Foreign Tax Credit
Overview and Related issues

The era of globalization and digitalization has brought a revolution in the way businesses are conducted, bringing the economies/geographies closer. While the businesses are evolving, the tax challenges relating to the right to tax the income between the Source and Residence Country are equally evolving.

Tax Treaties play a very crucial role to ensure that the taxes on income are distributed between the sovereigns while eliminating/ minimizing double taxation in the hands of the person earning the income. In this article, we are giving an overview of the regulations relating to the claim of Foreign Tax Credit (FTC) in India and the related tax issues.

Foreign Tax Credit

FTC is allowed to be a resident of India in respect of the tax paid by him in a source country or specified territory outside India either by deduction or otherwise.

FTC is allowed in the year in which the corresponding income has been offered to tax in India. Where the income is offered to tax in multiple years, FTC is allowed on a proportionate basis corresponding to the income offered in relevant years.

The key provisions relating to FTC in the Income-Tax Act, 1961 (ITA) read with the rules thereunder[1] are as follows:

1. FTC is allowed in respect of tax paid outside India irrespective of whether India has entered into a Double Taxation Avoidance Agreement (DTA) with such country or specified territories or not. Where DTA is entered, the FTC is allowed for the taxes covered under the DTA. The provision of the DTA has an overriding effect over the provisions in ITA to the extent they are more beneficial. In case of no DTA, the FTC claim may be considered as per the provisions of section 91 of the ITA.

1. Section 90, 91 of the Income tax Act, 1961(ITA) read with Rule 128 of the Income tax Rules 1962.

2. FTC is restricted to the amount of tax payable in India on the corresponding income. Excess foreign tax paid over the taxes payable in India will not be allowed as credit. FTC can be claimed only against the tax, surcharge, and cess payable on the corresponding income in India. As such, it cannot be claimed against any interest or penalty payable under the provisions of the ITA.
3. FTC is allowed where the taxes are payable in India on the corresponding income under the normal provisions of ITA as well as where Minimum Alternate Tax (MAT) is payable. Where the FTC is claimed against MAT, the excess of FTC over the FTC allowable against tax payable under the normal provisions of ITA will be ignored while computing the MAT credit carried forward.
4. For claiming the FTC, the taxpayer is required to file the prescribed form - Form 67 by the end of the relevant assessment year in which the corresponding income is offered to tax and where the return of income has been furnished within the due date of filing an original tax return or belated tax return. The form is required to be filed online and needs to be accompanied by the relevant proofs substantiating the payment of taxes in a foreign country.

Over the years, there have been various issues relating to the eligibility to claim FTC, the amount that can be claimed as a credit, relating to filing of Form 67, which we have covered in the ensuing paragraphs.

i. Eligible persons for claiming FTC in India

The taxpayer is eligible to claim the FTC paid in the source country in the country of residence. Where a taxpayer qualifies as a tax resident in both the countries i.e., in the Source and Residence country, then his tax residency is determined by the tie-breaker rule provided in the DTA or may be determined by the competent authorities as specified in the DTA.

In India, a person who qualifies as a "tax resident" is further categorized as Resident and Ordinarily Resident (ROR) or Resident but not ordinarily resident (RNOR), depending on their number of days of stay in India. Irrespective of the residential status, i.e., ROR or RNOR, the taxpayer should be eligible to claim credit for the taxes paid in the source country once he qualifies as Resident. Reference in this regard can be made to the decision of the Hon'ble Delhi Tribunal in the case of Aditya Khanna[2] wherein it was held that RNOR is also eligible to claim FTC in India in respect of taxes paid abroad on doubly taxed income.

2. [2019] 105 taxmann.com 323

ii. Relief against State Taxes

In certain countries (for example the USA), income taxes are levied by the State as well as the Central Government. The eligibility to claim FTC for State taxes is a subject matter of dispute, especially where there is a DTA with that respective Country and the taxes under the DTA do not cover state taxes.

For instance, in the USA, the tax is levied by the Federal Government as well as State Government. The DTA between India and USA covers only federal taxes. A question arises whether the state taxes paid in the USA can be claimed as FTC.

The Karnataka High Court, in the case of Wipro Ltd[3], has held that where DTA does not cover taxes like state taxes payable on income, FTC can be availed under Section 91 of the ITA. The DTA between India and USA does not cover state taxes payable in the USA. The High Court held that taxes on income paid to the state of a country like the USA should be allowed as a credit under section 91 of the ITA.

The Mumbai Tribunal, in the case of Tata Sons Ltd[4] has held that Section 91 of ITA does not discriminate between State and Federal taxes and, in effect, provides for both types of Income-taxes to be considered for the purpose of tax credits against Indian Income-tax liability. Hence, the taxpayer is, in principle entitled, to tax credits in respect of the State as well as Central tax payable outside India.

The Ahmedabad Tribunal, in the case of Dr. Rajiv I. Modi[5] allowed credit for state taxes paid in the USA.

As such, the judiciary has held that FTC is eligible for both State as well as Central taxes.

iii. Allowability of FTC where income is exempt from tax in India

Where an income is subject to profit-linked deduction and no tax is payable in India, a question arises whether the taxpayer shall be eligible to claim FTC in respect of such income. Here the language of the DTA Article on the elimination of Double taxation is very important.

In this context, the decision of the Karnataka HC in the case of Wipro Ltd (supra) is relevant. The taxpayer had claimed a deduction under Section 10A of the ITA and claimed FTC for the taxes paid in USA and Canada. The FTC claim was disputed as to whether the taxpayer is eligible to claim FTC where there is no tax paid on the income in India. The Hon'ble HC held that the income is chargeable to tax and is includible in the total income of the taxpayer, but no tax is paid because of the deduction/ exemption given under Section 10A of the ITA for a period of 10 years. The said deduction/ exemption granted under the statute has the effect of suspending the collection of income tax for a period of 10 years. It does not make the said income not leviable to income tax. Merely because the deduction/ exemption has been granted, it cannot be assumed that the taxpayer is not liable to tax, and therefore, the assessee is eligible for FTC under Section 90(i)(a)(ii) of the ITA.

3. [2015] 62 taxmann.com 26, [2016] 382 ITR 179
4. [2011] 10 taxmann.com 87 (Mum.)
5. [2017] 86 taxmann.com 253

Further, the Hon'ble HC held that the income derived by an Indian resident, which is taxable in the USA (directly or by deductions), would get FTC in India for the entire amount of income tax paid in the USA under India-USA DTA.

In this connection, the India-USA Tax Treaty is relevant:

India-USA [Article 25(2)(a)]

'Where a resident of India derives income which, by the provisions of this Convention, may be taxed in the United States, India shall allow as a deduction from the tax on the income of that resident an amount equal to the income-tax paid in the United States, whether directly or by deduction. **Such deduction shall not, however, exceed that part of the income-tax (as computed before the deduction is given) which is attributable to the income which may be taxed in the United States.'**

The Court held that the India-USA DTA does not make the payment of income tax in India as a condition precedent to claim FTC and that the only embargo prescribed is that the FTC will be available to an assessee only in respect of that income, which is taxed in the USA. The reading of the Hon'ble HC had the effect of allowing FTC even in a case where the income of the Indian resident is not taxable in India and only taxable in the USA.

The decision of the Wipro case was followed by the Bangalore Tribunal in the case of Ittiam Systems Private Limited[6], where full credit of FTC paid in USA, Germany, and Japan, having similar double taxation articles, were allowed.

Similarly, the Delhi Tribunal in the case of Canon India Private Limited[7] allowed FTC on the entire amount of taxes paid in Japan following the Wipro case (supra). A similar finding has been made in the case of HCL Comnet Systems and Services Ltd.[8] and by the Mumbai Tribunal in the case of Tata Consultancy Services Ltd.[9].

However, the Mumbai Tribunal, in the case of Digital Equipments India Ltd.[10] analyzed the India-USA DTA and held that the India-USA DTA in the last sentence of Article 25(2)(a) states unambiguously and beyond any controversy that the deduction on account of income tax paid in the USA, from income tax payable in India, cannot exceed Indian income tax liability in respect of such income. The Tribunal further held that the India-USA DTA, and other DTAs as well, does stipulate that the FTC cannot exceed the income tax leviable in respect of that income in the country of which the assessee is resident.

The Revenue's appeal against the ruling of the HC of Karnataka in Wipro (Supra) has been granted a Special Leave for Appeal[11], leaving the decision of the HC to be adjudicated upon by the Supreme Court. It will be interesting to see how the Apex Court interprets India-USA DTA.

6. ITA No. 2464 & 2465/Bang/2017
7. ITA No. 468/Del/2021
8. ITA No. 5555/Del/2014
9. ITA No. 5713/Mum/2016 & ITA No. 1650/Mum/2016
10. 94 ITD 340
11. [2018] 95 taxmann.com 107 (SC)

iv. Whether FTC can be claimed as business deduction

Section 40(a)(ii) of the ITA states that any sum paid on account of any rate or tax levied on the profits or gains of any business is not allowed as a deduction. Explanation to Section 40(a)(ii) of the ITA clarifies that any sum paid on account of any rate or tax levied includes and shall always be deemed to have included any sum eligible for relief of tax under section 90 of the ITA or as the case may be, deduction from the Indian Income tax payable under Section 91 of the ITA.

In view of the above, it appears that the taxes paid abroad are not eligible for deduction under Section 40(a)(ii) of ITA, where relief under Section 90 or 91 is claimed.

The Hon'ble Bombay HC, in the case of Reliance Infrastructure v CIT[12] held that where the taxpayer is not entitled to claim FTC, it is entitled to claim a deduction of such expense which computing its income from Business and profession.

Similarly, the Mumbai Tribunal in the case of Bank of India[13], denied a refund of foreign taxes but allowed it as a business expense deduction in the absence of Indian tax liability on foreign incomes. In the present case, the taxpayer had earned income from foreign jurisdiction on which the taxes were paid outside India. There was no tax liability in India on account of the set off of the losses. The Mumbai Tribunal did not follow the Wipro case and denied the claim of refund but allowed the claim of the taxpayer to allow taxes paid as a deduction. The Mumbai Tribunal observed that the explanation to Section 40(a)(ii) was introduced to cover the cases where the taxpayers were claiming FTC and business deductions. As such, where FTC is not available, deduction under Section 40(a)(ii) should be allowable to the taxpayer.

v. Filing of Form 67

For claiming FTC, the taxpayer is required to file online Form 67. Earlier, Form 67 was required to be filed at the time of filing the original return of income. The said provisions got amended from 1 April 2022[14], where the window to file Form 67 has been extended till the end of the relevant assessment year in which the income is offered to tax.

Delay in filing Form 67 – whether deduction will be allowed:

The Hon'ble Bangalore Tribunal in the case of Hertz Software India (P.) Ltd[15], where the taxpayer is a company, failed to furnish Form 67 at the time of filing an original tax return, and the same was furnished during the ongoing assessment proceedings. The Hon'ble Tribunal allowed the credit of the FTC to the taxpayer and observed as under:

1. Submission of Form No. 67 before the filing of returns is not mandatory but a directory requirement because rule 128(9) does not provide for disallowance of FTC in case of delay in filing of Form No. 67.
2. There is no condition prescribed in DTA that the FTC can be disallowed for non-compliance with any procedural provision. As the provisions of DTA override the provisions of the ITA, the taxpayer has a vested right to claim the FTC under the tax treaty, and the same cannot be disallowed for the mere delay in compliance with a procedural provision.

12. 390 ITR 271
13. ITA 869/Mum/2018
14. Amendment in Rule 128 vide notification no. 100/2022, dated 18-08-2022
15. [2022] 139 taxmann.com 448

A similar view was taken by the Mumbai Tribunal in the case of Sonakshi Sinha[16] where it was held that rule 128(9) provides that the statement in Form No 67 shall be furnished on or before the due date specified for furnishing the return of income under section 139(1). It further explained while laying down a particular procedure, if no negative or adverse consequences are contemplated for nonadherence to such procedure, the relevant provision is considered to be not mandatory but purely directory.

Based on the above judicial decisions, FTC should be available even if there is a delay in filing Form 67.

Processing of Return – Delay in filing of Form 67:

The tax return is processed by the CPC, and where there is a delay in filing Form 67, the FTC is denied. The taxpayer has the option to file an application for rectification or file an appeal against the CPC order. Given the litigation costs, it is recommended that the taxpayer files Form 67 within the prescribed timelines.

Concluding Remarks

The taxpayers need to be vigilant while making a claim of FTC and ensure that the wording of the Treaty are examined, where FTC is covered by DTA. In case of no DTA, the FTC claim may be considered as per the provisions of section 91 of the ITA.

On the amount of FTC to be claimed, the treaty wordings would be relevant, and it may be possible to claim credit for full taxes paid outside India. Reliance in this regard may be placed on the Karnataka High Court decision in the case of Wipro (supra). However, it may be noted that the tax department has preferred an appeal against this decision of Karnataka HC in the Supreme Court. It would be interesting to see the verdict of the Apex Court in the case of Wipro (supra), especially after the introduction of Rule 128 of the Income-Tax Rules, 1962. Until the Apex courts put this controversy to rest, the FTC claim of full taxes paid outside India is likely to be a subject matter of litigation.

Further, where FTC is not available, there is a possibility to claim the foreign taxes as a deduction. However, such a claim shall not be free from litigation.

The extension of the timeline to file form 67, considering the practical challenges faced by the taxpayer, is a welcome move. While FTC should not be denied merely because form 67 has been filed late, given the litigation costs, it is recommended that the taxpayer files Form 67 within the prescribed timelines.

16. [2022] 197 ITD 263

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