Will taxes paid in Japan by Japanese expatriates due to extended stay in Japan forced by Covid-19 be available for credit in India? – An analysis in view of recent court ruling

Introduction

In the year 2020, instead of Tokyo Olympics, whole world is witnessing an unprecedented situation created by COVID-19 pandemic. Nations had closed their borders and had imposed international and domestic travel restrictions, as a step to curb the spread of pandemic.

Government of India too had imposed complete lock down for three months starting from the last week of March, 2020 and had cancelled all international flights. Amidst this situation, most of the expatriate employees of the overseas entities including Japanese companies, working in India, had chosen to temporarily return to their home countries around the month of March/April, 2020.

Since, travel restrictions on international flights got extended, their stay in Japan exceeded 183 days during Financial Year ("FY") 2020-21.[1] During this period of extended stay in Japan, these expatriates have continued to render services to their Indian employer companies from Japan.

This peculiar situation caused by the pandemic has created a controversy in tax laws whereby Japanese expatriates holding tax residential status of Ordinary Resident ("OR") and Not Ordinary Residents ("NOR") for FY 2020-21 are getting taxed in India as well as in Japan. Taxed in India because of holding OR/NOR status and in Japan because of staying there for more than 183 days under the status of Non-Residents ("NR").

This has created a situation of double taxation for Japanese expatriates. Question here arises that will India (being the country where these employees are tax residents) grant foreign tax credit ("FTC") of Japanese taxes to these employees keeping in view the unpreceded situation whereby a person is forced to stay out of place of work?

In this regard, it would be pertinent to note the recent judgment of the Income Tax Appellate Tribunal, Delhi Bench ("ITAT Delhi) in the case of Kapil Dev Ranwan vs. DCIT [ITA No. 875/Del/2017]. In this case the ITAT Delhi allowed credit of taxes paid in UK to the taxpayer, who was resident of India in the concerned year.

In this article we have analysed this ruling to evaluate if the favourable ruling based on the India-UK Tax Treaty can be considered as applicable in case of the Japanese expatriates as well. If it is possible, then this may provide relief from double taxation both in India and Japan.

Let us look at the facts of the Kapil Dev Ranwan ruling

Taxpayer, a salaried employee of IBM India, was on an international assignment to the UK. His stay in the UK in the relevant year was 241 days, whereas he also held the status of ROR in India.

In his revised return the taxpayer claimed FTC of taxes withheld in the UK under section 90 of the Income-tax Act, 1961 read with Article 24 of the India-UK Tax Treaty. However, the tax officer did not allow the reliefs claimed by the taxpayer holding that the taxpayer

[1] In India FY 2020-21 is from April 1, 2020 to March 31, 2021

would fall under Article 16(2) of the India-UK Tax Treaty. The tax officer erroneously held that his stay in UK was less than 183 days and hence the income cannot be taxed in UK. Tax officer concluded that the taxpayer erroneously paid tax in the UK as he should be eligible for short stay exemption in the UK as per Article 16(2) of the India-UK Tax Treaty and hence the claim of FTC was denied to him.

Article 16(2) of the India-UK Tax Treaty provides that remuneration derived by a resident of a Contracting State (in this case India) in respect of an employment exercised in the other Contracting State (UK) shall not be taxed in that other State (UK) if:

a) his stay in that other State, is not more than 183 day in the relevant fiscal year;
b) the remuneration is paid by, or on behalf of, an employer who is not resident of that other State; and
c) the remuneration is not deductible in computing the profits of an enterprise chargeable to tax in that other State.

The first appellate authority sided with the conclusion of the tax officer. On second appeal, the Income Tax Appellate Tribunal (ITAT) Delhi decided the matter in favour of the taxpayer holding that he was entitled to FTC relief under Article 24 of the India-UK Tax Treaty. This decision of the ITAT was based on the conclusion that the taxpayer was not eligible for short stay exemption under Article 16(2) in the UK as the stay of the taxpayer in the UK exceeded 183 days.

Article 24 of the India-UK Tax Treaty provides that for a taxpayer who is resident in India in the relevant year, so as to be eligible to avail credit of the taxes paid outside India the following conditions are required to be met:

(a) Taxpayer derives items of income from the other treaty country.
(b) Such items of Income have been taxed in the treaty country.
(c) Such taxation is in accordance with the provisions of the convention.

The taxpayer in this case had met the above three conditions, and hence the decision was pronounced in his favour by the ITAT Delhi.

Facts of the case compared with the situation of the referred Japanese expatriates

Facts of the Kapil Dev Ranwan case	Facts of Japanese expatriates (under Covid-19 situation)
Taxpayer is a salaried employee of an Indian entity, who was seconded to work on an international assignment to the UK	Japanese expatriates are salaried employees working in India with the Indian employer under secondment arrangement with Japanese company
Residential status in India in the relevant year: ROR	This works only for expatriates holding ROR or NOR status during FY 2020-21
Duration of stay in the UK: More than 183 days due to employment	Duration of stay in Japan: More than 183 days due to Covid-19 situation
Salary income received in the UK in the course of employment which is with the UK company	Salary income received in Japan in the course of employment which is with the Indian company
Short stay exemption not available in the UK as the stay exceeds 183 days	Short stay exemption not available in Japan as the stay exceeds 183 days
The same income has also been subject to tax in India as the assignee is ROR in India	The same income is also taxable in India as the assignee is ROR/NOR in India during FY 2020-21

Conclusion

The ITAT Delhi in the case of Kapil Dev Ranwan has allowed claim of tax credit to the taxpayer for the taxes paid in UK on the doubly taxed income, relying on Article 24 of the India-UK Tax Treaty.

It may be noted that the above referred provisions of Article 16 and 24 of the India's treaty with the UK are identical to the relevant provisions of the treaty with Japan.

In view of the above, it is possible to argue that the conditions as have been met by the taxpayer in the said ITAT Delhi ruling are also met by the Japanese expatriates holding ROR/NOR status during the FY 2020-21. Hence, based on the similarity in the facts of the case vis-à-vis the current matter under discussion of the Japanese expatriates, as well as the similarity in the provisions of the India-UK and India-Japan Tax Treaty it may be claimed that the referred ruling will be applicable in case of the referred Japanese expatriates as well.

The matter is yet to be raised by the tax authorities and examined by the appellate authorities. however, it is important to note that to take benefit of this ruling and claiming FTC in India certain conditions should be satisfied. The most important being that, the total income of the Japanese expatriates holding status of ROR/NOR, received in India or in Japan, should be offered to tax in India and taxes should have been withheld in Japan. FTC claim is not available to Japanese expatriates whose residential status would be Non-Resident during the FY 2020-21.

Further it would be also relevant to note ITAT Mumbai Bench's verdict in the case of Amarchand & Magnaldas & Suresh A.Shroff & Co. vs. Assistant Commissioner of Income Tax (ITA No. 2613 (MUM) of 2019)] . The Assessing Officer ("AO") had denied the credit of taxes withheld by the client in Japan with respect to the professional fee earned by the taxpayer in Japan, stating that taxes had been deducted incorrectly as the provision of Article 12 for FTS does not apply in this case. The AO had further claimed that the correct provision would have been Article 14 for "Independent personnel services" which too becomes non-applicable to the assessee as they do not have a fixed base in Japan and hence do not fulfil the conditions. Mumbai ITAT allowed the tax credit to the assessee stating that "it was a position well visualized by the multilateral bodies, developing the treaty provision in question, that in all the cases in which the interpretation of the residence country about the applicability of a treaty provision is not the same as that of the source jurisdiction about that provision, and yet the source country has levied taxes-whether directly for by way of tax withholding, the tax credit cannot be declined" .

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