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International Tax

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Delhi HC allows credit by deeming foreign taxes as 'payable' though dividend did not suffer actual taxation, emphasises on Tax Sparing provisions under India – Thailand DTAA

Snapshot

Delhi HC has upheld Indian company's claim of deemed foreign tax credit ("FTC") on dividends from Thai subsidiary, which were exempt from taxation in Thailand under Thai Revenue Code.

Taking into consideration provisions of Tax Sparing under Article 23 of Indo-Thai DTAA, 'Tax payable' in context of India – Thailand DTAA has been held to include tax which would have been payable in Thailand but for an exemption accorded by Investment Promotion Act.

Accordingly, Foreign taxes that would have been payable are allowed as credit against taxes payable in India on dividend income arising from Thailand.

Brief Facts

Taxpayer was an Indian company and had received dividend income from its wholly owned subsidiary in Thailand and had offered the same to tax in India.

Foreign companies receiving dividend income from Thailand were liable to tax at 10% in Thailand as per the Revenue Code of Thailand. However, Investment Promotion Act in Thailand granted exemption from income tax with respect to (i) net profits earned by certain eligible companies in Thailand and (ii) on dividends distributed by such Thai companies. Accordingly, the taxpayer's dividend income was exempt from tax in Thailand.

Considering, that but for the exemption under Investment Promotion Act, income would have been taxable at the rate of 10% income tax in Thailand, such taxes were deemed as Tax Payable in Thailand and the same was claimed as FTC against Indian tax liability on dividends from Thai subsidiary based on the provisions of Article 23 of Indo-Thai DTAA.

Revenue's Contentions

Revenue authorities contended that Article 23(2) of the DTAA allows relief against incomes which have been subjected to tax in both the countries – India and Thailand and since no tax was paid in Thailand, the income could not be considered as having been subjected to tax in Thailand. Further, since tax was paid only in India, Revenue authorities were of the view that there was no double taxation and that question of relief from double taxation did not arise. Revenue authorities also contended that Thailand's Investment Promotion Act provides exemptions to Thai entities and not foreign companies and

hence Indian taxpayer's case was not covered by Tax sparing provisions of the DTAA.

Considering that the Taxpayer's income was exempt from tax in Thailand and that no tax was actually paid in Thailand, Revenue authorities denied FTC claimed by the Taxpayer, which was upheld by CIT (Appeals).

Taxpayer's Claim

Taxpayer relied on the provisions of Tax Sparing under Article 23(3) of the DTAA between India and Thailand, wherein, "Thai tax Payable" for the purpose of FTC under Article 23(2) of the DTAA has been deemed to include any amount which would have been payable as Thai tax but for an exemption or reduction of tax granted under the provisions of the Investment Promotion Act or of the Revenue Code which are designed to promote economic development in Thailand. Considering that Thai subsidiary was granted exemptions under Investment Promotion Act, dividends distributed by Thai subsidiary, being income in the hands of the Indian Company were exempted by virtue of Investment Promotion Act. However, considering the provisions of Article 23(3) of the DTAA, it was contended that FTC should be allowed for deemed tax payable in Thailand but not paid by virtue of the aforesaid exemption.

Taxpayer also relied on the decision of Delhi High Court in the case of Krishak Bharti Cooperative Limited [ITA 578/2016 and ITA 177/2021], wherein, FTC was granted against Indian tax payable on dividends received by Taxpayer from Omani subsidiary with respect to deemed taxes payable in Oman however not paid in Oman on account of exemptions granted under Omani tax laws.

Taxpayer's claim for FTC was thus allowed by Delhi bench of ITAT, which was appealed against before the High Court.

Decision of Delhi High Court

The High Court held that provisions of Indo-Thai DTAA would prevail over the provisions of the domestic laws of India in case of conflict on account of provisions of Article 23(1) of the DTAA and Section 90(2) of the Indian Income-tax Act ("ITA").

The High Court held that ordinarily the term "tax payable" would mean tax, which is owed or due, although not paid. However, where the expression has been defined under the DTAA, the intent of the countries to DTAA has to be ascertained from the provisions of the DTAA and not from its ordinary meaning. High Court observed that provisions of Article 23(3) of the DTAA defined 'Thai tax payable' to include deemed taxes which were payable in Thailand but for the exemption under Investment Promotion Act or Thai Revenue Code. High Court held that the provisions of Article 23(3) were designed to promote economic development in Thailand and incentivize investments in Thailand by granting credit for taxes otherwise payable but not paid in Thailand by virtue of exemptions under specific Statutes.

High Court thus held that where the phrase 'Thai Tax Payable' had been defined under Article 23(3) of the DTAA, the provisions of Article 23(2) stating that credit shall be provided in respect of incomes which are subjected to tax in both countries cannot be read in isolation and that the provisions of Article 23 of the DTAA has to be read in whole. The Court held that the concept of Tax Sparing has been embedded in several Indian DTAAs such as with France, Jordan, Oman and Thailand and where Article 23 of India – Thailand DTAA engrafted a mechanism to incentivize investments for economic development by providing credit for taxes paid by the country receiving investments, FTC should be granted for taxes payable but spared in Thailand.

The Court also made reference to the Klaus Vogel's commentary on Double Taxation Conventions and held that the concept of Tax Sparing has been recognized by many Indian tax treaties as well as by international authors and that while the same could lead to double non-taxation, tax sparing provisions in tax treaties are intentionally agreed upon by Governments of contracting countries to provide FTC for notional or deemed taxes to provide tax incentives and promote economic development and growth of the countries.

FTC with respect to deemed taxes payable in Thailand but not paid on account of exemption accorded by virtue of Investment Promotion Act in Thailand were thus held to be allowable u/s 90 of the ITA.

KCM Comments

It has been held in various Indian judicial decisions that the phrases 'liable to tax' and 'subjected to tax' are not synonyms and that while the phrase 'Liable to taxation' connotes being in the tax net, the phrase 'Subjected to tax' is concerned with actual taxation. However, in light of the Tax Sparing provisions of the DTAA, the Court has held that credit should be granted even with respect to incomes which did not suffer actual taxation in Thailand on account of specific exemptions and accordingly, the phrase 'Subjected to tax' in Article 23 of the DTAA has been read contextually without going by the general meaning of the phrase.

It may not be out of place to mention that Tax Sparing clauses have been part of several Indian DTAAs. In fact, in the old India-France DTAA, it was mentioned that in case of dividends, where the Indian tax thereon has been reduced or exempted by the operation of section 80J, 80K and 80M of the ITA, it shall be deemed that the amount by which the Indian tax has been reduced or exempted has been actually paid in India for the purpose of application of 'subjected to tax' tests and for computation of FTC.

Here it may be relevant to mention that in the case of Wipro Ltd. [2006] 5 SOT 805 (BANG.) as upheld in [2016] 382 ITR 179 (Karnataka), the High Court has held that as per Section 90 of the ITA, a DTAA may be entered not only for avoidance of double taxation but also for granting relief from taxation and accordingly, relief u/s 90 should be allowed if the Government has entered into an agreement with the Government of another country in this regard. Further, in the case of Krishak Bharti Cooperative Limited, as relied by the Taxpayer, the Delhi High Court has allowed FTC on dividends from Omani company based on tax sparing provisions of India – Oman DTAA. SLP has been filed by Revenue

Authorities before Supreme Court against the decisions in the case of Wipro Limited as well as in the case of Krishak Bharti Cooperative Limited. Final hearing has been held on SLP filed against the Delhi High Court decision in the case of Krishak Bharati by Supreme Court on 13th July 2023. It would thus be interesting to see rulings of the Apex Court in the above cases of grant of FTC to Indian Taxpayers in light of full tax credit under India – USA DTAA and in light of tax sparing provisions under India – Oman DTAA, respectively.

India-Thailand DTAA has been amended in 2015, where tax sparing credit clause has been deleted. However, the decision still holds good for various other Indian DTAAs which have similar tax sparing provisions. It would also be interesting to see the impact of Article 6 of MLI on Tax Sparing provisions under Indian DTAAs with various countries where the Preamble to tax treaties have been modified to reflect that treaties are only intended to eliminate double taxation without creating opportunities for double non-taxation and where the provisions of Article 6(3) of the MLI i.e. "Desiring to further develop their economic relationship and to enhance their co-operation in tax matters," have not been added to the preamble of the tax treaty.

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