AAR rules on availability of relief under the tax treaty at withholding stage

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In brief

In a recent ruling[1], the Authority for Advance Rulings (AAR) has held that an employer was not required to withhold taxes on salary paid to a non-resident (NR) employee in India so long as the salary was not subject to tax in India.

Further, the AAR has also affirmed that in case of resident employees, who are subject to taxation on overseas income, the employer may allow credit of taxes paid in the foreign country while discharging the withholding taxes due in India.

In detail

Facts

- The applicant, an Indian company had sent its employees on an overseas assignment for rendering services to a foreign company.
- Apart from base salary and certain allowances in the foreign country, the employees continued to receive monthly salary and bonus in India.
- During the period of assignment, employees would be rendering services only in the foreign country and would not be rendering services in India.

Issues before the AAR

- In case of an employee who qualifies as a NR and the salary paid in India is not taxable in India, whether the applicant is under obligation to withhold taxes.
- Whether the applicant can allow a credit of the taxes paid in the foreign country by Resident and Ordinarily Resident (ROR) employees while discharging its obligation under section 192 of the Income-tax Act, 1961 (the Act).

Applicant's contentions

- The applicant was required to withhold taxes under section 192 of the Act only on income chargeable to tax at the average rate applicable to the employee.
- The salary subject to tax needs to be computed in accordance with the provisions of the Act after allowing various reliefs/ benefits including double taxation relief available under section 90 of the Act.
- In case of employees working simultaneously under more than one employer, the Act allows the employee to furnish the details of salary, tax withheld, etc., and such other particulars to either of the employers. The employer will consider the above information and withhold taxes after allowing a credit towards taxes paid in the foreign country.
- In the case of NR employees where services are rendered outside India, as the income accrues outside India, the same would not be subject to tax in India merely on the basis of receipt in India.[2]

[1] AAR No. 1299 of 2012 ruling dated 29 January 2018
[2] Section 2(45) read with section 5(2), section 9(1)(ii) and section 15

- In case of NR's where the employee rendered services only in the foreign country and qualifies as a tax resident of the said foreign country, the treaty confers the taxation rights to the foreign country.
- As the salary paid in India was not subject to tax in India, the applicant did not have an obligation to withhold tax in India.

Revenue's contentions

- In case of NRs, as the contract of employment had been entered in India and the employee–employer relationship with the Indian company subsists, the employment was exercised in India.
- The applicant/ deductor may not have had the opportunity or expertise to verify foreign tax credits at the time of withholding.
- Section 90A(4) of the Act mandates the requirement of furnishing a Tax Residency Certificate in case of treaty relief claim in certain situations.
- For the above reasons, treaty relief, if any, needs to be availed only at the time of filing of tax returns and would be allowed after due verification by the tax officer.

AAR's ruling

The AAR has ruled that section 192(1) of the Act is clear and casts an obligation on the employer to withhold tax on salary paid in India **only** if the same is chargeable to tax. Accordingly, the AAR has confirmed that taxes need not be withheld by the applicant for NR employees wherein the services were rendered outside India.

The AAR has also confirmed that the provisions of section 192(2) of the Act would apply in case of ROR employees. In such situations, the applicant would be required to collate details of salary earned, taxes withheld, etc., and allow appropriate credit for taxes paid outside India after due verification of the same.

The takeaways

The ruling has provided clarity on availing of treaty relief at the withholding stage. Although the ruling is fact specific, it provides persuasive value for Companies having outbound mobile employees to explore the possibility of availing treaty relief at the withholding stage. However, one has to carefully consider the following:

- Robust internal processes to be followed to avail treaty relief;
- To be mindful of penal consequences in case of inappropriate claim of treaty relief;
- Procedural challenges such as availability of overseas compensation and tax paid/ due details in a timely manner; and
- Reporting of treaty claim in quarterly withholding tax returns of the company.

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

Bengaluru

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

Chennai

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

Hyderabad

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

Kolkata

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

Mumbai

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

Gurgaon

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

Pune

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

For more information

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

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