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Taxability of salary received in India for overseas services and 'tax year' to be followed under a tax treaty when tax years of countries are different

In brief

In a recent decision in the case of Bholanath Pal[1] (the assessee), the Bangalore bench of the Income-tax Appellate Tribunal (the Tribunal) held that under the Income-tax Act, 1961 (the Act), salary of an individual for services rendered overseas cannot be taxed in India merely because it is received in India.

It also held that while applying the provisions of the Double Taxation Avoidance Agreement (tax treaty) with a foreign country which follows a tax year different from that of India, the corresponding period of Indian tax year needs to be considered.

Facts

- The assessee, an individual was an employee of Motorola India Pvt. Ltd. (Motorola India). During May 2000, he was transferred to Motorola Japan and he worked as its Managing Director until April 2006, when he repatriated to India.

- During the financial year (FY or tax year) 2005-06, he stayed in India for 83 days i.e. 45 days between April and December 2005 and 38 days between

[1] Bholanath Pal *v.* ITO [ITA No 10/Bang/2011, order dated 30 May 2012]

January and March 2006. Therefore, in terms of section 6(1) of the Act, he qualified to be a 'non-resident' of India for the FY 2005-06. The assessee's entire stay in India during his visits to India was in connection with Motorola Japan's business.

- Japan follows calendar year as its tax year. In terms of the domestic tax laws of Japan, the assessee qualified to be a 'resident' of Japan for the calendar year 2005 and a 'non-resident' of Japan for the calendar year 2006.

- During the period of his services to Motorola Japan, for the purposes of administrative convenience, his salary was paid in India through Motorola India. While paying the salary, Motorola India had deducted the applicable taxes and issued the assessee a tax withholding certificate in Form 16.

- In the tax return filed by the assessee for FY 2005-06, the assessee claimed the entire salary as exempt from tax in India.

Order of the Assessing officer (AO)

The AO did not accept the assessee's claim and held that:

- Under section 5(2) of the Act, salary is taxable in India since it is received in India.

- India-Japan tax treaty is applicable only to a resident of at least one of the countries. Therefore, it is not applicable to the assessee for the period from January to March 2006 (since he was a non-=resident both in Japan and India for this period).

- Salary received for the period between January and March 2006 is fully taxable.

- Salary relatable to the days of presence in India during the period from April to December 2005 (i.e. 45 days) is also taxable in India since the services are rendered in India.

Order of the CIT (A)

The Commissioner of Income-tax (Appeals) (CIT(A)) upheld the order of the AO, except for a minor relief, by taking a view that though the presence of the assessee in India between April and December 2005 is 45 days, he should be taxed only for 15 days, as the remaining 30 days might include annual leave and business trips which are not taxable.

Key issues before the Tribunal

- Whether the treaty between India and Japan is applicable to the assessee?

- Whether exemption under Article 15(1) of India-Japan tax treaty is allowable for the period from January to March 2006?

- Whether salary for the period of 83 days of business visits to India is exempt in India?

- Whether under the provisions of the Act, salary received in India by a non-resident for services rendered in Japan is taxable on receipt basis?

Assessee's contentions

Indian tax year is from April to March whereas that of Japan is from January to December. Japan considers an individual to be its tax resident if he is present in Japan for 183 days or more during its tax year. Since the assessee's stay in Japan during the calendar year 2006 was less than 183 days, he qualified to be a non-resident of Japan for that year. When there is a divergence in the taxable years between two treaty countries, the tax year of the country in which assessment is

made has to be considered. Otherwise, the benefits available under the tax treaty intended to avoid double taxation becomes infructuous. Therefore, in the present situation, the period of Indian tax year (April to March) has to be considered to determine residential status in Japan as well. Since the assessee's stay in Japan between April 2005 and March 2006 is more than 183 days, he should be considered to be a resident of Japan for the purposes of the tax treaty and hence claim of exemption under Article 15(1) of the tax treaty should be available.

Visits to India are in connection with Motorola Japan's business only. It is not for rendering employment services to Motorola India. In terms of Article 15(2) of the tax treaty, he is not taxable in India.

Clause (2) to section 5 of the Act provides for taxability of income of a non-resident of India if it is received in India. However, this clause is 'subject to the provisions of the Act'. Hence, the other provisions of the Act are empowered to exclude an income from the ambit of taxation even if the same is received in India. Section 15 of the Act is one such provision which provides for taxability of salary on accrual basis (except when it is received in advance or arrears). Hence, mere receipt cannot be the reason for taxation of salary accrued outside India.

Revenue's contentions

The Department's Representative (DR) argued that calendar year has to be considered as the tax year in Japan even for the purposes of the tax treaty and hence, tax treaty is not applicable for the period between 1 January and 31 December 2006. The DR also contended that the assessee has rendered employment services to Motorola India (as it has withheld taxes and issued Form 16 for the salary paid in India) and hence, exemption under Article 15(2) of the tax treaty is not applicable.

Tribunal's ruling

Since the period of Indian tax year and Japan tax year are different, for applying the treaty, the corresponding period of the Indian tax year has to be considered even for the purpose of determination of the tax residential status in Japan. The assessee qualifies to be a tax resident of Japan for the corresponding Indian tax year 2005-06 and hence, the provisions of treaty are applicable to him.

Under the provisions of the treaty between India and Japan, salary is taxable in the country in which the individual, being a tax resident, is rendering employment services. Salary cannot be taxed in India for the days of presence in India, caused by business visits as an employee of an overseas employer, as long as the stay does not exceed 183 days during the tax year.

In terms of Article 15(1) and 15(2) of the tax treaty, the assessee is entitled for exemption of tax in respect of his income from salary for the entire year.

Even under the provisions of the Act, the assessee is not taxable, as section 5(2) of the Act starts with the expression "subject to the provisions of this Act", and as such, cannot be the basis for taxation of salary accrued outside India.

For the aforesaid reasons, the Tribunal has ruled that the salary which was received by the assessee for the services rendered by him in Japan for the period 1 April 2005 to 31 March 2006, is not liable to tax in India.

Conclusion

The above decision of the Tribunal highlights the need for liberal interpretation of the treaty such that double taxation can be avoided. The emphasis laid by the Tribunal *vis-a-vis* the interpretation of the period applicable for 'tax year' for the purposes of the tax treaty, in situations where signing countries adopt different fiscal periods, makes this an important ruling in international taxation. Also, the decision can be considered as another step towards settling the domestic law controversy surrounding taxation of salary on accrual basis.

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Ahmedabad President Plaza, 1st Floor Plot No 36 Opp Muktidham Derasar Thaltej Cross Road, SG Highway Ahmedabad, Gujarat 380054 Phone +91-79 3091 7000	**Bangalore** 6th Floor, Millenia Tower 'D' 1 & 2, Murphy Road, Ulsoor, Bangalore 560 008 Phone +91-80 4079 7000	**Bhubaneswar** IDCOL House, Sardar Patel Bhawan Block III, Ground Floor, Unit 2 Bhubaneswar 751009 Phone +91-674 253 2279 / 2296	**Chennai** PwC Center, 2nd Floor 32, Khader Nawaz Khan Road Nungambakkam Chennai 600 006 Phone +91-44 4228 5000	**Hyderabad** #8-2-293/82/A/113A Road no. 36, Jubilee Hills, Hyderabad 500 034, Andhra Pradesh Phone +91-40 6624 6600
Kolkata South City Pinnacle, 4th Floor, Plot – XI/1, Block EP, Sector V Salt Lake Electronic Complex Bidhan Nagar Kolkata 700 091 Phone +91-33 4404 6000 / 44048225	**Mumbai** PwC House, Plot No. 18A, Guru Nanak Road - (Station Road), Bandra (West), Mumbai - 400 050 Phone +91-22 6689 1000	**Gurgaon** Building No. 10, Tower - C 17th & 18th Floor, DLF Cyber City, Gurgaon Haryana -122002 Phone : +91-124 330 6000	**Pune** GF-02, Tower C, Panchshil Tech Park, Don Bosco School Road, Yerwada, Pune - 411 006 Phone +91-20 4100 4444	For more information contact us at, pwctrs.knowledgemanagement@in.pwc.com