**Ref No. 02/05/16-17** **Date:** 2nd May 2016

**Kind Attn:**

**Director (Tax Policy & Legislation)-IV**
**Central Board of Direct Taxes,**
Room No. 147-F,
North Block, New Delhi – 110001.

By email

**Subject: Comments on 'Draft Rules for Grant of Foreign Tax Credit'.**

**Ref: Draft Rules for Granting Relief or Deduction of Income-Tax under Section 90 / 90A / 91 of the Income Tax Act' issued on 18th April 2016 vide F. No. 142/24/2015-TPL.**

**Dear Sir,**

We are grateful for the opportunity to comment and provide suggestions on the 'Draft Rules for Grant of Foreign Tax Credit'.

Issuance of guidance for grant of foreign tax credit is a positive step and would help reduce ambiguities in the practices currently followed. On an analysis of the proposed guidelines, however, there are some issues - as listed in the following paragraphs - which we request you to kindly address:

## 1. Draft Rule 1

1.1. It has been stipulated under this Rule that the credit of foreign tax **paid** shall be allowed in the year in which the income corresponding to such tax has been offered to tax in India. This would tantamount to refusal of foreign tax credit in case of timing mismatches. A typical example is given below to highlight the difficulty that could arise in such cases:

1.1.1. Say a Resident individual in India engaged in manufacture of transformers has appointed an agent in Singapore to sell its goods locally as well as to explore other South East Asian markets in January 2016. The agent works exclusively for the Indian resident and is therefore deemed to constitute a permanent establishment for the Indian resident in Singapore. Consequently, the Indian resident – although being a non resident of

Singapore – is required to file his return of income in Singapore too for the income earned locally. The tax year in India follows the financial year April to March whereas the tax year in Singapore follows the calendar year. Therefore, the Indian resident would have to report income for the period from January 2016 to March 2016 in his Indian income tax return for AY 2016-17 as well as in his Singaporean income tax return for Assessment Year 2017 (corresponding to calendar year 2016). The due date of filing return of income in India for AY 2016-17 is 31st July 2016 whereas the due date for filing return of income in Singapore for Assessment year 2017 is 15th April 2017. The tax payment in Singapore is usually demanded within one month from the service of Notice of Assessment[1]. The Indian resident would therefore make tax payment for income earned in Singapore for Assessment Year 2017 only after date of filing his return of income in Singapore viz. 15th April 2017. Under such circumstances, the Indian resident would be refused any grant of foreign tax credit in India against the Singapore tax paid corresponding to the period January 2016 to March 2016. This would become a recurring phenomenon now that Finance Bill 2016 proposes to amend Sec 139(4) of Income Tax Act, 1961 to curtail time limit for filing belated return of income to the end of the Assessment Year (viz. 31st March 2017 in this case).

1.2. In view of such timing mismatches and the hardship to be likely faced by assessees, the OECD Commentary expressly states that the State of Residence must provide for relief regardless of when the tax is levied by the State of Source[2]. The State of Residence must therefore provide relief of double taxation through the credit or exemption method with respect to such item of income even though the State of Source taxes it in an earlier or later year[3]. If such tax credit is refused by the State of Residence, the only remedy available with the taxpayer would be to either litigate or invoke the mutual agreement procedure both of which alternatives would involve avoidable wastage of resources.

1.3. Reference may also be given to US regulations in this regard. Form 1116 (Foreign Tax Credit for Individual, Estate or Trust) and corresponding guidance Publication 514 state that

[1] Unless the taxpayer opts for GIRO installment plan

[2] OECD (2014), Model Tax Convention on Income and on Capital: Condensed Version 2014,OECD Publishing; Paragraph 32.8 on Commentary on Articles 23A and 23B.

[3] Ibid

foreign tax credit could be availed on payment or accrual basis subject to redetermination[4]. The redetermination is dependent upon the time limit between accrual and payment of tax and foreign exchange fluctuation (subject to a tolerance band).

1.4. It may therefore be suggested that foreign tax credit in India could also be similarly allowed to the assessee on accrual basis by framing appropriate guidelines for redetermination (For e.g. only if the foreign taxes are paid before the proposed time limit u/s 139(5) of Income tax Act, 1961).

## 2. Draft Rule 4

2.1. It may be unfair to refuse foreign tax credit in situations where payment of foreign taxes are initially disputed in the State of Source but eventually the liability is extinguished / paid off beyond the due date prescribed u/s 139(4) / (5) of Income Tax Act, 1961 pursuant to a court ruling in the State of Source or suo moto payment being made by the taxpayer to buy peace of mind in the State of Source.

2.2. Similar to the suggestion provided under Draft Rule 1, foreign tax credit may be granted for disputed foreign taxes on an accrual basis subject to elaborate redetermination rules.

## 3. Draft Rule 5

3.1. Rule 5(i) limits the foreign tax credit to the tax payable under the Income Tax Act, 1961 for each source of income respectively. In the case of individuals, it may be stipulated that the tax payable under the Income Tax Act, 1961 has to be computed before having regard to any deductions (such as Chapter VIA deductions), minimum exemption limit and progressive tax slabs since otherwise such individual would in a way lose the benefit of such deductions, minimum exemption limit and progressive tax slabs provided under the Income Tax Act, 1961 and at the same time, double taxation may not be alleviated completely.

3.2. Rule 5(ii) provides for adopting the telegraphic transfer buying rate on the date on which such tax has been paid or deducted. The suggestions given for Draft Rule 1 and 4 regarding grant of foreign tax credit on an accrual basis may also warrant consequential

[4] https://www.irs.gov/uac/About-Form-1116

reconsideration under this Rule for specifying the date on which such exchange rate is to be adopted.

3.3. Presently, under Rule 115 as well as Rule 115A, the telegraphic transfer buying rate refers to the rate of exchange adopted by the State Bank of India. In absence of any pan-India standardized online facility to extract such exchange rates, it creates hardship for assessees to obtain exchange rates for incomes earned at various points in time of the year. Instead, the RBI reference rate is freely and easily available on its website. Further, RBI has recently decided to base its reference rate for the rupee on actual market transactions to make it tamper proof[5]. It may therefore be suggested to adopt the RBI reference rate instead of the rate of exchange adopted by the State Bank of India for the purpose of application of Rule 26, 115, 115A as well as the draft rules for grant of foreign tax credit.

## 4. Draft Rule 8

4.1. Rule 8 mandates the cumulative furnishing of various documents for allowance of foreign tax credit. This Rules creates various difficulties as elaborated below:

4.1.1. This may invariably prove to be burdensome for assessees (For e.g. despite the acceptance of tax return filed by an assessee as final in the State of Source, the assessee would still have to obtain a certificate from the foreign tax authority specifying the nature of income and the amount of tax paid by it).

4.1.2. Difficulties may arise in obtaining such documents (For e.g. foreign payers may be unwilling to share the acknowledgement of online tax payment or bank counter foil or slip or tax payment challan when they would have issued tax deduction certificate itself).

4.1.3. The due date for furnishing such documents has also not been mentioned in this Rule. Consequently, the assessee may not know at the time of filing its return of income in India whether the amount of foreign tax is disputed or not in the State of Source if the assessment may not have yet taken place in the State of Source.

4.2. It may be therefore suggested to reasonably relax the rigour of this Rule to avoid hardship at the time of availing foreign tax credit in India.

[5] http://www.thehindubusinessline.com/economy/towards-a-tamperproof-rupee-reference-rate/article8438084.ece

## 5. General Suggestions

5.1. It may be suggested that suitable illustrations be given to explain the application of these Rules especially in the cases involving availing underlying tax credit and cases involving tax sparing.

We sincerely hope that the above comments may be considered and be useful to the benefit of the CBDT.

**Yours sincerely,**

**Pankaj Bhuta** [B.Com (Hons.), F.C.A.]
**Harshal Bhuta** [M.Com., F.C.A., A.D.I.T., LL.M. (Hons.) in International Tax Law [WU (Vienna)]
**Tanvi Vora** [M.Com, A.C.A.]

**P. R. BHUTA & CO. Chartered Accountants**

***Address*** : 2-I, Jeevan Sahakar, 2nd Floor,
Sir P. M. Road, Fort,
Mumbai – 400001, India.
***Telephone*** : +91 22 22660010/3427; 43471727
***Fax*** : +91 22 22662793
***E-mail*** : info@bhutaco.com
***Website*** : www.bhutaco.com