable in any country other than Japan:

(a) …

(b) Where the income derived from India is a dividend paid by a company which is a resident of India to a company which is a resident of Japan and which owns not less than 25 per cent either of the voting shares of the company paying the dividend, or of the total shares issued by that company, the credit shall take into account the Indian tax payable by the company paying the dividend in respect of its income.

Illustration – Credit Method – Underlying Tax Credit

100% Holding Company

Sr. No.	Particulars	Amount
1	Income earned in CoS by SubCo	1,00,000
2	Tax in CoS on income of SubCo @ 20%	20,000
3	Net income after tax (1 - 2)	80,000
4	Dividend distributed (100%) to HoldCo.	80,000
5	Withholding tax by CoS on Dividend Distributed @ 10%	8,000
6	Dividend net of foreign tax to HoldCo. (4 - 5)	72,000
7	Gross Up (2 + 5)	28,000
8	Taxable Income in CoR (6 + 7)	1,00,000
9	Tax by CoR @ 30%	30,000
10	Credit for taxes paid in CoS (2+ 5)	28,000
11	Net Tax after UTC Relief (9 – 10)	2,000
12	Net Return in the hands of HoldCo. (6 – 11)	70,000

Credit Method – With or Without Underlying Tax Credit

Data for Comparison	Amount (Rs.)
Income earned by SubCo. in CoS	1,00,000
Tax in CoS @ 20%	20,000
Net Income of SubCo.	80,000
Dividend distributed to HoldCo. (100%)	80,000
WHT on dividend by CoS @ 10%	8,000

Exemption Method (RC)	Amount (Rs.)
Foreign Income earned by HoldCo. (Dividend)	72,000
Income of CoR	0
Net Income in the hands of HoldCo.	72,000
Tax in CoR (Exemption method)	Nil
Net income after tax in CoR	72,000

Sr. No.	Credit Method (RC)	Without UTC	With UTC
1.	Foreign Income earned by HoldCo. (Dividend)	72,000	72,000
2.	Gross Up	8,000	28,000
3.	Income considered for tax in CoR	80,000	1,00,000
4.	Tax in CoR @ 30%	24,000	30,000
5.	Credit for tax paid in CoS	8,000	28,000
6.	Net tax payable in CoR (4 - 5)	16,000	2,000
7.	Net income after tax (1 – 6)	56,000	70,000

Credit Methods – Tax Sparing and Underlying Tax Credit

Sr. No.	Particulars	Amount
1	Profit before Tax of SubCo in India	20,00,000
2	Deduction under Chapter VI-A of the Act	12,00,000
3	Taxable Income	8,00,000
4	Tax @ 40%	3,20,000
5	Post-tax distributable profits of SubCo. (1 – 4)	16,80,000
6	Dividend distributed by SubCo.	8,00,000
7	Dividend paid by SubCo. to HoldCo. (holding 50% share)	4,00,000
	Calculation of Tax Credit	
8	Withholding tax in India on dividend @15%	60,000
9	Underlying Tax Credit (7 * 4 / 5)	76,190
10	Tax Sparing = [7 * (2*40%) / 5]	1,14,286
11	Total Tax Credit in CoR (8+9+10)	2,50,476

Indian Treaties Overview

Chapter V – Methods of elimination of Double Taxation

Bilateral Relief

Exemption Method		Credit Method			
Full Exemption	Exemption with progression	Full Credit	Ordinary Credit	Underlying tax credit	Tax sparing credit
Bangladesh (PE Profits) Brazil (dividend)	Germany, Italy	Namibia, Canada (from Canada perspective)	Most of Indian DTAAs	Singapore DTAA, - Mauritius DTAA	UK, Singapore, Italy

Overview – Indian DTAAs – Article 23

Various treaties which provide for UTC in respect of dividend income

The only treaties where full credit is available - Namibia and US.

Indian Treaties usually follow the “ordinary credit” method of granting tax credit

Treaties containing all the three methods of elimination of double taxation, viz. exemption, credit and tax sparing for different types of incomes

- Bulgaria
- Czech Republic
- Poland

Article 23 B – Variant : Underlying Tax Credit (UTC)

- To avoid economic double taxation
- India's DTAAs providing for UTC
  - Mauritius, Singapore (Both Ways)
  - Canada, China, Germany, Japan, UK, US (One Way)
- Participation threshold for exemption
  - Aminimum requirement of shareholding
    - Generally - 10%/25%
    - Manner of holding – direct / indirect
    - Nature – shares, shares paying dividends, voting power, etc.

UTC under India-Mauritius DTAA

- Article 23(2)(b) of India-Mauritius DTAA

  (b) In the case of a dividend paid by a company which is a resident of Mauritius to a company which is a resident of India and which owns at least 10 per cent of the shares of the company paying the dividend, the credit shall take into account [in addition to any Mauritius tax for which credit may be allowed under the provisions of sub-paragraph (a) of this paragraph] the Mauritius tax payable by the company in respect of the profits out of which such dividend is paid.

- Position upto 31st December, 2018 re GBL 1 Cos
  - Corporate tax rate in Mauritius for GBL1 Co – 15%
  - M Co entitled to claim deemed FTC of 80% of Mauritian tax or actual tax withheld overseas, whichever is higher
  - Effective tax rate in Mauritius – 3%
  - Issue: UTC of 15% or 3%

Mauritius abolishing of deemed foreign tax credits

- Position after 1st January, 2019 – Effect of BEPS / OECD report on Harmful tax practices
  - From 1st January 2019, deemed FTC Regime available to GBC 1 companies abolished.
  - Grandfathering of pre 2017 companies till 2021 for deemed FTC @ 80% of tax dues
  - Introduction of 80% exemption regime on various incomes including Foreign dividend subject to condition that said amount not allowed as deduction in source country.
  - No actual foreign tax credit is allowed on foreign sourced income if the GBL company claimed the 80% exemption.
  - In case of actual foreign tax credit claimed on foreign dividends, the general tax credit includes foreign tax imposed on the profits out of which the dividends are paid (underlying tax), provided that the shareholding in the foreign company is at least 5%.
  - The Deemed Foreign Tax Credit regime available to banks is abolished as from 1st July 2019.

Type of Taxes covered

- Federal Income-tax

State Income-tax Dr. Rajiv I. Modi [TS-7156-ITAT-2017 (Ahd)]; Wipro Ltd [TS-5221-HC-2015 (Karnataka)]

- County Tax e.g. Swiss County Tax
- Surcharge and Education Cess
- Branch Profit Tax
- Dividend Distribution Tax
- Taxes levied by Municipal or Local Authorities
- PE Profit Tax
- Income-tax paid under presumptive taxation scheme
- Turnover Tax or Tonnage Tax
- Interest and Penalties
- "Tax Paid" vs. "Tax Payable"

Foreign Tax Credit Rules in India

Foreign Tax Credit Rules [FTC Rules]

- Prior to the introduction of FTC Rules, section 91 was the only provision which granted unilateral relief in respect of income which has suffered tax both in India and in a state with which no DTAA exists.
- There was a lack of clarity regarding the granting of FTC. The various judicial decisions on the issue were also conflicting in nature and thereby leading to no clear jurisprudence available for the granting of FTC.

- **Foreign Tax Credit Rules**
  - CBDT had issued draft rules (F. No. 142/24/2015-TPL dated 18 April 2016) for the grant of FTC inviting comments and suggestions on the same.
  - Subsequently, CBDT notified the final FTC Rules (Rule 128 of the Income-tax Rules, 1962) *vide* Notification no. 54/2016 dated 27 June 2016, which provides for the “manner and the extent” to which FTC should be granted.
  - Rule 128 has been made effective from 1st April, 2017.

Rule 128 – Foreign Tax Credit (FTC)

Rule	Description	Brief details
128(1)	Mode of granting FTC	By way of deduction or otherwise i.e. direct payment.
	Year of allowance of FTC	In the year in which the income corresponding to such tax is offered to/assessed to tax in India.
Proviso to 128(1)	Proportionate allowance of FTC	Where corresponding income is offered to tax in more than one year, FTC shall be allowed in the same proportion of income.
128(2)	Meaning of Foreign Tax	Country with which India has a DTAA: Taxes covered under the said DTAA. Others: Income Tax payable under the law in force in that country or specified territory referred to in clause (iv) of the Explanation to section 91.
128(3)	Tax against which FTC available	Tax, Surcharge and Cess under the Act
	Exclusions for FTC	Any sum payable by way of interest, fee or penalty
128(4)	Disputed FTC	No FTC Credit. FTC available in the year of such income being offered/assessed to tax in India if, within 6 months from the end of the month of the dispute-settlement, the following are furnished – (i) Evidence of settlement of dispute; (ii) Evidence to the effect that the liability for payment of such foreign tax has been discharged. (iii) An Undertaking that no refund qua such amount has directly/indirectly been claimed.

Rule 128 – Foreign Tax Credit (FTC)

Rule	Description	Brief details
128(5)(i)	Mode of Computing	Aggregate of the amounts of credit computed separately for each source of income arising from a particular country or specified territory outside India. FTC shall be lower of- - Tax payable under the Act on such income; - Foreign tax paid on such income.
Proviso to 128(5)(i)		Foreign tax paid exceeding the amount of tax payable in accordance with DTAA to be ignored.
128(5)(ii)	Exch. Rate for FTC Conversion	Telegraphic transfer buying rate on the last day of the month immediately preceding the month in which such tax has been paid or deducted.
128(6)	FTC against MAT or AMT	Available for MAT under section 115JB and AMT under section 115JC in the same manner as allowable against normal provisions.
128(7)	Excess FTC-MAT/AMT Credit	Excess FTC against the tax payable u/s 115JB/115JC vis-à-vis normal tax, to be ignored for computing the amount of credit u/s 115JAA/115JD in respect of the taxes paid u/s 115JB/115JC.
128(8)	Documentation	(i) Statement of income from the foreign country offered for tax for the previous year and of foreign tax deducted or paid on such income in Form 67. (ii) Certificate/statement specifying the nature of income and the amount of tax deducted therefrom or paid by the assessee – (a) From the tax authority of the foreign country; (b) From the person responsible for deduction of tax; (c)Signed by the assessee, accompanied by an acknowledgement of online payment or bank counter foil or challan in case of payment and proof of deduction where the tax has been deducted.

Rule 128 – Foreign Tax Credit (FTC)

Rule	Description	Brief details
128(9)	Form 67	Form 67 to be furnished on or before the due date u/s 139(1) (to be uploaded online with DSC or EVC). The Central Board of Direct Taxes (CBDT) has amended Rule 128 to provide that Form 67 can be furnished on or before the end of assessment year where return of income for such assessment year has been furnished within the time specified under Section 139(1) or Section 139(4).
128(10)	Refund of FTC	Form 67 to be furnished in a case where the carry backward of loss of the current year results in refund of FTC claimed in any earlier previous year.

Form 67

Part A – Sr. No. 5

Sl. No.	Name of the Country /Specified territory	Source of Income	Income from outside India	Tax paid outside India		Tax payable on such Income under normal provisions in India	Tax payable on such income under Section 115JB/ JC	Credit claimed under section 90/90A			Credit claimed under section 91 Amount	Total foreign Tax credit Claimed
				Amount	Rate			Article No. of Double Taxation Avoidance Agreement	Rate of tax as per Double Taxation Avoidance Agreements	Amount		
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)

Issues:

- In case Form 67 alongwith other docs not filed at the time of filing the return, the same may be filed later on – but if return processed / time for revision expired? – PWC (2020) 183 ITD 354 – Kolkata ITAT – Revenue directed to allow FTC post verification.
- In case of lack of clarity, to submit information by way explanatory note.

Issues – FTC Rules

- Rule 128 silent about "Underlying tax credit" on dividend income received by the Indian companies from their overseas subsidiary.
- Lack of clarity re FTC availability of State taxes in US, Branch Profits Tax on repatriation etc
- "Tax payable" could be subject matter of different interpretations like tax chargeable, tax paid etc
- Whether the tax dispute settled by the lower authorities / courts can be treated as finally settled? Also procedure to be followed where dispute is settled after the expiry of the time limit of filing revised return.
- Tax payable under the Act is computed on the total income after giving effect to items such as brought forward losses and deductions under Chapter VI-A, which may cause practical difficulties in computing as well as availing FTC.
- An entity, which is regarded as a separate legal entity in one country, whereas a see through entity in another country could lead to a complicated FTC scenario.
- A literal interpretation of section 91 could result in denial of FTC u/s 90 as well in cases relating to Limited Tax Treaties like Ethiopia, Iran etc. No clarity in Rule 128 on this respect.

Issues – FTC Rules

- Can Rule 128 go beyond the provisions of the Act / DTAA ?
  - Section 295(2)(ha)

    Power to make rules.

    ***295**. (1) The Board may, subject to the control of the Central Government, by notification in the Gazette of India, make rules for the whole or any part of India for carrying out the purposes of this Act.*

    (2) In particular, and without prejudice to the generality of the foregoing power, such rules may provide for all or any of the following matters :—

    (a)……….

    (ha) the procedure for 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 this Act;
- If DTAA provides for full tax credit, can Rule 128 restrict it to ordinary tax credit ?
- If DTAA provides for tax sparing can Rule 128 restrict it to actual tax paid ?
- Can FTC be restricted based on computation country-wise / source-wise ?
- Applicability of Rules to pending assessments
  - Amendment in Section 115JAA(2A) w.e.f. AY 2018-19.

MAT and FTC

MAT credit u/s 115JAA

Sr. No.	Particulars	Amount (in Rs.)
A	**Normal Provisions of the Income-tax Act**	
1	Foreign Sourced income from CoS	2,00,000
2	Income accruing or arising in India	2,00,000
3	Worldwide Income (1 + 2)	4,00,000
4	Deduction u/s 10AA	4,00,000
5	Total Income (3 – 4)	-
6	Income- tax paid at CoS – say @ 35% (1 * 35%)	70,000
7	Income-tax paid in India @ 30% (5 * 30%)	-
8	Foreign tax credit (Lower of 6 & 7)	-
9	Total income-tax paid (6 + 7 – 8)	70,000
B	**Book profits u/s 115JB (1 + 2)**	4,00,000
10	Tax on book profit – 15% (B * 15%)	60,000
11	Foreign Tax Credit under MAT [Lower of (1 * 15%) & 8]	-
12	Balance MAT Tax payable (10 – 11)	60,000
C	**MAT credit u/s 115JAA (10 -7)**	60,000

FTC allowed in excess of normal tax against MAT not eligible for credit

Particulars	Amount
Tax payable as per the normal provisions of the Act	100
MAT payable as per Section 115JB	160
Foreign Tax Credit	125
MAT Credit available (160 – 100)	60
Foreign Tax Credit in excess of tax under Normal provisions (125 – 100)	25
Carry forward of MAT credit under Section 115JAA (60-25)	35

Section 115JAA

<u>Section 115JAA</u>

(2A*) The tax credit to be allowed under sub-section (1A) shall be the difference of the tax paid for any assessment year under sub-section (1) of section 115JB and the amount of tax payable by the assessee on his total income computed in accordance with the other provisions of this Act:*

Provided that no interest shall be payable on the tax credit allowed under sub-section (1A).

2nd proviso inserted in sub-section (2A) of section 115JAA by the Finance Act, 2017, w.e.f. 1-4-2018

Provided further that where the amount of tax credit in respect of any income-tax paid in any country or specified territory outside India, under section 90 or section 90A or section 91, allowed against the tax payable under the provisions of sub-section (1) of section 115JB exceeds the amount of such tax credit admissible against the tax payable by the assessee on its income in accordance with the other provisions of this Act, then, while computing the amount of credit under this sub-section, such excess amount shall be ignored.

Multilateral Instrument

Article 5 – Methods of Elimination of Double Taxation

Article 5 of MLI – Application of Methods of Elimination of Double Taxation

- Article 5(1) – Compatibility Clause: Provides three options viz. Option A to C for elimination of double taxation.
  - Option A: If income is exempted / taxed at lower rate by CoS by virtue of CTA, CoR to tax such income and allow ordinary credit i.e. restricting credit to the extent of tax liability in CoR.
  - Option B: Elimination of double taxation in case of Hybrid Instruments
  - Options C: CTA providing exemption method for elimination of double taxation, to be replaced by Ordinary Credit Method i.e. restricting credit to the extent of tax liability in CoR.
- Article 5(2) - Main provision relating to Option A
- Article 5(3) - Compatibility clause in relation to Option A
- Article 5(4) - Main provision relating to Option B
- Article 5(5) - Compatibility clause in relation to Option B
- Article 5(6) - Main provision relating to Option C
- Article 5(7) - Compatibility clause in relation to Option C - Para 1 to apply 'in place of'…..
- Article 5(8) - Reservation clause for entire Article not to apply - Not selected by India
- Article 5(9) - Reservation clause in relation to Option C of Article 5 not to apply
- Article 5(10) - Notification clause.

Article 5 of MLI – India's Position

- **India has selected Option C: Credit Method over Exemption Method**
- **Impact on Indian Covered Tax Agreements [CTAs]**

Countries Notified by India	Positions of the Other Contracting Jurisdictions	Impact on India's CTA with the Country
Bulgaria	Reserved the right with respect to entire Article 5	No Impact
Egypt	Silent	Option C to apply
Greece	Reserved the right with respect to Article 5 with respect to India	No Impact
Slovak Republic	Selected Option C	Option C to apply
Other CTAs	Other CTAs already adopt the credit method for elimination of Double Taxation.	India's DTAAs with these countries remain unaltered with respect to method of elimination of double taxation.

Practical Issues

Issues

Differences in Domestic laws of Contracting States

- Different Assessment Year
- Differences regarding Characterization of Income: One Contracting State may consider income to be in nature of Royalty/ FTS. Other Contracting State may consider income to be in nature of business Profits. (Som Datt Builders [1989] 29 ITD 495 (Cal ITAT) – not mandatory that both states should tax under same head, but necessary that both states have taxed it
- Different Assessment Practices / payment of taxes in Other Contracting state.
- Timing Difference in Taxing Income : ESOP taxation when shares are granted / when shares are actually allotted.
- Change of Residential Status on Receipt of Income

Others

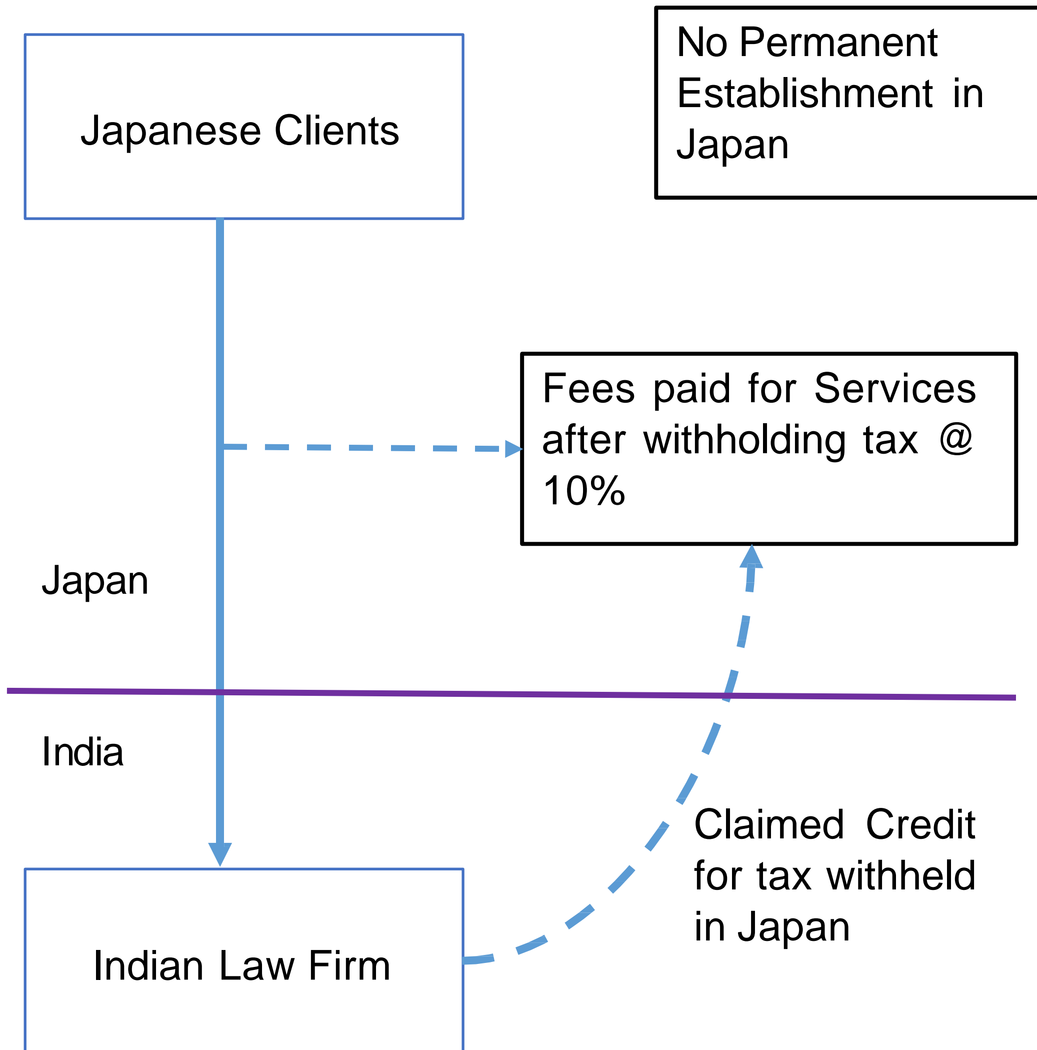
Other Issues

- Whether relief u/s 91 can be taken in respect of incomes not covered within the purview of DTAAs?
- Excess FTC- No carry forward provisions
- FTC for fiscally transparent entities
- Treaty Shopping

Selected Judicial Pronouncements

Amarchand & Mangaldas & Suresh A. Shroff & Co. vs. ACIT

[2020] 122 taxmann.com 248 (Mumbai - Trib.)



Facts

- Assessee, a law firm assessed as a partnership firm in India.
- Received fee from Japanese clients after withholding tax @10% under Article 12 of the India-Japan DTAA.
- Denied FTC on the ground that the income was covered under Article 14 - Independent Personal Service (IPS) Article.
- In terms of Article 14, income from professional services can be taxed in Japan only if the assessee has a fixed base in Japan. Since the assessee did not have a fixed base in Japan, the A.O. held that withholding of tax was not in accordance with the DTAA provisions.
- CIT(A) upheld the order of the A.O.

Amarchand & Mangaldas & Suresh A. Shroff & Co. vs. ACIT Cont'd

Held

- Article 23(2)(a) of the India-Japan DTAA requires India to grant credit for tax deducted in Japan in accordance with the provisions of the DTAA. The words 'in accordance with the provisions' would mean taxes withheld in the source state which could be reasonably said to be in harmony, or in conformity, with provisions of the DTAA.
- While interpreting the above words, one is required to take a judicious call as to whether the view adopted by the source jurisdiction was reasonable and bona fide, though such a view may be or may not be the same as the legal position in the residence jurisdiction.
- Article 12 and Article 14 overlap as regards coverage of professional service. However, Article 12(4) excludes payment made to an individual for independent personal services mentioned in Article 14.
- Since the income was received by a partnership firm, exclusion in Article 12(4) was not applicable.
- Therefore, income was rightly subjected to tax in Japan. Accordingly, the assessee was qualified to claim FTC under the India-Japan DTAA.

Judicial Precedents – Credit for State Taxes

Manpreet Singh Gambhir v. DCIT [2008] 26 SOT 208 (Delhi)

Issues: Whether State taxes paid in US are eligible for Credit?

Whether FTC only on 'doubly taxed income'?

Computation of Income and tax thereon by Assessee

Sr. No.	Particulars	Amount (Rs.)
1.	Salary from USA	7,22,850
2.	Deduction u/s 80RRA	4,54,555
3.	Tax benefit claimed by assessee:	
a.	Federal Income-tax	1,75,739
b.	State Income-tax	60,667

Computation of Income and tax thereon by A.O.

Sr. No.	Particulars	Amount (Rs.)
1.	Salary from USA	7,22,850
2.	Deduction u/s 80RRA	4,54,555
3.	Taxable Income	2,68,260
4.	Income tax thereon	80,478

Manpreet Singh Gambhir v. DCIT [2008] 26 SOT 208 (Delhi)

Held

- On reading the provisions of Article 25(2) of the DTAA with the USA it is evident that a resident of India who earns income which is also taxed in the USA, he is to be allowed deduction from the tax in India on the income to the extent to which the tax is paid in the USA.
- However, in the event he is not liable to pay tax or if the tax payable by him because of deduction/exemption granted is less than the tax payable outside India, the assessee cannot claim credit for entire taxes paid.
- The tax payable on the total income was Rs. 2,70,757 but that tax was not entirely because of the salary income taxed in the USA.
- Assessee could not claim credit of taxes paid in the USA against his other income which was chargeable in India and which was not doubly taxed.
- Credit could be allowed only against doubly taxed income. That is clear from the words in article 25, 'India shall allow as a deduction from the tax on the income of that resident’.
- Assessee could get only proportionate tax credit.
- No Credit for State Taxes

Also re Doubly taxed Income –

- **K.V.A.L.M Ramanathan Chettiar v. CIT [1973] 88 ITR 169 (SC) – ‘such doubly taxed income’**
- **DCIT vs iGate Global Solutions Ltd. [2019] 111 taxmann.com 192 (Pune-Trib)**

Judicial Pronouncements

Whether State taxes paid in US are eligible for Credit?

Favourable

- **Tata Sons Ltd. vs DCIT [2011] 10 taxmann.com 87 (Mum)**

  US State Tax to be eligible as credit under Section 91 inspite of India-US DTAA providing only for Federal Tax Credit.

- **DCIT vs Rajiv I Modi [2017] 86 taxmann.com 253 (Ahmedabad-Trib.)**

  An assessee is entitled to tax credits in respect of State income taxes paid abroad as section 91 does not differentiate between State and Federal taxes and provides for both types of Income taxes to be taken into account for purpose of tax credits against Indian Income Tax liability.

- **Aditya Khanna vs ITO (IT) [2019] 105 taxmann.com 323 (Delhi-Trib)**

Against

- **Manpreet Singh Gambhir v. DCIT [2008] 26 SOT 208 (Delhi)**

Judicial Pronouncements

Credit of income-tax paid in a foreign country in relation to income which is exempt u/s 10A

Favourable

- **Wipro Ltd. vs DCIT [2015] 62 taxmann.com 26 (Karnataka) –** Exempt income is nonetheless chargeable u/s 4 & 5. Exemption for only 10 years. S 90/91 use "income chargeable" and hence FTC allowed
- **Tata Consultancy Service Ltd. vs ACIT [2019] 111 taxmann.com 42 (Mumbai-Trib.**)
    - *The Court observed, as per the embargo placed in the DTAA, the assessee is entitled to such tax credit only in respect of that income which is taxed in USA. In similar context, the Court also referred to the tax treaty with Canada where the provisions does not allow credit for tax paid in Canada if the income is not subjected to tax in India. With regard to country's with which India does not have any agreement for avoidance of double taxation, the Court observed that as per section 91 of the Act, the assessee would be eligible to avail tax credit. Thus, on a careful reading of the aforesaid judgment of the Hon'ble Karnataka High Court, it becomes clear that where the respective tax treaty provides for benefit for foreign tax paid even in respect of income on which the assessee has not paid tax in India, still, it would be eligible for tax credit under section 90 of the Act. Like Article 25 of the Indo-USA treaty, treaties with various other countries such as Indo-Denmark, Indo-Hungary, Indo-Norway, Indo-Oman, Indo-US, Indo-Saudi Arabia, Indo-Taiwan also have similar provision providing for benefit of foreign tax credit even in respect of income not subjected to tax in India. However, Indo-Canada and Indo-Finland treaties do not provide for such benefit unless the income is subjected to tax in both the countries. Therefore, the foreign tax credit would be available to the assessee in all cases except the foreign tax paid in Finland and Canada. The Assessing Officer is directed to grant credit accordingly.*
- **Wipro Ltd. distinguished in Bank of India vs. ACIT [TS-118-ITAT-2021(Mum)]**

Judicial Pronouncements

- **Is Foreign Tax Credit eligible on the basis of income received or on the basis of gross receipts?**

  Not on the basis of gross receipts. For multiple PE overseas, income of each PE to be computed to claim FTC. On facts, PE profits computed without allocating expenses as they had earned only passive income. Hence reasonable to allocate expenses only to PE having active income

  - **Elitecore Technologies (P.) Ltd. vs DCIT [2017] 77 taxmann.com 149 (Ahmedabad-Trib.)**

- **Whether the Indian employer can consider a claim of FTC at withholding stage in respect of the taxes paid in the USA by the employee in PY 2012-13, when he qualified as a ROR in India?**

  Yes

  - **British Gas India Pvt Ltd. [2006] 155 Taxman 326 (AAR)**
  - **CIT vs Coromandel Fertilizers Ltd. [1991] 187 ITR 673 (AP).**
  - **Texas Instruments (India) Private Limited [2018] 90 taxmann.com 353(AAR)**

Judicial Pronouncements

Hierarchy of adjustments

- **CIT vs. Sami Labs Limited [2011] (ITA No. 231 of 2009)**

1. **Non-refundable taxes**
    a. Foreign Tax Credit u/s 91 of the Act.
    b. Foreign Tax Credit u/s 90 of the Act
    c. MAT Credit – Since it is liable to be adjusted within the period prescribed (15 years)
2. **Refundable taxes**
    a. Tax deduction at source
    b. Advance tax Paid
    c. Self-Assessment Tax
3. **Under no circumstances, FTC / MAT credit can become subject matter of refund.**
4. No interest is claimable against FTC / MAT credit.
5. ‘Assessed Tax’ in Section 234C is an indication of the priority of adjustments.
6. Interest under Sections 234B and 234C liable to the extent FTC / MAT Credit is determined as not eligible.

Thank You