

SATURDAY INTERNATIONAL TAX GYAN !!!

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Invendis Technologies India (P.) Ltd.

v.

ACIT Circle 3(1)(1), Bengaluru

For computing net profit ratio of domestic company for foreign tax credit (FTC), other income from foreign sources in relation to business should be included. FTC cannot be used to pay tax on Indian source Income.



Date: 09.07.2022

FACTS OF THE CASE

- ❖ The assessee is Private Limited Company engaged in the business of manufacturing of Telecommunication products and software development services.
- ❖ The **assessee filed the return** of income for the A.Y. 2014-15. The **case was selected for scrutiny** and notice under section 143(2) was issued. The assessee had business operation in India as well as in foreign country viz., Ghana.
- ❖ The income is earned by the assessee in Ghana with which India has no agreement regarding avoidance of double taxation.
- ❖ While calculating **tax rate in Ghana** the assessee company had calculated the same **on Gross receipts** while tax paid **in India was on net income and not on gross receipts.**
- ❖ AO calculated the FTC on the net profit of the company from foreign receipts using NP ratio without considering other income earned.

REVENUE'S CONTENTION

- ❖ The expression '**such doubly taxed income**' has reference to the foreign income which is again being subjected to tax by its inclusion in computation of income under the Indian law.
- ❖ Hence the **assessee's claim** that the **relief to be allowed for the entire tax paid in Ghana on** the basis that **gross receipt is doubly taxed** cannot be accepted without going into the details of how much of such income is doubly taxed.

Assessee's Contention

❖ Assessee contends that:

1. The **net profit ratio** method as adopted by the AO for computation of foreign tax credit has not been prescribed by section 90/91 of the Act.
2. In the absence of any method, AO's action of arbitrarily applying the net profit ratio for computation of **foreign tax credit (FTC)** u/s. 91 is unjustified.
3. **Effective rate of tax in Ghana** = Tax paid in Ghana / Income assessed in Ghana
4. (i) The **other income** shown in the P&L account is mainly in connection with the business. For the purpose of computing the **Book profits u/s.115JB** the other income is included as part of net profit.
(ii) Since the Indian effective rate of tax is arrived at including the other income, for the purpose of computing the effective tax rate of Ghana assessing officer is not justified in not including the same
5. Considering the **effective rate of tax at 18.5% excluding surcharge and cess is not correct** in the light of the decision of the Supreme Court in the case of CIT vs K Srinivasan (1972 AIR 491).

Legal provisions related to Income Tax Act, 1961

As per **Section 91(1) of Income Tax Act, 1961** – 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.

Legal provisions related to Income Tax Rules, 1962

As per **Rule 128 of Income Tax Rules, 1962** –

- (1) An assessee, being a resident shall be allowed a credit for the amount of any foreign tax paid by him in a country or specified territory outside India, by way of deduction or otherwise, in the year in which the income corresponding to such tax has been offered to tax or assessed to tax in India, in the manner and to the extent as specified in this rule.
- (2) The foreign tax referred to in sub-rule (1) shall mean,—
 - (a) in respect of a country or specified territory outside India with which India has entered into an agreement for the relief or avoidance of double taxation of income in terms of section 90 or section 90A, the tax covered under the said agreement;
 - (b) in respect of any other country or specified territory outside India, the tax payable under the law in force in that country or specified territory in the nature of income-tax referred to in clause (iv) of the Explanation to section 91.

Form 67 needs to be filed before due date of filing return of Income tax claim such foreign tax credit.

RULING

- ❖ Considering the facts, the exclusion of “Other Income” is not the right approach.
- ❖ **Indian rate of tax** = Indian Income-tax / Total Income
- ❖ In this case the Indian rate of tax has been arrived at by the assessee at 20.01%. However the AO has arrived at the Indian rate of tax at 18.50%. This is because the AO adopted the rate of tax on book profits **u/s.115JB** of the Act.
- ❖ However the AO had considered the tax before surcharge and Education cess and arrived at a rate of 18.50%.
- ❖ The issue of surcharge and cess being part of income tax is settled by the **Supreme Court** in the **case of CIT vs K Srinivasan (supra)** where the Hon’ble Supreme Court has clearly laid down that the words “income tax” would include surcharge and additional surcharge.
- ❖ Hence for the purpose of arriving at effective Indian rate of tax, **surcharge and educational cess** should be considered i.e. @ 20.01%.

OUR COMMENTS

Assessee company had total sale of Rs. 200 from which Rs. 100 was from foreign source on which tax was withhold in foreign country of Rs. 7.5. In India company had paid 25% tax on the profit of Rs. 50 (25% NP ratio) from Rs.200 received.

Assessee's calculation	
Foreign income	100
Tax on foreign income (WHT rate = 7.5% on gross income)	7.5
Indian company profit	50
Tax on Indian company (Tax rate in India 25%)	12.5
Since tax rate of foreign country is lower he should get credit of total tax paid in foreign country i.e. 7.5 against tax paid in India.	

Revenue's calculation	
Indian company Profit	50
Tax on above profit in India	12.5
Foreign income earned	100
Profit from above foreign income	25
Tax paid in Foreign country	7.5
Effective foreign tax rate	30%
FTC available (25% tax on profit share in foreign income)	6.25
As per AO FTC can be available on doubly taxed income i.e. profit of the company and also the effective foreign tax rate needs to be calculated on the profit and not gross receipt	

Considering both the above contentions it can be said that:

- 1. Effective tax rate for foreign income needs to be calculated only on income which is doubly taxed and not on gross receipts.**
- 2. FTC cannot be used to pay tax on Indian Income.**

OUR COMMENTS

- ❖ For the purpose of computing the net profit ratio of total income of the assessee in India which is used as the basis for arriving at the net income of Ghana should **include ‘other income’ earned from foreign sources.**
- ❖ We have also held that the **‘effective Indian rate of tax’** should include surcharge and education cess i.e. 20.01% [Honb’ble Supreme Court Judgement ,CIT vs K Srinivasan (supra)].
- ❖ Foreign Tax credit (FTC) will be available only on **“doubly taxed income”** and not on Gross Receipts.

Section/Article	91(1) of the Income Tax Act
DTAA/Country	Not Available
Court	Bangalore ITAT
Date of decision	27.04.2022

Note: Case law name in **Red**- in favour of the revenue, **Green**- In favour of the Assessee, **Orange** = Partial



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