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THE FINANCIAL EXPRESS



Tax
talk

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Claim relief on hypothetical tax amount

Globalisation is a reality and with it comes the movement of employees around the world. Due to differences in tax regimes around the world and the dreaded fear of double taxation, "income tax" rings alarm bells for a mobile employee. To circumvent this, one must look at tax equalisation and the related hypothetical tax and tax perquisite (tax paid by the employer on behalf of the employee).

Hypothetical tax refers to the home country tax of the employee, which is withheld from salary during the tenure of the host country assignment. As the name suggests, these are not actual taxes to be deposited with the revenue authorities. Instead, it represents the amount that an employee would have borne had he or she continued to work in his or her home country. The home country salary is

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reduced by 'hypothetical tax' to arrive at the 'net salary'.

For instance, consider an employee moving from Singapore to India, with an annual salary of S\$200,000, on which the tax incidence in Singapore is S\$40,000 (at 20% tax). Assuming there is no other income taxable in India, his Indian tax burden on this income is S\$60,000 (at 30% tax). Now, under tax equalisation, the employee will continue to bear only S\$40,000 as hypothetical taxes and the incremental tax liability of S\$20,000 for Indian taxes and the actual Singapore taxes would be met by the company. Thus, the employee would be tax indifferent and his tax burden would be limited to the hypothetical tax only.

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From a tax perspective, the question is whether the hypothetical tax constitutes income. Some past rulings – for instance, the Mumbai Income Tax Tribunal judgment (Jaydev H Raja) and the recent 2009 Delhi High Court judgment (Dr Percy Batlivala) – held that hypothetical tax is not an income accruing in India and can be claimed as a deduction by the employee from his gross salary.

There are opposing views and judgements on whether the hypothetical tax is a set-off from the gross salary or the tax perquisite.

While the above decisions and discussions are restricted to the tax treatment of hypothetical taxes in case of individuals coming on assignment to India, this concept also holds much practical relevance in the case of out-bound Indians. However, this needs to be discussed and debated in view of the stringent interest and penal laws linked to employer withholding.

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