

Taxes withheld in foreign jurisdiction and medicare cannot be construed to be part of taxable salary in India

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In brief

In a recent judgement¹, the Bangalore Bench of the Income-tax Appellate Tribunal (Tribunal) has taken a favourable view providing relief to an individual who was transferred to the US. The judgement passed by the Tribunal provides that for an outbound expat, Federal and State taxes withheld in the US and medicare should not to be included for computing taxable income in India. Further, the Tribunal has also affirmed that in spite of the income not being taxed, proportionate foreign tax credit (FTC) would be available as per the India-US Double Taxation Avoidance Agreement (tax treaty).

In detail

Facts

- The taxpayer, an individual employee, was transferred from an Indian entity to US entity from 07 October, 2010 to 21 June, 2012.
- The taxpayer qualified as ordinary resident in India for the assessment year 2011-12 (subject AY) as per the provisions of Income-tax Act, 1961 (the Act).
- During the subject AY, the taxpayer derived income from salary on which employer withheld taxes (Federal & State), payable as per the US tax laws.
- The taxpayer did not include medicare paid in US while computing taxable income in India.

- The taxpayer offered to tax the salary net of taxes withheld in US. The tax payer claimed credit of such taxes.
- The key issue was whether the taxes withheld and medicare paid in US should have been part of the total taxable salary in India.

Revenue's contentions

- Taxes withheld in foreign jurisdiction should have been included in the total income while computing tax liability in India
- On similar footing, medicare paid in USA was included in the salary income for computing tax liability in India.

Taxpayer's contentions

- The taxes withheld in US

viz. both Federal and State tax was income deemed to be accrue or arise outside India.

- Section 198 of the Act provides that tax withheld as per the provisions of the Act was deemed income but however was silent on inclusion of taxed withheld in foreign jurisdiction.
- Further section 5(1)(c) of the Act is distinct from 5(1)(a) and 5(1)(b) of the Act to the extent that it does not include any income which is 'deemed to be received' or 'deemed to accrue or arise' outside India.

Basis the above, taxes withheld in US was to be construed as income

¹ ITA No.2149 (Bang) 2016

deemed to be accrued or arisen outside India and not subject to tax in India.

- In relation to medicare it was not taxable as the benefit was contingent in nature and employee did not get the right to benefit at the time of contribution.
- Further, if at all taxes withheld in US was considered as income in India, then credit of such taxes (i.e. state taxes) could not be denied to the taxpayer.

Tribunal's ruling

- Taxes withheld in US would not constitute income that

accrued or arose outside India as per section 5(1)(c) of the Act as the same was not actually received by the taxpayer.

- The issue pertaining to FTC was remanded back to the Tax Officer for determination of quantum of FTC as per Article 25 of the tax treaty which would be restricted to tax payable on total income prior giving effect to FTC.
- Medicare paid outside India by the employer would not be taxable in India.

The takeaways

- This decision could provide relief to resident individuals

who travel abroad on long/ short term assignments and receive salary in India and outside. The taxable income of such employees in India would be reduced by the foreign taxes withheld.

- However, adoption of the decision in other jurisdictions needs to be evaluated on case to case basis as this could be challenged by the tax authorities.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact your local PwC advisor

Our Offices

Ahmedabad

1701, 17th Floor, Shapath V,
Opp. Karnavati Club,
S G Highway,
Ahmedabad – 380051
Gujarat
+91-79 3091 7000

Hyderabad

Plot no. 77/A, 8-2-624/A/1, 4th
Floor, Road No. 10, Banjara Hills,
Hyderabad – 500034,
Telangana
+91-40 44246000

Gurgaon

Building No. 10, Tower - C
17th & 18th Floor,
DLF Cyber City,
Gurgaon – 122002
Haryana
+91-124 330 6000

Bengaluru

6th Floor
Millenia Tower 'D'
1 & 2, Murphy Road, Ulsoor,
Bengaluru – 560 008
Karnataka
+91-80 4079 7000

Kolkata

56 & 57, Block DN.
Ground Floor, A- Wing
Sector - V, Salt Lake
Kolkata – 700 091,
West Bengal
+91-033 2357 9101/
4400 1111

Pune

7th Floor, Tower A - Wing 1,
Business Bay, Airport Road,
Yerwada, Pune – 411 006
Maharashtra
+91-20 4100 4444

Chennai

8th Floor
Prestige Palladium Bayan
129-140 Greams Road
Chennai – 600 006
Tamil Nadu
+91 44 4228 5000

Mumbai

PwC House
Plot No. 18A,
Guru Nanak Road (Station Road),
Bandra (West), Mumbai – 400 050
Maharashtra
+91-22 6689 1000

For more information

Contact us at
pwctr.knowledgemanagement@in.pwc.com

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