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GMS Flash Alert

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India - Advance Rulings on Withholding, Foreign Tax Credits for Nonresident Employees

India's advance ruling authority has determined that no tax withholding is required on salaries paid by an employer in India to its nonresident employees working outside India. The Authority for Advance Rulings ("AAR") has also held that foreign tax credits may be claimed at the withholding stage for resident employees.

WHY THIS MATTERS

Because domestic tax law in India does not expressly provide for foreign tax credits for residents or any relief to nonresidents for salary paid in India, at the withholding stage, this decision could prove useful in exploring options to apply the decision or seek a similar ruling. This would be of interest to companies sending large numbers of assignees outside India.

Overview

The Income-tax Act, 1961 ("the Act")[1] provides for taxation of income including salary, based on the residential status of the individual when such income is due, received or accrued.

In January 2018, the AAR held[2] that:

1 Salary received in India by an employee qualifying as nonresident ("NR"), for employment rendered outside India, accrues outside India. Consequently, the salary would not be taxable in India and the Indian employer would not be obliged to withhold tax in India.

2 A foreign tax credit ("FTC") may be considered at the withholding stage by the Indian employer while determining withholding tax on salary income for employees qualifying as resident and ordinary resident ("ROR") in India.

Facts

In 2014, an Indian employer asked the AAR to rule on the taxability in India of the salary of its employee while working in the United States.

The employer had sent an employee on an assignment for two years, during which time the employee's salary was paid by the U.S. entity. During the tenure of the U.S. assignment, the employee received a part of the salary in India. However, all services were rendered in the United States and no services were rendered in India.

The employee had qualified as NR in India for the tax year (TY) 2011-12, resident and ordinary resident (ROR) in India for the TY 2012-13, and resident in the United States for the calendar years 2010, 2011, and 2012.

The employee filed returns in the United States as a resident for the calendar years 2010, 2011, and 2012, and was taxable in the U.S. on the entire salary paid in the U.S. and in India, as the related services were rendered in the United States.

The Indian employer asked the AAR to rule on:

Question 1 Whether the Indian employer is obliged to withhold taxes on the salary paid in India to the employee in TY 2011-12, when the employee qualified as an NR in India.

Question 2 Whether the Indian employer can consider an FTC claim at the withholding stage for the taxes the employee paid in the United States in TY 2012-13, when he qualified as an ROR in India.

AAR Rulings and Analysis

Question 1

Under judicial and other precedents,[3] the actual place of rendering services is the key test in determining the place of accrual of salary to an NR, the AAR noted. Salary received for services rendered outside India has to be considered as being earned outside India.

It is immaterial whether the employer is an Indian entity; the only material point for consideration is the place where the services were rendered. This is also borne out by the commentary on the OECD Model Convention which refers to the personal presence for performance of employment, and by the related provisions of the Act.[4]

Since the employment was performed in the United States, the AAR ruled that the related salary income did not accrue in India.

The AAR also relied on its own decision,[5] as well as others, holding that unless there is a liability on the employee to pay tax on salary income, there would be no obligation for the employer to withhold tax at the source.

Thus, the AAR held that the Indian employer is not required to withhold taxes on the portion of salary paid in India to its NR employee.

Question 2

The AAR determined that the employee is entitled to claim an FTC[6] under the Treaty.

Under the Act,[7] for payments received by an employee from more than one employer, the employee can furnish details of salary paid and tax deducted to one of the employers, who would then need to take them into account in computing withholding tax.

The AAR agreed with the judicial precedents and held that the FTC can be considered by the Indian employer at the withholding stage.

The AAR acknowledged that the mechanical provisions of the Act do not provide for claiming of FTC at the withholding stage. However, in the absence of any other provisions to provide such a benefit, the Indian employer could consider it while computing withholding tax.

In providing the FTC benefit at the time of computing withholding tax, the Indian employer must exercise due diligence in satisfying the employee's eligibility details including period of residence, tax residency certificate, details of income earned and taxes deducted, and the period of income.

The Revenue can take appropriate action under the Act for failures of the Indian employer in carrying out its due diligence.

KPMG NOTE

Any ruling of the AAR is binding only upon the applicant and the Revenue as to that applicant.

We encourage reviewing the amendments introduced in the 2012 and 2013 Finance Acts and related notifications, such as obtaining a tax residency certificate, and mandatory filing of return of income to claim treaty benefits. The Revenue would seek such information and documents when the employer/employee propose taking benefits under the tax treaties.

While the AAR has acknowledged that the mechanical provisions are not conducive for considering FTC at the withholding stage, it has held that a claim of FTC could be provided at the time of withholding. There could be a practical challenge for employers in computing the taxes paid overseas due to a difference in tax years. There could also be challenges in ascertaining the actual taxes paid overseas because taxes withheld may be refunded at a later point in time or may be subject to litigation. Also, the current forms and rules do not provide guidance on disclosing such claims while filing the withholding tax return in India or issuing a withholding tax certificate in India. Lastly, the current regulations also provide for filing Form 67 prior to or along with a return with a claim of FTC.

Further, as the AAR has opined that the Revenue could initiate appropriate action if it believes that the employer's due diligence in quantifying the claim of treaty benefits is not sufficient, litigation in this respect cannot be ruled out.

In view of the above, applicability of this ruling requires an evaluation of the facts and circumstances of each case.

FOOTNOTES:

1 Section 5,6 and 9 of the Act.

2 Texas Instruments (India) Pvt. Ltd AAR No 1299 of 2012 (Jan. 29, 2018).

3 Utanka Roy v. DIT (International Taxation), (2016) 390 ITR 109 (Cal); The Director Of Income Tax vs Sri Prahlad Vijendra Rao ITA No 838/ 2009; CIT vs Avtar Singh Wadhwan [2001] 247 ITR 260 (Bom); British Gas India Private Limited (AAR/725/2006); Coromandal Fertilizers Ltd [1991], 187 ITR 673 (AP).

4 Explanation to section 9(1)(ii).

5 British Gas India Private Limited, (AAR 725/2006).

6 Article 25 of the Treaty.

7 Section 192(2) of the Act.

RELATED RESOURCE

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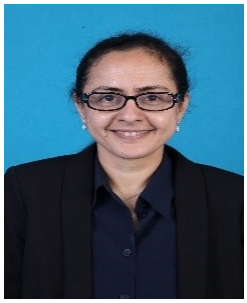

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