CASE STUDY – 1 TRANSFER PRICING

'A' Ltd., an Indian company, was incorporated in the year 2009. It is a wholly owned subsidiary of A Inc, USA. A Ltd. is engaged in the business of manufacturing and selling virtual reality cameras. During the previous year 2019-20, A Ltd. entered into various transactions with the following enterprises for purchase of raw materials, use of technology and sale of finished goods. The earnings before interest, dividend, tax and amortization of A Ltd for Financial year 2019-20 is ₹ 200 crores. The details of the transactions entered into by A Ltd. during F.Y.2019-20 are given hereunder:

S. No	Transaction	Enterprise	Amount (₹ in crores)
1	Purchase of raw-materials	AA Ltd, China	150
2	Payment of royalty	A Inc, USA	5
3	Sale of finished goods	AAA Ltd, Taiwan	50

Prior to F.Y.2019-20, A Ltd. had obtained loan of ₹ 1000 crores @8% from A LLC, Cyprus in April, 2018.

The following additional information pertaining to loans obtained by A Ltd. is provided for the previous year 2019-20:

- Interest of ₹ 80 crores paid to A LLC, Cyprus on the loan of ₹ 1000 crores. The book value of the total assets of A Ltd is ₹ 1800 crores.
- A Ltd. obtained loan of ₹ 100 crores from Bank of Chennai, India based on a guarantee provided by A Inc., USA. Interest of ₹ 8 crores paid on such loan and guarantee fee of ₹ 50 lacs paid to A Inc., USA.
- A Ltd. obtained loan of ₹ 50 crores from TN Mercantile Bank, India based on a letter of comfort provided by Mr. Balaji, who is an Indian resident and director of A Ltd. Interest of ₹ 4 crores is paid towards such loan.
- A Ltd. obtained an independent loan of ₹ 300 crores from Union City Bank, India for which interest of ₹ 3 crores has been paid to the bank.
- A Ltd. obtained loan of ₹ 50 crores from Bank of Taiwan, India Branch. Guarantee was provided by AAA Ltd., Taiwan. Interest paid for the concerned year is ₹ 3 crores.

Guarantee fees paid to AAA Ltd. is ₹ 25 lakhs. A Ltd. holds shares carrying 25% voting power in AAA Ltd., Taiwan.

- A Ltd. obtained interest-free loan of ₹ 50 crores from A Pty, Singapore. Out of the 25 directors of A Pty., Singapore, 10 are appointed by A Ltd.

- A Ltd. obtained foreign currency loan of $ 10 million from Wells Cargo Bank of USA, in USA, based on a back to back deposit made by A Inc. USA to the tune of $ 5 million in the bank. Interest of ₹ 6 crores is paid on such loan.

- A Ltd. obtained foreign currency loan of $ 20 million from Bank of USA, in USA, based on a back to back deposit made by A Inc., USA to the tune of $ 20 million in the bank. Interest works out to ₹ 12 crores.

- A Ltd. had to incur a sum of ₹ 1 crore as an interest towards the delayed payment to AA Ltd. China, being its creditor for supply of raw material. 90% of raw materials required by A Ltd. is supplied by AA Ltd., China. The price and other conditions for supply of raw material are influenced by AA Ltd., China.

Based on the above facts, you are required to answer the following questions:

I. OBJECTIVE TYPE QUESTIONS

Write the most appropriate answer to each of the following questions by choosing one of the four options given. *(5 x 2 = 10 Marks)*

1. Which of the following enterprises are associated enterprises/deemed associated enterprises of A Ltd.?

   (a) A Inc., USA; A LLC, Cyprus; and AAA Ltd., Taiwan.

   (b) A Inc., USA; A LLC, Cyprus; and A Pty, Singapore.

   (c) A Inc., USA; A LLC, Cyprus; and AA Ltd., China.

   (d) A Inc., USA; AA Ltd., China; and A Pty, Singapore.

2. If A Ltd. does not furnish transfer pricing report for F.Y.2019-20, what would be the quantum of penalty imposable under the Income-tax Act, 1961 for such a failure?

(a) 1% of the value of international transaction

(b) 2% of the value of international transaction

(c) ₹ 1 crore – fixed penalty

(d) ₹ 1 lakh – fixed penalty

3. In a case where primary adjustment to transfer price is made *suo motu* by A Ltd., the time limit for repatriation of "excess money" is -

(a) 60 days from 30^{th} September of the Assessment Year

(b) 90 days from 30^{th} September of the Assessment Year

(c) 60 days from 30^{th} November of the Assessment Year

(d) 90 days from 30^{th} November of the Assessment Year

4. The excess money which is available with the AE, if not repatriated to India within the prescribed time, shall be deemed to be an advance made by A Ltd. to such AE, if the primary adjustment to transfer price, made by it *suo motu* in its return of income, is in respect of -

(a) A.Y.2016-17 and the amount of primary adjustment is ₹ 2 crores.

(b) A.Y.2018-19 and the amount of primary adjustment is ₹ 1 crore

(c) A.Y.2018-19 and the amount of primary adjustment is ₹ 1.05 crore

(d) A.Y.2017-18 and the amount of primary adjustment is ₹ 1 crore.

5. Which of the following approaches does India follow in relation to secondary adjustments?
(a) Deemed equity approach
(b) Deemed dividend approach
(c) Deemed loan approach
(d) Either (a) or (c)

II. DESCRIPTIVE QUESTIONS

1. Based on the details provided in respect of interest paid by A Ltd., determine the amount of interest to be disallowed for A.Y.2020-21 under the relevant provisions of the Income-tax Act, 1961 relating to limitation of interest deduction, giving reasons for treatment of each item of interest. Consequently, determine the permissible interest deduction while computing income under the head "Profits and gains of business or profession". *(8 Marks)*

2.

   (i) Which Action Plan of BEPS is based on thin capitalization? Mention the provision incorporated in the Income-tax Act, 1961 in line with this Action Plan. *(2 Marks)*

   (ii) A Ltd. is contemplating to stop the current business activity and start a new business vertical. In this regard, it wants to know whether the interest disallowed under the relevant provision of the Income-tax Act, 1961 can be carried forward to next year and whether it could be set-off against the income of the new business.

   (2 Marks)

3. A Ltd, being a wholly owned subsidiary of a US entity A Inc., wants to understand whether transfer pricing provisions under the Income-tax Act, 1961 will trigger if it receives interest free loan from its foreign AE parent A Inc., USA. Advise. *(3 Marks)*

ELECTIVE PAPER 6C- INTERNATIONAL TAXATION

SUGGESTED SOLUTION – CASE STUDY 1

I. ANSWERS TO OBJECTIVE TYPE QUESTIONS

1. (c) A Inc., USA; A LLC, Cyprus; and AA Ltd., China.

2. (d) ₹ 1 lakh – fixed penalty

3. (d) 90 days from 30th November of the assessment year

4. (c) A.Y.2018-19 and the amount of primary adjustment is ₹1.05 crore

5. (c) Deemed Loan approach

II. ANSWERS TO DESCRIPTIVE QUESTIONS

1. Section 94B is applicable to an Indian company or a permanent establishment of a foreign company in India, being the borrower who pays interest in respect of any form of debt issued by

- non-resident, being an associated enterprises (AE) of such borrower or
- by a lender which is not an AE but where the AE provides either implicit or explicit guarantee to such lender or deposits a corresponding and matching amount of funds with the lender, then such debt would be deemed to have been issued by an AE.

In order to determine the interest disallowance amount under Section 94B, the interest paid to non-resident AEs and deemed AEs needs to be determined. Payment of interest to resident AEs is not to be considered for disallowance since the interest payment made to non-resident AEs alone are to be taken into account for such purpose. In the present case, the interest disallowance and permissible interest deduction under the head "Profits and gains from business or profession" would be -

Particulars	Amount (₹ in crores)

Interest paid to A LLC Cyprus [See Note (i)]	80.00
Interest paid to Bank of Chennai based on guarantee provided by A Inc, USA [See Note (ii)]	8.00
Guarantee Fee paid to A Inc, USA [See Note (iii)]	0.50
Interest paid to TN Mercantile bank based on letter of comfort by director of A Ltd. [See Note (iv)]	Nil
Interest paid to Union City Bank, India [See Note (v)]	Nil
Interest paid to Bank of Taiwan [See Note (vi)]	Nil
Guarantee fee paid to AAA Ltd., Taiwan [See Note (vi)]	Nil
Interest paid to Wells Cargo Bank based on deposits made by A Inc, USA [See Note (vii)]	Nil
Interest paid to Bank of USA based on deposits made by A Inc, USA [See Note (viii)]	12.00
Interest paid to AA Ltd, China, being interest on delayed payment to creditor [See Note (ix)]	1.00
Interest paid or payable to non-resident AE	**101.50**
EBIDTA	200.00
Excess Interest: lower of the following would be disallowed	**41.50**
- Interest paid or payable to non-resident AE in excess of 30% of EBIDTA [₹ 101.50 crores - ₹ 60.00 crores] ₹ 41.50 crores	
- Interest paid or payable to non-resident AE ₹ 101.50 crores	
Therefore, interest paid or payable allowable as deduction under the head "Profits and gains of business or profession" would be ₹ 76.25 crores [₹ 60 crores (₹ 101.50 crores – ₹ 41.50 crores), being the amount paid or payable to non-resident AE ***plus*** ₹ 16.25 crores, being the amount paid to other entities].	76.25

Notes:

(i) Interest paid to a non-resident AE falls within the scope of section 94B. A LLC is deemed to be an AE of A Ltd., since the loan advanced by it constitutes not less than 51% of the book value of total assets of A Ltd. Hence, interest paid to A LLC is to be considered for the purpose of limitation of interest deduction under section 94B.

(ii) The proviso to Section 94B(1) states "where the debt is issued by a lender which is not associated but an associated enterprise either **provides an implicit or explicit guarantee to such lender** or deposits a corresponding and matching amount of funds with the lender, such debt shall be **deemed to have been issued by an associated enterprise**."

Since A Ltd., India is a wholly owned subsidiary of A Inc., USA, A Ltd. and A Inc. are AEs.

Thus, the debt issued by Bank of Chennai would be deemed as issued by the A Inc. USA, being the AE, hence, the amount of interest paid on such debt has to be considered for the purpose of limitation of interest deduction under section 94B.

(iii) As per section 94B(5)(ii), debt means, *inter alia,* any loan that gives rise to interest which is deductible while computing business income.

Though guarantee fee is not specifically referred to in the meaning of the term "debt" defined under section 94B(5)(ii), the term 'interest' is defined in section 2(28A) of the Income-tax Act, 1961 to mean interest payable in any manner in respect of any moneys borrowed or debt incurred (including a deposit, claim or other similar right or obligation) and includes any service fee or other charge in respect of the moneys borrowed or debt incurred or in respect of any credit facility which has not been utilized." Therefore, given the wide definition that interest partakes, guarantee fee can be classified as interest. Accordingly, the same has to be considered for the purpose of limitation of interest deduction under section 94B.

(iv) Since the loan is obtained based on a letter of comfort provided by a resident director of A Ltd., the said interest will not be factored for the purpose of excess interest disallowance under section 94B.

(v) Since loan was obtained by A Ltd independently from a third-party lender Union City Bank of India, interest paid on such loan shall not be considered for the purposes of Section 94B, as the same is paid to an enterprise which is not a nonresident AE.

(vi) Since A Ltd.'s voting power in AAA Ltd., Taiwan is less than 26%, AAA Ltd., Taiwan is not an AE of A Ltd. Since loan was obtained by A Ltd from Bank of Taiwan, Indian branch, for which guarantee was given by an enterprise, not being an AE, this interest shall not be considered for the purposes of section 94B. Likewise, guarantee fee paid to AAA Ltd. shall also not be considered for the purposes of section 94B.

(vii) The proviso to section 94B(1) provides that "**where the debt is issued by a lender** which is not associated **but an associated enterprise** either provides an implicit or explicit guarantee to such lender or **deposits a corresponding and matching amount of funds with the lender**, such debt shall be deemed to have been issued by an associated enterprise."

Here, the loan of $ 10 million taken by A Ltd and the amount of $ 5 million deposited by A Inc., USA with Wells Cargo Bank can be viewed as not corresponding and matching to the amount of issued debt, hence, such debt is **not** deemed to have been issued by an AE.

Alternate view – *It is also possible to take a view that interest on loan to the extent of the deposit made by the non-resident AE has to be considered for the purposes of section 94B. In such a case, ₹ 3 crores being interest corresponding to loan of $ 5 million would be considered for the purposes of section 94B.*

(viii) In the given case, the loan taken by A Ltd and the amount deposited by A Inc. USA in Bank of USA is US $ 20 million. Since A Inc. USA, being an AE has **deposited a corresponding and matching amount of funds** with the lender, the debt issued by Bank of USA shall be deemed to have been issued by A Inc., being an AE. Thus, the amount of interest paid on such debt to Bank of USA would be considered for the purpose of limitation of interest deduction under section 94B.

(ix) Section 94B(5)(ii) defines the term “debt” as any loan, financial instrument, finance lease, financial derivative, or any arrangement that gives rise to interest, discounts or other finance charges that are deductible in the computation of income chargeable under the head "Profits and gains of business or profession".

In the present case, interest paid is towards delayed payment to AA Ltd China, being its creditor for supply of raw material can be considered as an arrangement that gives rise to interest or other finance charges that are deductible in computation of Income under the head "Profits and gains of business or profession[1]".

Further, since 90% of raw materials required by A Ltd. is supplied by AA Ltd., China and price and other conditions for supply of raw material are also influenced AA Ltd., China, AA Ltd., is deemed to be an AE of A Ltd. Thus, the amount of interest paid towards delayed payment has to be considered for the purpose of limitation of interest deduction under section 94B.

ALTERNATE ANSWER:

Section 94B(1) of the Income-tax Act, 1961, provides that notwithstanding anything contained in this Act, where an Indian company, or a permanent establishment of a foreign company in India, being the borrower, incurs any expenditure by way of interest or of similar nature exceeding one crore rupees which is deductible in computing income chargeable under the head "Profits and gains of business or profession" in respect of any debt issued by a non-resident, being an associated enterprise of such borrower, the interest ***shall not be deductible*** *in computation of income under the said head to the extent that it arises from excess interest, as specified in sub-section (2).*

As per section 94B(2), the excess interest shall mean an amount of ***total interest paid or payable*** *in excess of 30% of earnings before interest, taxes, depreciation and amortization (EBITDA) of the borrower in the previous year or*

[1] *CIT v. Vijay Ship Breaking Corporation decision of Supreme Court [2008] 175 Taxman 77 (SC)*

interest paid or payable to associated enterprises for that previous year, whichever is less.

As per Explanatory Memorandum to the Finance Bill, 2017, the interest expenses claimed by an entity to its associated enterprises shall be restricted to 30% of its earnings before interest, taxes, depreciation and amortization (EBITDA) or interest paid or payable to associated enterprise, whichever is less. It implies that "excess interest" means the amount

- *interest paid or payable by an entity to its non-resident associated enterprises in excess of 30% of earnings before interest, taxes, depreciation and amortization (EBITDA) of the borrower in the previous year or*
- *interest paid or payable to non-resident associated enterprises for that previous year, whichever is less.*

The intent behind insertion of this section also appears to restrict the interest paid to nonresident AE to 30% of EBITDA. In the above solution, the excess amount is computed in line with the intent expressed in section 94B(1) read with the Explanatory Memorandum.

However, an alternate view may also be possible on the basis of the interpretation as per the plain reading of section 94B(2).

On a plain reading of provisions of section 94B(2), it appears that the "excess amount" has to be computed by taking–

- ***total interest paid or payable** by the borrower in excess of 30% of earnings before interest, taxes, depreciation and amortization (EBITDA) of the borrower in the previous year or*
- *interest paid or payable to associated enterprises for that previous year, whichever is less.*

Accordingly, the interest disallowance and amount of interest paid or payable by A Ltd allowable as deduction under the head "Profits and gains of business or profession" would be –

Particulars	**Amount (₹ in crores)**
Interest paid to A LLC Cyprus	80.00

Interest paid to Bank of Chennai based on guarantee provided by A Inc, USA	8.00
Guarantee Fee paid to A Inc, USA	0.50
Interest paid to TN Mercantile bank based on letter of comfort by director of A Ltd.	4.00
Interest paid to Union City Bank, India	3.00
Interest paid to Bank of Taiwan	3.00
Guarantee fees paid to AAA Ltd., Taiwan	0.25
Interest paid to Wells Cargo Bank based on deposits made by A Inc, USA	6.00
Interest paid to Bank of USA based on deposits made by A Inc, USA	12.00
Interest paid to AA Ltd., China being interest on delayed payment to creditor	1.00
Total interest paid or payable by A Ltd.	**117.75**
Interest paid or payable to non-resident AE (computed above)	**101.50**
EBIDTA	200.00
Excess Interest: lower of the following would be disallowed,	**57.75**
- Total interest paid or payable in excess of 30% of ₹ 57.75 crores EBIDTA **[i.e., ₹ 117.75 crores – ₹ 60.00 crores]**	
- Interest paid or payable to non-resident AE ₹ 101.50 crores	
Therefore, interest paid or payable allowable as deduction under the head “Profits and gains of business or profession” would be ₹ 60 crores (₹117.75 crores – ₹ 57.75 crores)	60.00

2. **(i)** Multinational groups are often able to structure their financing arrangements to maximize these benefits. To prevent tax erosion on account of such arrangements, country's tax administrations often introduce rules that place a limit on the amount of interest that can be deducted in computing a company's profit for tax purposes. Such rules are designed to counter cross-border shifting of profit through excessive interest payments, and thus aim to protect a country's tax base. Under the initiative of the G-20 countries, the

Organization for Economic Co-operation and Development (OECD) in its Base Erosion and Profit Shifting (BEPS) project had taken up the issue of base erosion and profit shifting by way of excess interest deductions by the MNEs in its Action plan 4. The OECD has recommended several measures in its final report to address this issue. In view of the above, section 94B has been inserted in the Income-tax Act, 1961, in line with the recommendations of OECD BEPS Action Plan 4, to provide that interest paid or payable by an entity to its non-resident associated enterprises shall be restricted to 30% of its earnings before interest, taxes, depreciation and amortization (EBITDA) or interest paid or payable to non-resident associated enterprises, whichever is less.

(ii) Section 94B(4) provides that interest amount disallowed in a particular assessment year shall be carried forward and allowed as deduction against the profits and gains, if any, ***of any business*** carried on by the assessee. Therefore, based on the same, it can be concluded that A Ltd shall be eligible to carry forward the disallowed interest amount and claim the same as a deduction against the profits and gains from any business or profession carried on by it.

3. Indian Transfer Pricing regulations provide that any income arising from an international transaction shall be computed having regard to arm's length price. However, section 92(3) provides that transfer pricing provisions shall not apply in cases where such application results an increase in the expenditure or decrease in the revenue of the Indian entity. In the given case, as interest payment to the AE would only result in an increase in the expenditure of A Ltd. and subsequent reduction of profits, transfer pricing provisions under the Income-tax Act, 1961 shall not apply.

ELECTIVE PAPER 6C: INTERNATIONAL TAXATION

CASE STUDY - 2

Mr. Arjun Batra, a resident Indian, aged 58, has business interests in India and in some other foreign nations also. The Finance Manager has sent a mail, furnishing details of income earned in India and outside India during the P.Y. 2019-20.

Income earned in foreign nations

Arjun has derived income from two other nations E and F, with which India does not have DTAA.

The particulars of income earned in the two nations E and F are as under:

Particulars of Income	(Rs. in lakhs)	
	E	F
Gross rental receipts from commercial property	2	3
Share income from Partnership firm (loss)	-1	-1.5
Business income	2.2	3.3
STCG from sale of vacant site on 1.11.2019	15	Nil
Agricultural Income	1.2	1.8

Income earned in India

Particulars	(Rs. in lakhs)
Business income	1.5
Long-term capital gains on sale of residential house in Mumbai on 1.3.20	45
Agricultural income from lands in Bengaluru	3.2

The Manager (Finance) has informed that following investments were made in India during the year ended 31-3-2020:

Particulars of Income	(Rs. In lakhs)
Purchase of residential house at Jaipur on 22-3-2020 in wife's name	37
Contribution to PPF	1.50

Income-tax rate structure:

Country E

(Rs.)	Tax rate
Upto Rs.3 lakhs	Nil
Rs.3 to Rs.6 lakhs	15%
Above Rs.6 lakhs	22%

Country F

Flat 27% without any basic exemption limit.

Tax treatment/ concessions in other nations

(i) No statutory allowance/deduction in respect of house property income in Country E as well as Country F.

(ii) Loss from firm can be set off against other business income in Country F only.

(iii) Agricultural income is exempt in Country E only.

A Search is conducted by the Income-tax department in India in the premises of Mr. Arjun Batra on 30.4.2020 and it has come to the notice of the department that Mr. Arjun Batra has earned income to the tune of Rs.5 lakhs in country E during the previous year 2018-19.

Further, Income-tax department noticed the existence of undisclosed gold jewellery which was purchased on 21-4-2018. Neither this income, nor the asset in question, has any bearing to income chargeable under the provisions of the Income-tax Act, 1961.

The jewellery had been purchased for Rs.4.2 lakhs. Its value as per report of Valuer recognized by the Government is Rs.5.2 lakhs as on 1-4-2020 and Rs.5.3 lakhs as on 30-4-2020.

I. MULTIPLE CHOICE QUESTIONS

Write the most appropriate option to each of the following questions by choosing one of the four options given. Each question carries two marks.

1. Let us say Arjun has earned income from house property in Country X which is taxable under the domestic tax laws of Country X. Such income is also taxable in the hands of Arjun in India, since he is resident in India. Assume that the DTAA between India and Country X provides for taxation of such income in the source state only. In this situation,

   (a) Such income is exempt in India by virtue of the DTAA between India and Country X

   (b) Such income will be exempt in India, provided that Arjun obtains a Tax Residency Certificate from the Government of Country X.

   (c) Such income is taxable in India, since Arjun is resident in India.

   (d) Such income is taxable in India, since the Income-tax Act, 1961 does not provide for exemption of income from house property outside India.

2. Assume that Arjun has earned an income of Rs.4 lakhs by way of lump sum consideration for copyright of book from a publisher in Country Y, with which India does not have a DTAA. The same has been taxed at a flat rate of 5% in Country Y. In India, his gross total income is Rs.7 lakhs. The double taxation relief available is -

   (a) Rs.20,000

   (b) Rs.5,000

   (c) Rs.7,800

   (d) Rs.1,950

3. Assume that Arjun had acquired a factory building in Country Z for Rs.24 lakhs on 21-3-2017, for which Rs.18 lakhs was invested from explained sources which had suffered tax in India. This asset comes to the knowledge of the Assessing Officer on 20-5-2019. The market value of the asset as on 1-4-2019 is Rs.40 lakhs. The value of undisclosed foreign asset as per Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 (BM Act) is

   (a) Rs.40 lakhs

(b) Rs.22 lakhs

(c) Rs.10 lakhs

(d) Rs.6 lakhs

4. Continuing the facts of MCQ 3., assume that the Assessing Officer has issued the notice under BM Act on 30-5-2020. The time limit for completion of assessment under the BM Act is

(a) 31-3-2023

(b) 30-5-2022

(c) 31-3-2024

(d) 30-5-2023

5. In respect of the foreign income and foreign asset unearthed by the income-tax department during the search on 30-4-2020, which of the following statements are correct, with reference to the taxability of the impugned items in the hands of Mr. Arjun in India under the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 (BM Act)?

(i) Both undisclosed income and undisclosed asset would be taxable in the P.Y.2020-21

(ii) Both undisclosed income and undisclosed asset would be taxable in the P.Y.2018-19

(iii) Undisclosed income is taxable in the P.Y.2018-19 and undisclosed asset in the P.Y.2020-21

(iv) Undisclosed asset is taxable in the P.Y.2018-19 and undisclosed income in the P.Y.2020-21

(v) The value of undisclosed asset is Rs.4.2 lakhs

(vi) The value of undisclosed asset is Rs.5.2 lakhs

(vii) The value of disclosed asset is Rs.5.3 lakhs

The correct answer is –

(a) (i) and (vi)

(b) (ii) and (v)

(c) (iii) and (vi)

(d) (iv) and (vii)

II. DESCRIPTIVE QUESTIONS

1. Ascertain the income-tax liability of Mr. Arjun Batra for the assessment year 2020-21. ***(15 marks)***

ELECTIVE PAPER 6C: INTERNATIONAL TAXATION SOLUTION TO CASE STUDY 2

I. ANSWERS TO MCQs (Most appropriate answers)

1. (a)
2. (d)
3. (c)
4. (a)
5. (c)

II. ANSWERS TO DESCRIPTIVE QUESTION

Answer to Q.1:

Computation of total income of Mr. Arjun Batra for the A.Y.2020-21

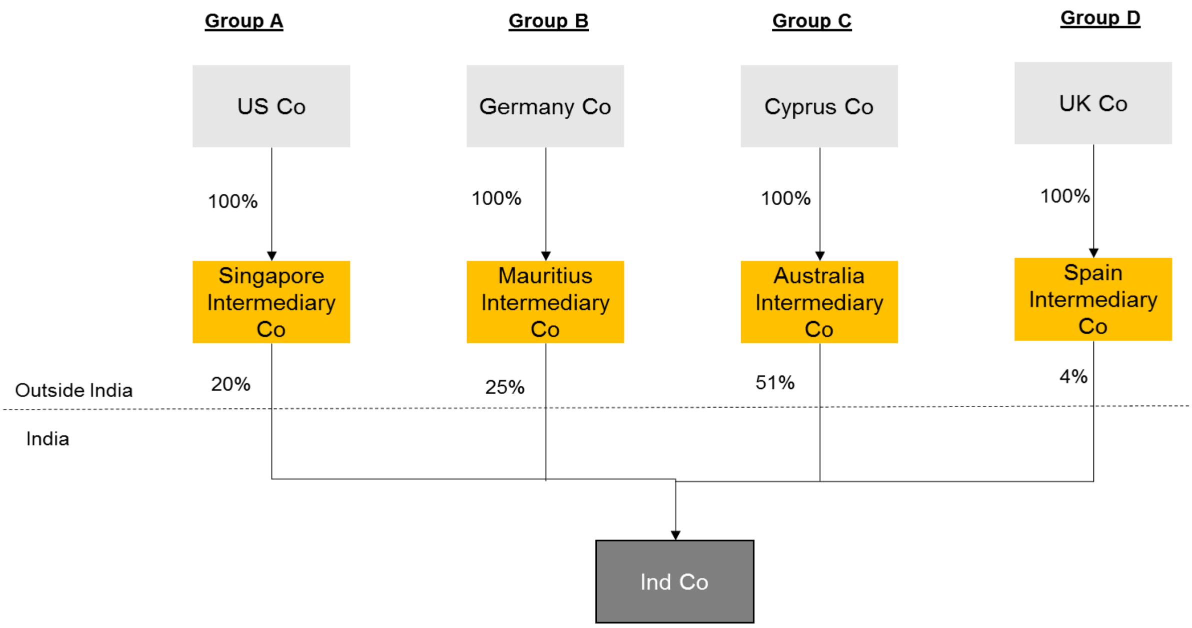
Particulars	**Rs. In lakhs**	
Income from house property		
Rent received [Rs.2 lakhs +Rs.3 lakhs]	5.0	
Less: Deduction u/s 24(a) at 30% of NAV	1.5	3.5
Profits and gains of business or profession		
Own business income [Rs.2.2 lakhs (Country E) + Rs.3.3 lakhs (Country F) + Rs.1.5 lakhs (India)]	7.0	
Loss from partnership firm in Country E [Rs.1 lakh] and Country F [Rs.1.5 lakhs]	(2.5)	4.5
[Share of profit from foreign firm is not exempt. Hence, loss can be set-off against business income]		
Capital gains		
Long-term capital gains on transfer of residential house in Mumbai	45.0	
Less: Exemption u/s 54 – Purchase of residential house in Jaipur in wife's name within two years from the date of transfer	37.0	
Net long-term capital gains	8.0	
Short-term capital gains on transfer of vacant site in Country E	15.0	23.0
Income from other sources		
Agricultural income in Country E and Country F [Rs.1.2 lakhs + Rs.1.8 lakhs]	3.0	
Agricultural income from lands in Bengaluru [exempt u/s 10(1) since earned in India]	-	3.0
Gross Total Income		**34.0**
Less: Deduction under Chapter VI-A: Section 80C – PPF		1.5
Total Income		**32.5**

Computation of tax liability of Mr. Arjun Batra for A.Y.2020-21	Rs.
Tax on Rs.35.7 lakhs, being non-agricultural income [Rs.32.5 lakhs] + agricultural income [Rs.3.2 lakhs]	
Tax on LTCG of Rs.8 lakhs@20%	1,60,000
(+) Tax on other income of Rs.27.7 lakhs	6,43,500
	8,03,500
(-) Tax on Rs.5.7 lakhs, being agricultural Income [Rs.3.2 lakhs] + Basic Exemption Limit [Rs.2.5 lakhs]	26,500
	7,77,000
Add: Health and education cess @4%	31,080
	8,08,080
Indian rate of tax = 8,08,080 x 100/32,50,000 = 24.864%	
Less: Rebate u/s 91 on income of Country E + Country F	4,49,179
Tax payable in India	**3,58,901**
Tax payable (Rounded off)	**3,58,900**
<u>Computation of average rate of tax in Country E</u>	**Rs. in lakhs**
Gross rental receipts from commercial property [No deduction is allowed from this in Country E]	2.0
Share income from partnership firm (loss) to be ignored	-
Business income	2.2
STCG from sale of vacant site on 1-11-2018	15.0
Agricultural income [Exempt in Country E]	-
Total income	**19.2**
<u>Rates of tax in Country E</u>	
Upto 3 lakhs Nil	-
3 to 6 lakhs 15%	0.45
Above 6 lakhs 22%	2.904
	3.354
Average rate of tax in Country E = 3.354 x 100/19.2 = 17.469%	
Doubly Taxed Income (in Country E)	**Rs. in lakhs**
Gross rental receipts form commercial property (Rs.2 lakhs – Rs.0.6 lakhs, being 30% of Rs.2 lakhs)	1.4
Share of loss from partnership firm	(1.0)
Business income	2.2

STCG from sale of vacant site on 1-11-2018	15.0
	17.6
Double Taxation Relief at India rate of tax or rate of tax in Country E, whichever is lower	17.469%
Double Taxation Relief = 17.469% of Rs.17.6 lakhs = Rs.3,07,454	
Doubly Taxed Income (in Country F)	
Gross rental receipts from commercial property [Rs.3 lakhs (-) 30% of Rs.3 lakhs]	2.1
Business income	3.3
Share of loss from partnership firm	(1.5)
Agricultural income	1.8
Total income	**5.7**
Rate of Tax in Country F	27%
Double Taxation Relief at Indian rate of tax (24.864%) or rate of tax in Country F (27%), whichever is lower	24.864%
Double Taxation Relief = 24.864% of Rs.5.7 lakhs = Rs.1,41,725	
Double Taxation Relief [Country E & Country F] = Rs.3,07,454 + Rs.1,41,725	4,49,179

CASE STUDY - 3

Ind Co is an unlisted, private limited, Indian company incorporated under the Companies Act, 1956 and is engaged in the business of the manufacturing of automobile components. Ind Co is held by 4 groups of shareholders (Groups A, B, C and D) in different proportions. Groups A, B, C and D are headquartered in US, Germany, Cyprus and UK respectively. However, these headquarter companies do not hold shares of Ind Co directly, but hold the shares through intermediary companies in Singapore, Mauritius, Australia, Spain respectively, as depicted in the shareholding pattern below:



The date of acquisition of shares by each of the Groups is given below:

Date of acquisition			
Group A	**Group B**	**Group C**	**Group D**
Date of acquisition by US Co in Singapore Intermediary Co - 1 April 2013	Date of acquisition by Germany Co in Mauritius Intermediary Co - 1 April 2013	Date of acquisition by Cyprus Co in Australia Intermediary Co - 1 April 2013	Date of acquisition by UK Co in Spain Intermediary Co - 1 April 2013
Date of acquisition by Singapore Intermediary Co in Ind Co - 1 March 2018	Date of acquisition by Mauritius Intermediary Co in Ind Co -1 April 2013	Date of acquisition by Australia Intermediary Co in Ind Co - 1 April 2013	Date of acquisition by Spain Intermediary Co in Ind Co - 1 April 2013

Each of the Groups are now proposing to restructure their shareholding in Ind Co. Alternatively, they are also considering the proposal of exiting from Ind Co by transferring their stake to a buyer that is to be identified. The restructuring/ exit is proposed to be undertaken on 31 May 2020 by each of the Groups.

The last accounting year end (for the purpose of complying with the tax laws of the territory) for each of the entities and their respective book values of assets as on such date are provided below:

Group A	Group B	Group C	Group D
US Co – 31	Germany Co – 31 March	Cyprus Co – 31 March 2020	UK Co - 31 March

December 2019 Book value – INR 500 crores	2020 Book value – INR 200 crores	Book value – INR 100 crores	2020 Book value – INR 100 crores
Singapore Intermediary Co – 30 June 2019 Book value – INR 25 crores	Mauritius Intermediary – 31 December 2019 Book value – INR 25 crores	Australia Intermediary Co – 31 December 2019 Book value – INR 100 crores	Spain Intermediary Co - 31 March 2020 Book value – INR 7 crores

Ind Co follows 1 April - 31 March as the Financial Year and the book value of assets of Ind Co as on 31 March 2020 was INR 100 crores.

The book values of assets (after reduction of liabilities), fair market values of assets (after reduction of liabilities) and liabilities of some of the entities as on 31 May 2020 (i.e., date of transfer) is as below:

Particulars	Book value (INR crores)	Fair market value (INR crores)	Liabilities (INR crores)
Group A			
US Co	550	1000	100
Singapore Intermediary Co	30	50	0
Group B			
Germany Co	200	500	50
Mauritius Intermediary Co	30	60	0
Group C			
Cyprus Co	100	400	0
Australia Intermediary Co	120	300	0
Group D			
UK Co	120	150	50
Spain Intermediary Co	7	12	0
Ind Co	**110**	**180**	**20**

Groups A, B, C and D hold no other shares or assets in India other than investment in shares of Ind Co.

Note: Assume the fair market value and liability of all the companies as on 31.3.2020 is same as it is on 31.05.2020

I. MULTIPLE CHOICE QUESTIONS

Write the most appropriate option to each of the following questions by choosing one of the four options given. Each question carries two marks.

1. Based on the facts in the case, where US Co proposes to transfer shares of Singapore Intermediary Co, which of the following Double Taxation Avoidance Agreements ('DTAA'), would be applicable for analysing the taxability in the hands of US Co in India -

    (a) US-Singapore DTAA

(b) India- Singapore DTAA

(c) India-US DTAA

(d) None of the DTAAs are applicable

2. With respect to transfer of shares of Singapore Intermediary Co by US Co, which of the following would be the 'specified date' for the purpose of determining whether such shares derive its value substantially from assets located in India:

(a) 30th June 2019

(b) 31st December 2019

(c) 31st March 2020

(d) 31st May 2020

3. With respect to transfer of shares of Mauritius Intermediary Co by Germany Co, what would be the value of 'assets located in India' –

(a) INR 27.5 crores

(b) INR 32.5 crores

(c) INR 45 crores

(d) INR 50 crores

4. Ind Co is required to report details with respect to transfer of shares of Singapore Intermediary Co by US Co in which of the following forms-

(a) Form 3CEA

(b) Form 3CT

(c) Form 49D

(d) There is no reporting requirement on Ind Co and reporting requirement applies only on Singapore Intermediary Co

5. What is the timeline within which Ind Co is required to furnish information pertaining to transfer of shares of Mauritius Intermediary Co by Germany Co if the transaction has the effect of directly or indirectly transferring rights and management of Ind Co -

(a) Within the due date for filing return of income for the year in which the transfer has taken place

(b) Within 90 days from the date of the transaction

(c) Within 90 days from the end of the Financial Year in which such transfer has taken place

(d) There is no requirement on Ind Co to furnish information

6. DESCRIPTIVE QUESTIONS

1. Examine the tax consequences of the following transactions under section 9(1)(i) of the Income-tax Act, 1961 and the applicable Double Taxation Avoidance Agreements -

(a) Transfer of shares of Singapore Intermediary Co by US Co to an unrelated Buyer ***(4 Marks)***

(b) Transfer of shares of Mauritius Intermediary Co by Germany Co to an unrelated Buyer ***(4 Marks)***

(c) Transfer of shares of Australia Intermediary Co by Cyprus Co to an unrelated Buyer ***(3 Marks)***

(d) Transfer of shares of Spain Intermediary Co by UK Co to an unrelated Buyer ***(4 Marks)***

EXHIBIT I

<u>EXTRACTS OF ARTICLE ON CAPITAL GAINS FROM DOUBLE TAXATION AVOIDANCE AGREEMENTS</u>

India-US DTAA

"ARTICLE 13 - **GAINS**

Except as provided in Article 8 (Shipping and Air Transport) of this Convention, each Contracting State may tax capital gains in accordance with the provisions of its domestic law."

India- Singapore DTAA

"ARTICLE 13 – **CAPITAL GAINS**

1. *Gains derived by a resident of a Contracting State from the alienation of immovable property, referred to in Article 6, and situated in the other Contracting State may be taxed in that other State.*
2. *Gains from the alienation of movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State or of movable property pertaining to a fixed base available to a resident of a Contracting State in the other Contracting State for the purpose of performing independent personal services, including such gains from the alienation of such a permanent establishment (alone or together with the whole enterprise) or of such fixed base, may be taxed in that other State.*
3. *Gains from the alienation of ships or aircraft operated in international traffic or movable property pertaining to the operation of such ships or aircraft shall be taxable only in the Contracting State of which the alienator is a resident.*

4A. Gains from the alienation of shares acquired before 1 April 2017 in a company which is a resident of a Contracting State shall be taxable only in the Contracting State in which the alienator is a resident.

4B. Gains from the alienation of shares acquired on or after 1 April 2017 in a company which is a resident of a Contracting State may be taxed in that State.

4C. However, the gains referred to in paragraph 4B of this Article which arise during the period beginning on 1 April 2017 and ending on 31 March 2019 may be taxed in the State of which the company whose shares are being alienated is a resident at a tax rate that shall not exceed 50% of the tax rate applicable on such gains in that State.

5. *Gains from the alienation of any property other than that referred to in paragraphs 1, 2, 3, 4A and 4B of this Article shall be taxable only in the Contracting State of which the alienator is a resident."*

Germany-Mauritius DTAA

"ARTICLE 13 – CAPITAL GAINS

1. *Gains derived by a resident of a Contracting State from the alienation of immovable property referred to in Article 6 and situated in the other Contracting State may be taxed in that other State.*
2. *Gains from the alienation of movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State including such gains from the alienation of such a permanent establishment (alone or with the whole enterprise), may be taxed in that other State.*
3. *Gains from the alienation of ships or aircraft operated in international traffic or movable property pertaining to the operation of such ships or aircraft shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated.*
4. *Gains derived by a resident of a Contracting State from the alienation of shares, participation, or other rights in the capital of a company or an interest in a partnership which is a resident of the other Contracting State may be taxed in that other Contracting State.*
5. *Gains from the alienation of any property other than that referred to in paragraphs 1 to 4, shall be taxable only in the Contracting State of which the alienator is a resident.*

6. *Where an individual who was a resident of a Contracting State for a period of 5 years or more has become a resident of the other Contracting State, paragraph 5 shall not prevent the first-mentioned State from taxing under its domestic law the capital appreciation of shares in a company resident in the first-mentioned State for the period of residency of that individual in the first-mentioned State. In such case, the appreciation of capital taxed in the first-mentioned State shall not be included in the determination of the subsequent appreciation of capital by the other State."*

India-Germany DTAA

"ARTICLE 13 – **CAPITAL GAINS**

1. *Gains derived by a resident of a Contracting State from the alienation of immovable property situated in the other Contracting State may be taxed in that other State.*
2. *Gains from the alienation of movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State or of movable property pertaining to a fixed base available to a resident of a Contracting State in the other Contracting State for the purpose of performing independent personal services, including such gains from the alienation of such a permanent establishment (alone or with the whole enterprise) or of such fixed base, may be taxed in that other State.*
3. *Gains from the alienation of ships or aircraft operated in international traffic or movable property pertaining to the operation of such ships or aircraft shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated.*
4. *Gains from the alienation of shares in a company which is a resident of a Contracting State may be taxed in that State.*
5. *Gains from the alienation of any property other than that referred to in paragraphs 1 to 4 shall be taxable only in the Contracting State of which the alienator is a resident."*

India-Mauritius DTAA

"ARTICLE 13 – **CAPITAL GAINS**

1. *Gains from the alienation of immovable property, as defined in paragraph (2) of article 6, may be taxed in the Contracting State in which such property is situated.*
2. *Gains from the alienation of movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State or of movable property pertaining to a fixed base available to a resident of a Contracting State in the other Contracting State for the purpose of performing independent personal services, including such gains from the alienation of such a permanent establishment (alone or together with the whole enterprise) or of such a fixed base, may be taxed in that other State.*
3. *Notwithstanding the provisions of paragraph (2) of this article, gains from the alienation of ships and aircraft operated in international traffic and movable property pertaining to the operation of such ships and aircraft, shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated.*

3A. *Gains from the alienation of shares acquired on or after 1st April 2017 in a company which is resident of a Contracting State may be taxed in that State.*

3B. *However, the tax rate on the gains referred to in paragraph 3A of this Article and arising during the period beginning on 1st April, 2017 and ending on 31st March, 2019 shall not exceed 50% of the tax rate applicable on such gains in the State of residence of the company whose shares are being alienated;*

4. *Gains from the alienation of any property other than that referred to in paragraphs 1, 2, 3 and 3A shall be taxable only in the Contracting State of which the alienator is a resident.*

5. *For the purposes of this article, the term "alienation" means the sale, exchange, transfer, or relinquishment of the property or the extinguishment of any rights therein or the compulsory acquisition thereof under any law in force in the respective Contracting States.*

India-Cyprus DTAA

"ARTICLE 13 – **CAPITAL GAINS**

1. *Gains derived by a resident of a Contracting State from the alienation of immovable property referred to in Article 6 and situated in the other Contracting State may be taxed in that other State.*
2. *Gains from the alienation of movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State or of movable property pertaining to a fixed base available to a resident of a Contracting State in the other Contracting State for the purpose of performing independent personal services, including such gains from the alienation of such a permanent establishment (alone or with the whole enterprise) or of such fixed base, may be taxed in that other State.*
3. *Gains from the alienation of ships or aircraft operated in international traffic or movable property pertaining to the operation of such ships or aircraft shall be taxable only in the Contracting State of which the alienator is a resident.*
4. *Gains from the alienation of shares of the capital stock of a company the property of which consists directly or indirectly principally of immovable property situated in a Contracting State may be taxed in that State.*
5. *Gains from the alienation of shares other than those mentioned in paragraph 4 in a company which is a resident of a Contracting State may be taxed in that State.*
6. *Gains from the alienation of any property other than that referred to in paragraphs 1, 2, 3, 4 and 5, shall be taxable only in the Contracting State of which the alienator is a resident."*

India-Australia DTAA

"Article 13 – **Alienation of Property**

1. *Income or gains derived by a resident of one of the Contracting States from the alienation of real property referred to in Article 6 and, as provided in that Article, situated in the other Contracting State may be taxed in that other State.*
2. *Income or gains derived from the alienation of property, other than real property referred to in Article 6, that forms part of the business property of a permanent establishment which an enterprise of one of the Contracting States has in the other Contracting State or pertains to a fixed base available to a resident of the first-mentioned State in that other State for the purpose of performing independent personal services, including income or gains from the alienation of such a permanent establishment (alone or with the whole enterprise) or of such a fixed base, may be taxed in that other State.*
3. *Income or gains derived from the alienation of ships or aircraft operated in international traffic, or of property other than real property referred to in Article 6 pertaining to the operation of those ships or aircraft, shall be taxable only in the Contracting State of which the enterprise which operated those ships or aircraft is a resident.*
4. *Income or gains derived from the alienation of shares or comparable interests in a company, the assets of which consist wholly or principally of real property referred to in Article 6 and, as provided in that Article, situated in one of the Contracting States, may be taxed in that State.*
5. *Income or gains derived from the alienation of shares or comparable interests in a company, other than those referred to in paragraph (4), may be taxed in the Contracting State of which the company is a resident.*

6. *Nothing in this Agreement affects the application of a law of a Contracting State relating to the taxation of gains of a capital nature derived from the alienation of property other than that to which any of paragraphs (1), (2), (3), (4) and (5) apply."*

UK-Spain DTAA

"Article 13 – **Capital Gains**

1. *Gains derived by a resident of a Contracting State from the alienation of immovable property referred to in Article 6 and situated in the other Contracting State may be taxed in that other State.*
2. *Gains from the alienation of movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State including such gains from the alienation of such a permanent establishment (alone or with the whole enterprise) may be taxed in that other Contracting State.*
3. *Gains derived by a resident of a Contracting State from the alienation of ships or aircraft operated in international traffic by an enterprise of that State or movable property pertaining to the operation of such ships or aircraft, shall be taxable only in that State.*
4. *Gains derived by a resident of a Contracting State from the alienation of shares, other than shares in which there is substantial and regular trading on a Stock Exchange, or comparable interests, deriving more than 50 per cent of their value directly or indirectly from immovable property situated in the other Contracting State may be taxed in that other State.*
5. *Gains from the alienation of shares or other rights, which directly or indirectly entitle the owner of such shares or rights to the enjoyment of immovable property situated in a Contracting State, may be taxed in that State.*
6. *Gains from the alienation of any property other than that referred to in paragraphs 1, 2, 3, 4 and 5 shall be taxable only in the Contracting State of which the alienator is a resident."*

India-UK DTAA

"Article 14- **Capital Gains**

1. *Except as provided in Article 8 (Air Transport) and 9 (Shipping) of this Convention, each Contracting State may tax capital gains in accordance with the provisions of its domestic law."*

India-Spain DTAA

"Article 14 – **Capital Gains**

1. *Gains derived by a resident of a Contracting State from the alienation of immovable property, referred to in Article 6, and situated in the other Contracting State may be taxed in that other State.*
2. *Gains from the alienation of movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State or of movable property pertaining to a fixed base available to a resident of a Contracting State in the other Contracting State for the purpose of performing independent personal services, including such gains from the alienation of such a permanent establishment (alone or together with the whole enterprise) or of such fixed base, may be taxed in that other State.*
3. *Gains from the alienation of ships or aircraft operated in international traffic or of movable property pertaining to the operation of such ships or aircraft shall be taxable only in the Contracting State of which the alienator is a resident.*
4. *Gains from the alienation of shares of the capital stock of a company the property of which consists, directly or indirectly, principally of immovable property situated in a Contracting State may be taxed in that State.*

5. *Gains for the alienation of shares of the capital stock of a company forming part of a participation of at least 10 per cent in a company which is a resident of a Contracting State may be taxed in that Contracting State.*

6. *Gains from the alienation of any property other than that mentioned in paragraphs 1, 2, 3, 4 and 5 shall be taxable only in the Contracting State of which the alienator is a resident."*

ELECTIVE PAPER 6C: INTERNATIONAL TAXATION

SOLUTION TO CASE STUDY 3

I. ANSWERS TO MCQs (Most appropriate answers)

1. (c)
2. (d)
3. (d)
4. (c)
5. (b)

II. ANSWERS TO DESCRIPTIVE QUESTIONS

Answer to Q.1:

Income of a non-resident from transfer of a capital asset situated in India is deemed to accrue in India as per the provisions of section 9(1)(i) of the Income-tax Act,1961. As per *Explanation 5* to section 9(1)(i), an asset being any share or interest in a company or entity incorporated outside India shall be deemed to be situated in India if, if the share or interest, derives directly or indirectly, its value substantially from assets located in India.

Further, *Explanation 6* to section 9(1)(i), provides that the share or interest in a company or entity registered or incorporated outside India, shall be deemed to derive its value substantially from the assets (whether tangible or intangible) located in India, if on the specified date, the value of Indian assets:
- exceeds the amount of INR 10 crores; and

- represents at least 50% of the value of all assets owned by the company, or entity, as the case may be

Specified date for this purpose would be the date on which the accounting period of the company or entity ends preceding the date of transfer of a share or an interest.

However, in case the book value of the assets of the company or entity on the date of transfer exceeds by at least 15%, the book value of the assets as on the last balance sheet date preceding the date of transfer, the date of transfer shall be the specified date.

Value of an asset means Fair Market value as on specified date, of such asset without reduction of liabilities in respect of the asset.

Further, section 90(2) provides that where the Indian Government has entered into DTAAs which are applicable to the taxpayers, then, the provisions of the Act or the provisions of the DTAA, whichever is more beneficial to the taxpayer, shall apply.

In light of the above, the provisions of the DTAA and the provisions of the Act have been examined with respect to the each of the Groups below.

(a) Transfer of shares of Singapore Intermediary Co by US Co.

In the instant case, specified date is 31.05.2020

Fair value of assets of Singapore Intermediary Co as on 31.5.2020 - INR 50 crores

Fair value of Ind Co as on 31.5.2020 (without reduction of liabilities) - INR 200 crores

Fair value of Ind Co as held by Singapore Intermediary Co (20%) - INR 40 crores

Since, the value of assets located in India i.e., INR 40 crores exceeds INR 10 crores and also exceeds 50% of the value of assets of Singapore Intermediary Co, the shares of Singapore Intermediary Co would be deemed to derive its value substantially from assets located in India.

Hence, the shares of Singapore Intermediary Co would be deemed to be a capital asset situated in India and the capital gains from transfer of shares of Singapore Intermediary Co would be deemed to accrue or arise in India. Accordingly, the gains would be taxable in the hands of US Co in India as per the Income-tax Act, 1961. However, the provisions of the applicable DTAA would need to be examined.

The India-US DTAA would be the applicable DTAA, for the purpose of analysing taxability in India of the transfer of shares of Singapore Intermediary Co by US Co, since in the instant case, India is the 'country of source' and US is the 'country of residence'.

As per Article 13 of the India-US DTAA, US and India may tax capital gains in accordance with the provisions of its domestic law. Hence, the capital gains income from transfer of shares of Singapore Intermediary Co by US Co shall be taxable in India.

(b) Transfer of shares of Mauritius Intermediary Co by Germany Co.

In the instant case, specified date is 31.05.2020

Fair value of assets of Mauritius Intermediary Co as on 31.5.2020 - INR 60 crores

Fair value of Ind Co as on 31.5.2020 (without reduction of liabilities) - INR 200 crores

Fair value of Ind Co as held by Mauritius Intermediary Co (25%) - INR 50 crores

Since, the value of assets located in India i.e., INR 50 crores exceeds INR 10 crores and also exceeds 50% of the value of assets of Mauritius Intermediary Co, shares of Mauritius Intermediary Co would be deemed to derive its value substantially from assets located in India.

Hence, the shares of Mauritius Intermediary Co would be deemed to be a capital asset situated in India and the capital gains from transfer of shares of Mauritius Intermediary Co would be deemed to accrue or arise in India. Accordingly, the gains would be taxable in the hands of Germany Co in India as per the Income-tax Act, 1961. However, the provisions of the applicable DTAA would need to be examined.

The India-Germany DTAA would be the applicable DTAA, for the purpose of analysing taxability in India of the transfer of shares of Mauritius Intermediary Co by Germany Co, since in the instant case, India is the 'country of source' and Germany is the 'country of residence'.

Clauses (1) to (3) of Article 13 of the India-Germany DTAA, would not be relevant to the instant case. As per clause (4) of Article 13 of the India-Germany DTAA, *"gains from the alienation of shares in a company which is a resident of a Contracting State may be taxed in that State".*

In the instant case, the shares being transferred are those of Mauritius Intermediary Co, which is not a resident of India. Accordingly, the instant case would not be covered under clause (4) of Article 13 and the residual clause (5) of Article 13 would be applicable. As per clause (5), *"Gains from the alienation of any property other than that referred to in paragraphs 1 to 4 shall be taxable only in the Contracting State of which the alienator is a resident"*. The alienator is Germany Co, which is a resident of Germany and not India and accordingly, the capital gains shall be taxable only in Germany and is not taxable in India.

Since the provisions of the DTAA can be applied, where they are more beneficial to the taxpayer than the provisions of the Act, in the instant case, the provisions of the DTAA can be applied and accordingly, the capital gains would not be taxable in India.

(c) Transfer of shares of Australian Intermediary Co by Cyprus Co.

In the instant case, specified date is 31.05.2020

Fair value of assets of Australian Intermediary Co as on 31.5.2020 - INR 300 crores

Fair value of Ind Co as on 31.5.2020 (without reduction of liabilities) - INR 200 crores

Fair value of Ind Co as held by Australian Intermediary Co (51%) - INR 102 crores

Since, the value of assets located in India i.e., INR 102 crores exceeds INR 10 crores but it does not represent at least 50% of the value of assets of Australian Intermediary Co, shares of Australian Intermediary Co would not be deemed to derive its value substantially from assets located in India.

Hence, the shares of Australia Intermediary Co would not be deemed to be a capital asset situated in India and the capital gains from transfer of shares of Australia Intermediary Co would not be deemed to accrue or arise in India. Accordingly, the gains would not be taxable in the hands of Cyprus Co in India as per the Income-tax Act, 1961.

Accordingly, it would not be necessary to examine the provisions of the applicable DTAA.

(d) Transfer of shares of Spain Intermediary Co by UK Co.

In the instant case, specified date is 31.03.2020

Fair value of assets of Spain Intermediary Co as on 31.3.2020 - INR 12 crores

Fair value of Ind Co as on 31.3.2020 (without reduction of liabilities) - INR 200 crores

Fair value of Ind Co as held by Spain Intermediary Co (4%) - INR 8 crores

Since, the value of assets located in India i.e., INR 8 crores does not exceed INR 10 crores, shares of Spain Intermediary Co would not be deemed to derive its value substantially from assets located in India.

Hence, the shares of Spain Intermediary Co would not be deemed to be a capital asset situated in India and the capital gains from transfer of shares of Spain Intermediary Co would not be deemed to accrue or arise in India. Accordingly, the gains would not be taxable in the hands of UK Co in India as per the Income-tax Act, 1961.

Accordingly, it would not be necessary to examine the provisions of the applicable DTAA.

ELECTIVE PAPER 6C: INTERNATIONAL TAXATION

CASE STUDY - 4

Shivam completed his engineering from BITS Country "P" and thereafter, came back to India in Mid 2011 for further training and job placement. Since then, he has been working with a reputed MNC in Delhi and has been staying in a rented accommodation in Defence Colony, Delhi along with his parents and his wife Sudha, who is a doctor by profession.

Shivam has keen interest in Carnatic music and performs in music concerts in the Delhi Tamil Sangam from time to time along with his friend Arvind. Shivam and Arvind also perform in music concerts in Margazhi Maha Utsav held in Chennai every December. Carnatic Music is Shivam's passion and he does not charge for performing in music concerts.

Arvind visits Country "P" for 60 days every year. For the rest of the year, he stays in Delhi. He is engaged in the business of wholesale trade in foodgrains in Delhi. He has no source of income in Country "P" except rental income from house property purchased by him in the P.Y.2015-16 and interest on fixed deposits made by him with a bank in that country out of his Indian income.

Sudha and her team are engaged in a project with Cure House Inc., a company based in Country "R", to provide consultancy services in field of medicine to various research institutes in India. The engagement began during May 2019 and continued throughout the year. Due to the nature of project, Sudha frequently travels across the country to various institutes. There is no fixed place for provision of consultancy services. The expected revenue from the project is INR 70 crores.

Shivam's employer is an MNC which has offices across the globe. The Indian office of the company has been processing, in respect of Mr. Shivam, basic salary of INR 70,000, dearness allowance of INR 30,000 and special allowance of INR 5,000 every month.

During the year 2019-20, the company initiated a Global Mobility Program and selected Shivam for secondment to Country "Q" on a three-year assignment. Once Shivam starts his assignment, no further salary shall be processed from India payroll and he shall receive salary for services rendered in Country "Q" in his Country "Q" bank account. As per the terms of global mobility program, Shivam would be entitled to a monthly basic salary of QGD 1400 and cost of living allowance of QGD 1000. Tax at the rate of 15% would be withheld on such salary as per Country "Q" tax laws. Shivam would be staying there in a rent-free accommodation provided by the company for the three year period.

Shivam left India on September 30, 2019 for his overseas assignment and reached Country "Q" next day. His parents and Sudha stayed in India in the same rented accommodation in Defence Colony, Delhi owing to Sudha's work commitments. For F.Y.2019-20, Shivam paid rent of INR 25,000 per month in respect of the said accommodation.

On July 31, 2019, the company announced a bonus of INR 3,00,000 for the previous financial year (i.e. F.Y.2018-19). As a retention policy, such bonus was paid after the first half of the financial year i.e. in October 2019. Shivam received the bonus amount in his salary account with the bank in Country "Q".

Shivam had invested his overseas salary in purchase of securities of a Country "Q" company which yielded an interest income of QGD 5,000 due as on March 31, 2020. Such interest was taxed at 15% of the gross amount as per Country "Q" domestic tax laws. The rate of tax in respect of such income as per the India-Country "Q" DTAA is also 15% on the gross amount.

He has also purchased shares of Country "Q" Company and dividend of QGD 1,000 was credited to his bank account on March 31, 2020. Just like Indian tax laws, dividend paid by Country "Q" Company is exempt in the hands of shareholders.

On 31.03.2020, he had earned interest income of QGD 150 from his saving bank account in Country "Q", which is also exempt as per the domestic tax laws of Country "Q".

Shivam also owns a residential house property in Mumbai, which was let out at a monthly rent of INR 50,000 and security deposit equivalent to two months' rent was invested to earn interest at the rate of 10% per annum from the same. He annually spends INR 60,000 for medical treatment and nursing of his dependent disabled mother.

During his engineering days, Shivam had also invested in bonds issued by the Government of Country "P" and earned annual interest of foreign currency equivalent to INR 30,000 during the previous year. Such interest earned was exempt from tax in Country "P".

Other points:

As per Country "Q" tax laws, tax year means a financial year, being a period of 12 months beginning with 1st April. As per tax residency laws in Country "Q", a person shall be regarded as resident if he stays in Country "Q" for more than 180 days in a financial year.

QGD is the currency abbreviation for the Country "Q" dollar, the currency of Country "Q".

Based on the above facts, you are required to answer the following questions:

I MULTIPLE CHOICE QUESTIONS

Write the most appropriate answer to each of the following questions by choosing one of the four options given. Each question carries two marks.

1. Delhi Tamil Sangam, as per its rules, pays a fixed honorarium per concert to each musician performing in the concerts organised by it. Shivam, however, refuses to accept this sum. If he requests Delhi Tamil Sangam to pay such sum directly to Help All, an unregistered institution providing relief to the poor and needy in rural India, what would be the tax consequence?

   (a) No amount would be chargeable to tax in the hands of Mr. Shivam, since this is a case of diversion of income at source by overriding title.

   (b) The amount payable to Help All would be chargeable to tax only in the hands of Mr. Shivam, since it is a case of application of income.

   (c) The amount payable to Help All would be chargeable to tax only in the hands of the institution which has received the amount.

   (d) The amount payable to Help All would be chargeable to tax both in the hands of Mr. Shivam and in the hands of the institution.

2. Mr. Arvind opened a bank account in Country "P" on 1.7.2017. He has made deposits of foreign currency equivalent to INR 5 lakhs on 1.7.2017, INR 7 lakhs on 1.10.2017, INR 12 lakhs on 1.9.2019 and INR 25 lakhs on 1.3.2020, in that bank, out of Indian income which has not been assessed to tax in India. The deposit of INR 12 lakhs on 1.9.2019 is made out of the withdrawal of earlier deposits made on 1.7.2017 and 1.12.2017 with the said bank. Further, out of INR 25 lakhs deposited by him on 1.3.2020, Mr. Arvind withdrew INR 2 lakhs on 31.3.2020. The value of an undisclosed asset in form of bank account under the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 will be taken as:

(a) INR 49 lakhs

(b) INR 47 lakhs

(c) INR 37 lakhs

(d) INR 35 lakhs

3. If Cure House Inc. opts for advance ruling for the project of providing consultancy in field of medicine, such ruling shall be binding on:

(a) Cure House Inc., in relation to the abovementioned project

(b) Jurisdictional Assessing Officer of Cure House

(c) Both (a) and (b)

(d) Cure House Inc. and Jurisdictional Assessing Officer in relation to the abovementioned project and for any future transaction of similar nature in India

4. Which of the following would **not** be considered as a permanent home of Mr. Shivam in context of the relevant rule in the DTAA with Country "Q" for dual residency?

(i) House in Defence Colony, Delhi where his family lives

(ii) Own house in Mumbai which has been let out

(iii) Rent-free accommodation provided by his employer in Country "Q"

The correct answer is -

(a) Only (i) above

(b) Only (ii) above

(c) Only (iii) above

(d) Both (i) and (iii) above

5. Mr. Arvind acquired a flat in Country "P" in the P.Y.2015-16 for INR 50 lakhs out of his Indian income. Out of the said sum, INR 20 lakhs was assessed to tax in India during the P.Y.2015-16 and earlier years. This asset comes to the notice of the Assessing Officer in the year 2019-20. If the value of the flat on 1.4.2019 is INR 90 lakhs, the amount chargeable to tax in the year 2019-20 would be:

(a) INR 90 lakhs

(b) INR 70 lakhs

(c) INR 54 lakhs

(d) INR 30 lakhs

II DESCRIPTIVE QUESTIONS

1. (i) With reference to the DTAA between India and Country "Q", examine whether Shivam is a resident in India or Country "Q" in the year 2018-19. ***(5 Marks)***

   (ii) With reference to the DTAA between India and Country "R", comment on whether provision of consultancy services through Sudha would lead to creation of PE in India for Cure House Inc., a Country "R" company. ***(2 Marks)***

2. Determine the total income and tax liability of Shivam for the previous year 2018-19 as per the provisions of the Income-tax Act, 1961. Advance tax calculations may be ignored. Ignore the perquisite value of rent free accommodation provided to Shivam in Country "Q". Indicate reasons for treatment of each item. Working Notes should form part of your answer. ***(8 Marks)***

EXHIBIT I

Telegraphic Transfer Buying Rate

SBI TT buying rate for Country "Q" – India currency conversion:

Date	Exchange Rate (INR)	Date	Exchange Rate (INR)
30.09.2019	45.95	31.01.2020	47.83
31.10.2019	46.85	28.02.2020	48.52
30.11.2019	45.10	31.03.2020	48.61
31.12.2019	46.95		

EXHIBIT II

Rate of exchange for conversion into rupees of income expressed in foreign currency

[Rule 115 of the Income-tax Rules, 1962]

(1) The rate of exchange for the calculation of the value in rupees of any income accruing or arising or deemed to accrue or arise to the assessee in foreign currency or received or deemed to be received by him or on his behalf in foreign currency shall be the telegraphic transfer buying rate of such currency as on the specified date.

Explanation: For the purposes of this rule

(*1*) "telegraphic transfer buying rate" shall have the same meaning as in the *Explanation* to rule 26;

As per *Explanation* to Rule 26 "telegraphic transfer buying rate", in relation to a foreign currency, means the rate or rates of exchange adopted by the State Bank of India, for buying such currency, having regard to the guidelines specified from time to time by the Reserve Bank of India for buying such currency, where such currency is made available to that bank through a telegraphic transfer.

(*2*) "specified date" means—

(*a*) in respect of income chargeable under the head "Salaries", the last day of the month immediately preceding the month in which the salary is due, or is paid in advance or in arrears;

(*b*) in respect of income[by way of] "interest on securities", the last day of the month immediately preceding the month in which the income is due;

(*c*) in respect of income chargeable under the heads "Income from house property", "Profits and gains of business or profession" [not being income referred to in clause (*d*)] and "Income from other sources" (not being income by way of dividends [and "Interest on securities"]), the last day of the previous year of the assessee;

(*d*) in respect of income chargeable under the head "Profits and gains of business or profession" in the case of a non-resident engaged in the business of operation of ships, the last day of the month immediately preceding the month in which such income is deemed to accrue or arise in India ;

(*e*) in respect of income by way of dividends, the last day of the month immediately preceding the month in which the dividend is declared, distributed or paid by the company;

(*f*) in respect of income chargeable under the head "Capital gains", the last day of the month immediately preceding the month in which the capital asset is transferred :]

Provided that the specified date, in respect of income referred to in sub-clauses (*a*) to (*f*) payable in foreign currency and from which tax has been deducted at source under rule 26, shall be the date on which the tax was required to be deducted under the provisions of the Chapter XVII-B.

(2) Nothing contained in sub-rule (1) shall apply in respect of income referred to in clause (*c*) of the *Explanation* to sub-rule (1) where such income is received in, or brought into India by the assessee or on his behalf before the specified date in accordance with the provisions of the Foreign Exchange Regulation Act, 1973.

EXHIBIT III

Foreign Tax Credit [Rule 128 of the Income-tax Rules, 1962]

(1) An assessee, being a resident shall be allowed a credit for the amount of any foreign tax paid by him in a country or specified territory outside India, by way of deduction or otherwise, in the year in which the income corresponding to such tax has been offered to tax or assessed to tax in India, in the manner and to the extent as specified in this rule:

Provided that in a case where income on which foreign tax has been paid or deducted, is offered to tax in more than one year, credit of foreign tax shall be allowed across those years in the same proportion in which the income is offered to tax or assessed to tax in India.

(2) The foreign tax referred to in sub-rule (1) shall mean,—

(a) in respect of a country or specified territory outside India with which India has entered into an agreement for the relief or avoidance of double taxation of income in terms of section 90 or section 90A, the tax covered under the said agreement;

(b) in respect of any other country or specified territory outside India, the tax payable under the law in force in that country or specified territory in the nature of income-tax referred to in clause (iv) of the Explanation to section 91.

(3) The credit under sub-rule (1) shall be available against the amount of tax, surcharge and cess payable under the Act but not in respect of any sum payable by way of interest, fee or penalty.

(4) No credit under sub-rule (1) shall be available in respect of any amount of foreign tax or part thereof which is disputed in any manner by the assessee:

Provided that the credit of such disputed tax shall be allowed for the year in which such income is offered to tax or assessed to tax in India if the assessee within six months from the end of the month in which the dispute is finally settled, furnishes evidence of settlement of dispute and an evidence to the effect that the liability for payment of such foreign tax has been discharged by him and furnishes an undertaking that no refund in respect of such amount has directly or indirectly been claimed or shall be claimed.

(5) The credit of foreign tax shall be the aggregate of the amounts of credit computed separately for each source of income arising from a particular country or specified territory outside India and shall be given effect to in the following manner:—

(i) the credit shall be the lower of the tax payable under the Act on such income and the foreign tax paid on such income :

Provided that where the foreign tax paid exceeds the amount of tax payable in accordance with the provisions of the agreement for relief or avoidance of double taxation, such excess shall be ignored for the purposes of this clause;

(ii) the credit shall be determined by conversion of the currency of payment of foreign tax at the telegraphic transfer buying rate on the last day of the month immediately preceding the month in which such tax has been paid or deducted.

(6) In a case where any tax is payable under the provisions of section 115JB or section 115JC, the credit of foreign tax shall be allowed against such tax in the same manner as is allowable against any tax payable under the provisions of the Act other than the provisions of the said sections (hereafter referred to as the "normal provisions").

(7) Where the amount of foreign tax credit available against the tax payable under the provisions of section 115JB or section 115JC exceeds the amount of tax credit available against the normal provisions, then while computing the amount of credit under section 115JAA or section 115JD in respect of the taxes paid under section 115JB or section 115JC, as the case may be, such excess shall be ignored.

(8) Credit of any foreign tax shall be allowed on furnishing the following documents by the assessee, namely:—

(i) a statement of income from the country or specified territory outside India offered for tax for the previous year and of foreign tax deducted or paid on such income in Form No.67 and verified in the manner specified therein;

(ii) certificate or statement specifying the nature of income and the amount of tax deducted therefrom or paid by the assessee,—

(a) from the tax authority of the country or the specified territory outside India; or

(b) from the person responsible for deduction of such tax; or

(c) signed by the assessee:

Provided that the statement furnished by the assessee in clause (c) shall be valid if it is accompanied by,—

(A) an acknowledgement of online payment or bank counter foil or challan for payment of tax where the payment has been made by the assessee;

(B) proof of deduction where the tax has been deducted.

(9) The statement in Form No.67 referred to in clause (i) of sub-rule (8) and the certificate or the statement referred to in clause (ii) of sub-rule (8) shall be furnished on or before the due date specified for furnishing the return of income under sub-section (1) of section 139, in the manner specified for furnishing such return of income.

(10) Form No.67 shall also be furnished in a case where the carry backward of loss of the current year results in refund of foreign tax for which credit has been claimed in any earlier previous year or years.

Explanation—For the purposes of this rule 'telegraphic transfer buying rate' shall have the same meaning as assigned to it in Explanation to Rule 26.

EXHIBIT IV

EXTRACTS OF DTAA BETWEEN INDIA AND COUNTRY "Q"

ARTICLE 4

FISCAL DOMICILE

1. *For the purposes of this Agreement, the term "resident of a Contracting State" means any person who is a resident of a Contracting State in accordance with the taxation laws of that State.*

2. *"Where by reason of the provisions of paragraph 1, an individual is a resident of both Contracting States, then his status shall be determined as follows:*

(a) he shall be deemed to be a resident of the State in which he has a permanent home available to him; if he has a permanent home available to him in both States, he shall be deemed to be a resident of the State with which his personal and economic relations are closer (centre of vital interests) ;

(b) *if the State in which he has his centre of vital interests cannot be determined, or if he has not a permanent home available to him in either State, he shall be deemed to be a resident of the State in which he has an habitual abode ;*

(c) *if he has an habitual abode in both States or in neither of them, he shall be deemed to be a resident of the State of which he is a national ;*

(d) *if he is a national of both States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement*

ARTICLE 23

AVOIDANCE OF DOUBLE TAXATION

1. *The laws in force in either of the Contracting States shall continue to govern the taxation of income in the respective Contracting States except where express provision to the contrary is made in this Agreement.*

2. *Where a resident of India derives income which, in accordance with the provisions of this Agreement, may be taxed in Country "Q", India shall allow as a deduction from the tax on the income of that resident an amount equal to the Country "Q" tax paid, whether directly or by deduction. Where the income is a dividend paid by a company which is a resident of Country "Q" to a company which is a resident of India and which owns directly or indirectly not less than 25 per cent of the share capital of the company paying the dividend, the deduction shall take into account the Country "Q" tax paid in respect of the profits out of which the dividend is paid. Such deduction in either case shall not, however, exceed that part of the tax (as computed before the deduction is given) which is attributable to the income which may be taxed in Country "Q".*

EXHIBIT V

EXTRACT OF DTAA BETWEEN INDIA AND COUNTRY "R"

ARTICLE 5

PERMANENT ESTABLISHMENT

1. *For the purposes of this Agreement, the term "permanent establishment" means a fixed place of business through which the business of an enterprise is wholly or partly carried on.*

2. *The term "permanent establishment" includes especially:*

   (a) *a place of management;*

   (b) *a branch;*

   (c) *an office;*

   (d) *a factory;*

   (e) *a workshop;*

(f) a sales outlet;

(g) a warehouse in relation to a person providing storage facilities for others;

(h) a farm, plantation or other place where agricultural, forestry, plantation or related activities are carried on; and

(i) a mine, an oil or gas well, a quarry or any other place of extraction of natural resources.

3. The term "permanent establishment" shall also include:

(a) a building site, a construction, installation or assembly project or supervisory activities in connection therewith, where such site, project or activities continue for a period or periods aggregating more than 180 days;

(b) the furnishing of services including consultancy services by an enterprise through employees or other personnel by the enterprise for such purpose, but only where activities of that nature continue (for the same or a connected project) within the Contracting State for a period or periods aggregating more than 180 days within any twelve-month period.

ELECTIVE PAPER 6C: INTERNATIONAL TAXATION

SOLUTION TO CASE STUDY 4

I. ANSWERS TO MCQs (Most appropriate answers)

1. (d)
2. (c)
3. (c)
4. (b)
5. (c)

II. ANSWERS TO DESCRIPTIVE QUESTIONS

1. (i) As per Article 4(1) of the India and Country "Q" DTAA, the term "resident of a Contracting State" means any person who is a resident of a Contracting State in accordance with the taxation laws of that State.

Therefore, for determining whether Mr. Shivam is a resident of India or Country "Q", first, the residential status as per the taxation laws of respective countries has to be ascertained.

As per section 6(1) of the Income-tax Act,1961, an individual is said to be resident in India in any previous year if he satisfies any one of the following conditions:

a) He has been in India during the previous year for a total period of 182 days or more; or

b) He has been in India during the 4 years immediately preceding the previous year for total period of 365 days or more and has been in India for at least 60 days in the previous year.

An Indian citizen, who leaves India in the previous year for the purpose of employment outside India, shall be considered as resident only if the period of his stay during the relevant previous year in India is 182 days or more.

Since Shivam left on 30th September 2019, he stayed in India during the P.Y. 2019-20 for 183 days. Therefore, he is a resident in India for the P.Y.2019-20.

Further, Shivam had come back to India after completing his engineering in Mid 2011 and since then he has been working in India. Hence, he fulfils the following conditions for resident and ordinarily resident:

(i) He is a resident in atleast 2 out of 10 years preceding the relevant previous year, and

(ii) His total stay in India in last seven years preceding P.Y. 2019-20 is 730 days or more.

Thus, Shivam is Resident and Ordinarily Resident in India for the P.Y.2019-20.

As per Country "Q" tax residency rules, Shivam qualifies to be resident for the year 2019-20 in Country "Q", since he stays for 182 days (more than 180 days) in Country "Q" in the Financial Year 2019-20.

Thus, as per the domestic tax laws of India and Country "Q", Shivam qualifies to be a resident both in India and Country "Q" during the year 2019-20. Hence, the tie-breaker rule provided in Article 4(2) of the India-Country "Q" DTAA will come into play.

This Rule provides that where an individual is a resident of both the countries, he shall be deemed to be resident of that country in which he has a permanent home and if he has a permanent home in both the countries, he shall be deemed to be resident of that country, which is the centre of his vital interests i.e. the country with which he has closer personal and economic relations.

From the facts, it is evident that Shivam has been living in a rented accommodation in Defence Colony, Delhi. Even after he moved to Country "Q", his family continues to stay in the same rented accommodation in Delhi. Hence, it can be considered as permanent home for him in India. In Country "Q", he has been provided with a rent-free accommodation by his employer for a period of three years, which would be considered as permanent home for him. Since he has a permanent home both in India and Country "Q", the next test needs to be analysed.

Shivam owns a house property in India from which he derives rental income. His family also resides in India. He performs in Carnatic music concerts in India, both in Delhi and in Chennai. Therefore, his personal and economic relations with India are closer, since India is the place where -

(a) the residential property is located and

(b) social and cultural activities are closer

Thus, by applying Article 4 of the India-Country "Q" DTAA, Shivam shall be deemed to be resident in India.

(ii) As per paragraph 3(b) of Article 5 'Permanent Establishment' of India-Country "R" DTAA, a service PE is established if the foreign enterprise provides services in India through employees or other personnel engaged for more than 180 days in a fiscal year. Thus, Service PE is not dependent upon the fixed place of business. It is only dependent on the continuation of the activity, which does not mandate physical presence/fixed place.

Hence, the project of Cure House for providing consultancy services, will expose it to creation of service PE in India.

2. Computation of total income of Shivam for A.Y. 2020-21

Particulars	INR	INR
Income from Salaries		
Salary from services rendered in India (April - September 2019)		
Basic Salary (INR 70,000 x 6)	4,20,000	
Dearness Allowance (INR 30,000 x 6)	1,80,000	
Special Allowance (INR 5,000 x 6)	30,000	
Bonus	3,00,000	
[Even though bonus is paid in an overseas bank account after the commencement of his overseas assignment, however, since it pertains to services rendered in India, it would be taxable in India]		
		9,30,000

Salary from services rendered in Country "Q" (October 2019 - March 2020)		
Basic Salary [See Note (i)]	3,93,680	
Cost of Living Allowance [See Note (i)]	2,81,200	6,74,880
		16,04,880
Less: Standard deduction u/s 16(ia)		40,000
		15,64,880
Income from House Property at Mumbai		
Net Annual Value [See Note (ii)]	6,00,000	
Less: Standard deduction @ 30%	(1,80,000)	
		4,20,000
Income from Other Sources		
Interest earned from investment of security deposit (INR 1,00,000 @10%)	10,000	
Interest earned on saving bank account with Country "Q" [QGD 150 x INR 48.61] [See Rule 115 in Note (i)]	7,292	
Interest on Securities of a Country "Q" company [QGD 5000 x INR 48.52] [See Rule 115 in Note (i)]	2,42,600	
Interest on bonds issued by Country "P" Government	30,000	
Dividend from a Country "Q" Company (QGD 1000 x INR 48.52] [See Rule 115 in Note (i)]	48,520	
(Dividend from foreign company is taxable in India)		
		3,38,412
Gross Total Income		23,23,292
***Less:* Deductions under Chapter VI-A**		
Deduction u/s 80DD	75,000	
(Flat deduction of INR 75,000 is allowed in respect of medical treatment of dependent disabled, irrespective of the expenditure incurred)		
Deduction u/s 80GG [See Note (iii)]	60,000	1,35,000
Total Income		**21,88,292**
Total Income (rounded off)		**21,88,290**

Computation of tax liability of Shivam for A.Y. 2020-21

Particulars	INR	INR
Tax on INR 21,88,290		4,68,987
Add: Health and education cess @4%		18,759
Tax Liability		4,87,746
Less: Foreign Tax Credit [See Note (v)]		

- on salary income	98,709	
- on interest income	36,390	1,35,099
Net tax liability		**3,52,647**
Net tax liability (rounded off)		**3,52,650**

Notes:

(i) In accordance with Rule 115, following rate of exchange has been used for conversion of income earned outside India :

- *Salary* – last day of the month immediately preceding the month in which the salary is due
- *Interest on securities*- last day of the month immediately preceding the month in which the income is due i.e. rate as on 28.02.2020
- *Interest earned on other than securities* i.e. interest on bank deposits- last day of the previous year i.e. rate as on 31.03.2020
- *Dividends* - last day of the month immediately preceding the month in which the dividend is declared, distributed or paid by the company i.e. rate as on 28.02.2020

Accordingly, income earned outside India in Indian currency would be computed in the following manner:

Overseas salary for the period October 2019 to March 2020:

Month	Basic Salary in QGD (1)	Cost of living Allowance (COLA) (2)	Rate of Exchange (3)	Basic Salary in INR (1 x 3)	COLA in INR (2 x 3)
Oct 19	1400	1000	45.95	64,330	45,950
Nov 19	1400	1000	46.85	65,590	46,850
Dec 19	1400	1000	45.10	63,140	45,100
Jan 20	1400	1000	46.95	65,730	46,950
Feb 20	1400	1000	47.83	66,962	47,830
Mar 20	1400	1000	48.52	67,928	48,520
Total	**8400**	**6000**	**-**	**3,93,680**	**2,81,200**

(ii) In absence of information relating to fair market value, standard rent and municipal rent, actual rent received is considered as Gross Annual Value

(iii) As Shivam is not receiving any house rent allowance from his employer and the house property owned by him is not in the same city of his residence/employment, Shivam is eligible to claim deduction under section 80GG as under :

Deduction shall be lower of the following:

- INR 5,000 per month = INR 60,000
- 25% of the adjusted total income = 25% of INR 22,48,292 = INR 5,62,073

- Actual rent – 10% of adjusted total income = INR 3,00,000 (25,000*12) – INR 2,24,829 (10% of 22,48,292) = INR 75,171

Adjusted total income = Gross total income after providing for deduction under section 80C to 80U but before deduction under section 80GG = INR 23,23,292 – INR 75,000 = INR 22,48,292.

Hence, deduction under section 80GG shall be INR 60,000.

(iv) Deduction under section 80TTA is allowed only on interest earned on saving deposits with Indian bank and not with overseas bank account.

(v) Since Shivam is a resident and ordinarily resident in India for the A.Y.2020-21 by virtue of section 6 of the Income-tax Act, 1961, his global income is taxable in India. In such case, the income arising in Country "Q" is doubly taxed. In order to avoid double taxation, Shivam can take the benefit of DTAA between India and Country "Q" by way of foreign tax credit in respect of the tax paid in Country "Q" or tax paid on such income in India, whichever is lower.

An income earned outside India which is exempt from tax in the respective country cannot be considered as doubly taxed income for the purpose of calculation of foreign tax credit, since no taxes have been paid on such income. Hence, interest on bonds issued by Country "P" Government, interest on savings bank account in Country "Q" and dividend earned on shares of a Country "Q" Company, though taxed in India but shall not be eligible for claiming foreign tax credit as they are exempt from tax in their respective countries.

With reference to Article 23 of India-Country "Q" DTAA, Indian resident shall be allowed credit of taxes paid in Country "Q" on the income which is also taxed in Country "Q". Hence, foreign tax credit shall be calculated as below:

<u>Calculation of foreign tax credit</u>

Doubly taxed Salary Income		INR
Basic Salary		3,93,680
Cost of Living Allowance		2,81,200
		6,74,880
Less: Standard deduction (40,000 x 6,74,880/16,04,880)		16,821
Doubly taxed salary income		**6,58,059**
Computation of foreign tax credit on doubly taxed salary income:		
Lower of:		
Tax withheld in Country "Q" on salary income at 15%	98,709	
Tax payable in India on salary income@22.29% (INR 4,87,746/ INR 21,88,290)	1,46,681	
Foreign tax credit		**98,709**

Double taxed Interest Income	INR
Interest Income on Securities of Country "Q" company	2,42,600
Computation of foreign tax credit on doubly taxed interest income:	
Lower of:	
Tax withheld in Country "Q" on interest income at 15%, which is also the rate as per the DTAA	36,390

Tax payable in India on interest income@22.29%	54,076
Foreign tax credit	**36,390**

Note – *Questions based on interpretation of articles of a DTAA may have alternate views.*

ELECTIVE PAPER 6C: INTERNATIONAL TAXATION

CASE STUDY - 5

Mr. Rai is a citizen of Mauritius. His immediate family including his parents, born in undivided India, is residing in India. He also has friends in different parts of India, on account of which he occasionally visits India. On one of his trips to India he met his childhood friend, Mr. Bhandari. The one thing that Mr. Rai and Mr. Bhandari share in common, is their passion for promoting organic foods. During their conversations they realize that they could potentially set up a business venture to take their childhood friendship, a step further.

They both spend a year preparing a detailed business plan which they pitch to some investor friends. Their investor friends evince interest which prods them to formally incorporate a company, to commence their operations. The company is called RB Pvt. Ltd. which is incorporated in Mauritius on August 15, 2018.

They draw up the charter documents, that is, Articles of Association and Memorandum of Association. It is decided that Mr. Rai and Mr. Bhandari would be the sole shareholders of the company, holding equal stake in RB Pvt. Ltd. The Chief Executive Officer of the company is Mr. Rai.

Mr. Rai, Mr. Bhandari and Mr. Roy (one of their investor friends) form the board of directors of the company. Mr. Roy is based out of Kolkata, India. Mr. Bhandari lives in Gurgaon, India.

After the formal registration of the company, they set out to find a suitable office space for the company in the city of Port Louis, Mauritius. In November 2018, they find a small office space in a new business complex close to the city center of Port Louis, Mauritius and take it on lease hold basis for a year. They designate this office space as their registered office where the books of accounts will be kept and maintained.

By April 1, 2019, they employ an office manager cum receptionist Mr. Sundaram to take care of the office. Next, they employ two individuals (Mrs. Indra and Mr. Raghu) with over ten years of experience with leading retail brands in Mauritius. Mrs. Indra and Mr. Raghu are to start implementing the detailed business plan drawn up by Mr. Rai and Mr. Bhandari. For the financial year 2019-20, the aggregate pay roll expenses for these three employees is Rs.15,00,000.

They arrange for a series of meetings with the board of directors to give their inputs and understand the plan of action. Upon the directions and approval of the board of directors, they commence their work of implementing the business plan.

The first steps that Mrs. Indra and Mr. Raghu are to take as per the business plan is to finalize any two organic foods grown in Mauritius that will be marketable in New Delhi, India. During the financial year 2019-20 the team has been able to identify black rice and barley as suitable products for supply.

They then set out to find suitable suppliers from Mauritius from whom the foods can be sourced. They need to then liaise with some retail stores in New Delhi where the produce can be introduced and sold. Depending on the viability of the business model, it can be scaled further.

Indian retail chain store Modern Bazaar has expressed interest in introducing the products in their stores on a pilot basis. Mr. Bhandari employs Mr. Sharma in June 2019 to take care of paper work and act as his local secretary. Mr. Sharma was born in India and has lived in India throughout. For the months he works during the financial year 2019-20, he is paid a salary of Rs.5,00,000.

During the financial year 2019-20 the company has a total of four board meetings. Each of the meetings is attended by the three directors personally. The first, second and third meeting is held in Mauritius while the next meeting is held in New Delhi, India. Basically, there is a meeting in every quarter.

The first meeting takes up one important matter that is, the grant of a power of attorney to Mrs. Indra to enable the work in Mauritius to go on smoothly. Accordingly, it is decided that all matters of day-to-day importance can be approved by Mrs. Indra. If the matter involves expenditure of more than Rs. 25,000, the approval of Mr. Rai would be mandatory.

The second meeting relates to finalizing the list of products to be launched by the company which takes place after much intense discussions. While Mr. Bhandari and Mr. Roy doubt the viability of black rice becoming popular in India, Mr. Rai has the final word on the matter.

The third meeting relates to potential investment to be put in by Mr. Roy, the third director-cum-investor. Mr. Roy proposes infusing funds of Rs.25,00,000 subject to receiving 20 percent stake in the company. This is agreed to, by Mr. Rai and Mr. Bhandari.

The fourth meeting takes up routine matters relating to the running of the company as well as the year-end appraisal of the company's performance as well as that of its employees.

After the books of accounts have been closed for the previous year 2019-20, it is assessed that the company made a profit of Rs.15,00,000. The profit comprised the following:

- Income from product sales made to Modern Bazaar – Rs.11,00,000
- Income by way of dividends and interest earned – Rs.4,00,000

The company's assets in India amount to Rs. 50,000 while its assets in Mauritius are in the tune of Rs. 2,00,000.

RB Pvt. Ltd. follows the relevant procedure for assessment and files the tax returns in Mauritius. They believe that they are not resident in India.

When Mr. Sharma is discussing the matter with his lawyer friend he is informed RB Pvt. Ltd. would be considered resident in India. However, Mrs. Indra and Mr. Raghu believe that the company only has tax liability in Mauritius as the company is incorporated there.

Assume that Mauritius and India have a Double Taxation Avoidance Agreement which is identical to that of the provisions of the UN Model Convention.

I. MULTIPLE CHOICE QUESTIONS

Write the most appropriate option to each of the following questions by choosing one of the four options given. Each question carries two marks.

1. During the P.Y. 2017-18 and P.Y. 2019-20, Mr. Rai was in India on business visits from June 15, 2017 to August 31, 2017 and July 1, 2018 to September 28, 2018, respectively. During the previous year 2019-20, Mr. Rai was in India during April-May 2019 and November 2019. What is the residential status of Mr. Rai for previous years 2018-19 and 2019-20, respectively?

   (a) Non-resident and Resident and Ordinarily Resident, respectively

   (b) Non-resident for both years

   (c) Resident and Ordinarily Resident for both years

(d) Resident but Not Ordinarily Resident for both years

2. During the Previous Year 2019-20, Mr. Rai received Rs.75,00,000 on account of sale of agricultural land in Mauritius. The money was first received in Mauritius and then remitted to his Indian bank account. Is the sum taxable in India?

   (a) No, as agricultural income is exempt u/s 10(1).

   (b) No, as the income has accrued and arisen outside India and is also received outside India.

   (c) Yes, since it is remitted to India in the same year.

   (d) Yes, as agricultural income earned outside India is not exempted in India in the hands of a resident.

3. Mr. Bhandari only holds the shares in RB Pvt. Ltd. If he sells the shares held by him in RB Pvt. Ltd. for a gain during the Previous Year 2019-20, which of the following statements is true?

   (a) The resultant gain is a short-term capital gain taxable under the normal provisions of the Act.

   (b) The resultant gain is a short-term capital gain taxable@15% u/s 111A.

   (c) The resultant gain is a long-term capital gain taxable@20% u/s 112.

   (d) The resultant gain is a long-term capital gain taxable@10% u/s 112A.

4. Mr. Bhandari receives dividend payment from RB Pvt. Ltd. in his Indian bank account during 2019-20 to the tune of Rs.1,50,000. Which of the following statements is true?

   (a) Mr. Bhandari is liable to pay tax on such dividend as it forms part of his total income

   (b) RB Pvt. Ltd. will have to pay a dividend distribution tax u/s 115-O on such payments

   (c) Mr. Bhandari is eligible for an exemption under section 10(34) in respect of such dividend.

   (d) Both (b) and (c)

5. During the previous year 2019-20, RB Pvt. Ltd. entered into contracts for purchase and sale of barley grains with PB Pvt Ltd. PB Pvt. Ltd. is a company incorporated in New Delhi. On account of which of the following facts, would the companies be considered to be associated enterprises?

   (a) One of the four directors of PB Pvt. Ltd. is Mr. Bhandari

   (b) RB Pvt. Ltd. owns 20% of shares in PB Pvt. Ltd.

   (c) RB Pvt. Ltd. extended a loan of Rs.20 lakhs to PB Pvt. Ltd. when the book value of the latter is Rs.42 lakhs

   (d) Mr. Bhandari owns 26% of shares in PB Pvt. Ltd.

II. DESCRIPTIVE QUESTIONS

1. The board decides to understand the matter at hand from a tax lawyer. Accordingly, Mr. Bhandari seeks a meeting with a tax lawyer on the question. The lawyer explains the following in an informal conversation:

RB Pvt. Ltd. would be considered to be a resident of India for tax purposes despite it having been incorporated in Port Louis, Mauritius. The reasons for the same are detailed as follows:

- Majority of the board of directors reside in India
- The place of incorporation of the company is irrelevant
- All the revenue generation activity is linked to India

In your opinion, can the Indian tax authorities argue that RB Pvt. Ltd. is resident in India for tax purposes, despite the fact that the company has been incorporated in Mauritius? Would their reasoning be the same as cited by the tax lawyer? ***(8 Marks)***

2. Assume that Mr. Bhandari has opened an office of RB Pvt. Ltd. in Pune from where he and Mr. Sharma execute the work of the company relating to Indian operations. RB Pvt. Ltd. is further considering advertising the product on internet using Facebook. RB Pvt. Ltd. enters into talks with Facebook for hosting the desired advertisements. It negotiated a sum of INR 10 lakhs, which is paid to Facebook for online advertisement services in March, 2020. Assume that Facebook does not have a permanent establishment in India.

   (a) Is the fee paid for online advertisement services by RB Pvt. Ltd. to Facebook Inc. taxable in India? Discuss. ***(3 Marks)***

   (b) If the answer to (a) is in the affirmative, is there any requirement to deduct tax at source? If tax is not so deducted, what would be the consequence? ***(3 Marks)***

   (c) What is the provision incorporated in the Indian tax laws to avoid double taxation of such income? ***(1 Mark)***

ELECTIVE PAPER 6C: INTERNATIONAL TAXATION

SOLUTION TO CASE STUDY 5

I. ANSWERS TO MCQs (Most appropriate answers)

1. (b)
2. (b)
3. (a)
4. (a)
5. (d)

II. ANSWERS TO DESCRIPTIVE QUESTIONS

Answer to Q.1:

As per Section 6(3) of the Income-tax Act, 1961, a foreign company can be considered to be resident if its POEM is in India. POEM has been defined as the place where the key commercial and strategic decisions are made. Additionally, the CBDT Guidelines on determining POEM have to also be kept in mind while undertaking this assessment.

In the given facts, RB Pvt. Ltd. is a foreign company as it has been incorporated in Mauritius. As per the CBDT guidelines, one has to assess whether this company satisfies the test of Active Business Outside India ('ABOI'). For the same, the following information needs to be looked at:

(1)	(2)	(3)	(4)	(5)
Particulars	**Mauritius**	**India**	**Total**	**% of (3) to total in (4)**
Value of assets	Rs.2 lakhs	Rs.50,000	Rs.2,50,000	20.00%
Number of employees	3	1	4	25.00%
Payroll expenses on employees	Rs.15 lakhs	Rs.5 lakhs	20	25.00%

It can be seen that the value of assets in India is only 20% of the total assets of the company, the number of employees in India is only 25% of the total number of employees and the payroll expenses incurred on such employees is only 25% of its total payroll expenditure. Thus, three out of four conditions for active business outside India are met. However, the passive income test has also to be met for ABOI.

Particulars	Rs.
Income from transactions where both purchases and sales are from/to associated enterprises	0
Total income by way of dividend and interest	4,00,000
Total income (Income from Product Sales from Modern Bazaar plus income by way of dividend and interest)	15,00,000

Passive income = income from transactions where both purchases and sales are from/to associated enterprises + total income by way of dividend and interest = Rs.4 lakhs

Percentage of passive income to total income = 4/15 × 100 = 27%

In this case, the passive income is less than 50% of the company's total income. Hence, the passive income test is met and the company has its Active Business Outside India.

The CBDT Guidelines state that if a foreign company's Active Business is Outside India, as long as the majority of board meetings are held outside India, the POEM would be outside India.

In the given facts, majority of board meetings take place outside India as three out of four meetings are held in Mauritius. Also, the *de facto* authority vests with Mr. Rai who lives in Mauritius. He has had the final word on the product lines. Every time there is a matter involving expenditure more than Rs.25,000, it is subject to his final approval.

Hence, RB Pvt. Ltd. can argue that the company is a non-resident, since its POEM is outside India. The reasons for the conclusion are quite different from those given by the lawyer in an informal conversation.

Answer to Q.2:

(a) Equalisation levy@6% is attracted on the amount of consideration for specified services received or receivable by a non-resident not having PE in India from a resident in India who carries on business or profession or from a non-resident having PE in India. Specified services include online advertisement and any provision for digital advertising space or any other facility or service for the purpose of online advertisement.

In this case, RB Pvt. Ltd. is a non-resident having a PE in India. Since there is an office in Pune for carrying on work of the company, RB Ltd. has a PE in India. Facebook Inc is a non-resident not having PE in India. It receives consideration of Rs.10 lakhs from RB Pvt. Ltd., a non-resident having PE in India, for online advertisement services provided by it. Hence, equalization levy@6% on Rs.10 lakhs is attracted in the hands of Facebook Inc.

In the hands of RB Pvt. Ltd., the amount of Rs.10 lakhs paid to Facebook Inc. would be allowable as business expenditure, provided equalization levy has been deducted at source.

(b) RB Pvt. Ltd. is liable to deduct equalization levy of Rs.60,000 from the amount of Rs.10 lakhs payable to Facebook Inc. In case it fails to so deduct equalization levy, it shall, notwithstanding such failure, be liable to pay the levy to the credit of the Central Government by 7th April, 2020. Further, penalty of an amount equal to Rs. 60,000 would be attracted for failure to deduct equalization levy. Also, disallowance of the expenditure of Rs.10 lakhs would be attracted under section 40(a)(ib) while computing business income of RB Pvt. Ltd.

(c) Section 10(50) of the Income-tax Act, 1961 exempts income arising from providing specified service of online advertisement, which are subject to equalization levy, from income-tax.

ELECTIVE PAPER 6C: INTERNATIONAL TAXATION

CASE STUDY - 6

M/s. Hari Om & Co., an Indian firm, is a leading tax consultant with headquarters in Mumbai. The firm has four resident partners, Mr. Shivakumar, Mr. Hari Prakash, Mr. Om Prakash and Mr. Narayan and one non-resident partner, Mr. Vallish. As per the partnership deed, the profits and losses are shared equally amongst partners. All partners are working partners and salary is paid to all partners as per the terms of the partnership deed.

Mr. Vallish, the non-resident partner, is a resident of Country L. Mr. Vallish has also invested in India Infradebt Ltd., an infrastructure debt fund notified under section 10(47). He is due to receive interest of Rs.5 lakhs in March, 2020 from such fund. He incurred expenditure of Rs. 10,000 to earn such income. Mr. Vallish's brother Harish is also resident of Country L. Both Mr. Vallish and Mr. Harish are citizens of India.

M/s. Hari Om & Co. provides consultancy services in relation to domestic tax laws, both direct and indirect. Over the last couple of years, they have taken up few assignments in the area of international taxation. These assignments relate to double taxation avoidance agreements, nonresident taxation and other international taxation matters.

The details of the assignments are as follows -

Assignment 1 [Client – Mr. Harry Smith]

Mr. Harry Smith, a citizen and resident of Country Y, and a swimmer came to India for participation in international swimming competition held in New Delhi. He came to New Delhi on 5th February, 2020 and left on 30th March, 2020 for Country Y. He received Rs. 15 lakhs for participation in competitions in India. He also received Rs. 2 lakh from XYZ Ltd. for advertisement of a product, namely shaving cream, on television. He contributed articles related to swimming in a newspaper for which he received Rs. 20,000. He incurred Rs.1 lakh as his travel costs to India. All other expenses were met by his sponsors. When he stayed in India, he also won a prize of Rs. 25,000 from horse racing in Mumbai. He has no other income in India during the year ended 31.3.2020. He wants to know his tax liability in India. He also wants to know whether he has to file return of income in India.

Mr. Harry Smith has a sister Ms. Rita Smith and a brother Mr. Austin Smith, who are also citizens and residents of Country Y. Ms. Rita Smith is a pop singer who accompanied Mr. Harry Smith to India in February-March, 2020. She earned Rs. 2 lakhs from music performances given by her in India during that period. She has no other income in India during the year. Mr. Harry Smith wants to know Ms. Rita Smith's tax liability in India and whether she has to file her return of income in India.

Assignment 2 [Client – MNO Ltd.]

MNO Ltd., a company having registered head office in Country X, for the first time, carried out operations during the year 2019-20 of purchase of goods in India on three occasions. Immediately after purchase, the company exported the same to China. The total value of such exports was Rs. 85 lakhs, on which it earned profits of Rs. 15 lakhs, before the expenses of Rs. 8 lakhs, which were directly paid by H.O. The company does not carry on any other operation in India. All its board meetings are held in Country X and key management and commercial decisions for the conduct of the company's business as a whole are taken in such board meetings. The company wants to know its tax liability in India for A.Y.2020-21.

Assignment 3 [Client - M/s. Pacific Airlines]

M/s. Pacific Airlines, incorporated as a company in Country Y, operated its flights to India and *vice versa* during the year 2019-20 and collected charges of Rs. 280 crores for carriage of passengers and cargo out of which Rs. 100 crores were received in Country Y Dollars for the passenger fare from Country Y to Delhi. Out of Rs. 100 crores, Country Y dollars equivalent to Rs. 40 crores is received in India. The total expenses for the year on operation of such flights were Rs. 11 crores. The company wants to know its income chargeable to tax in India for A.Y.2020-21 and the rate at which such income would be subject to tax.

Note *- India does not have any double tax avoidance agreement with Countries L, X and Y.*

Based on the above facts, answer the following questions –

Multiple Choice Questions

Write the most appropriate answer to each of the following questions by choosing one of the four options given. Each question carries two marks.

1. Assuming that the tax deductible at source, if any, has been fully deducted, does Mr. Harry Smith and Ms. Rita Smith have to file return of income in India for A.Y.2020-21?

(a) Yes, because they have earned income in India which is chargeable to tax as per the provisions of the Income-tax Act, 1961.

(b) No, because tax deductible at source has been fully deducted from income earned by them in India

(c) Harry Smith has to file his return of income but Rita Smith need not file her return of income

(d) Rita Smith has to file her return of income but Harry Smith need not file his return of income

2. MNO Ltd. is a company -

(a) resident in India, since it has carried on the operation of purchase of goods in India

(b) non-resident in India, since its registered head office is in Country 'X'

(c) non-resident in India, since key management decisions are taken in Country 'X'

(d) non-resident in India, due to reasons stated in (b) and (c) above.

3. The effective rate of income-tax applicable on total income of M/s. Pacific Airlines is –

(a) 42.432%

(b) 44.512%

(c) 43.68%

(d) 46.592%

4. Salary paid by M/s. Hari Om & Co. to its partners falls within the limits prescribed under section 40(b)(v). Does Hari Om & Co. have to deduct tax on salary paid to its partners?

(a) Yes; tax is deductible at source under section 192 on salary paid to its partners.

(b) No; salary paid to partners is not subject to tax deduction at source

(c) Yes; tax is deductible at source under section 192 on salary paid to resident partners and under section 195 on salary paid to the non-resident partner

(d) Salary paid to resident partners is not subject to tax deduction at source; but tax has to be deducted under section 195 on salary paid to the non-resident partner

5. Mr. Harish and Mr. Austin Smith have been appointed as senior officials of Country L embassy and Country Y embassy, respectively, in India in October, 2019. Mr. Harish and Mr. Austin Smith are subjects of Country L and Country Y, respectively, and are not engaged in any other business or profession in India. The remuneration received by Indian officials working in Indian embassy in Country L is exempt but in Country Y is taxable. The tax treatment of remuneration received by Mr. Harish and Mr. Austin Smith from embassies of Country L and Country Y, respectively, in India for the P.Y.2019-20 is:

(a) Exempt from income-tax under section 10

(b) Taxable under the Income-tax Act, 1961

(c) Remuneration received by Mr. Harish is exempt but remuneration received by Mr. Austin Smith is taxable

(d) Remuneration received by Mr. Harish is taxable but remuneration received by Mr. Austin Smith is exempt.

DESCRIPTIVE QUESTIONS

1.

(a) Compute the income-tax liability of Mr. Harry Smith and Ms. Rita Smith for A.Y.2020-21. (6 Marks)

(b) Let us suppose that there has been a failure to deduct tax at source on the amount of Rs.2 lakh paid by XYZ Ltd. to Mr. Harry Smith for advertisement of shaving cream. The Assistant Commissioner of Income-tax imposed penalty on the company for failure to deduct tax at source. The company seeks your advice on whether penalty is imposable for such failure and if so, in this case, whether such levy is in order. Examine. ***(3 Marks)***

2.

(a) Examine whether the income of MNO Ltd. would be subject to tax in India. If so, compute the income chargeable to tax in India. ***(2 Marks)***

(b) Determine the income of M/s. Pacific Airlines chargeable to tax in India ***(4Marks)***

ELECTIVE PAPER 6C: INTERNATIONAL TAXATION

SOLUTION TO CASE STUDY 6

I. ANSWERS TO MULTIPLE CHOICE QUESTIONS

1. (c)

2. (d)

3. (c)

4. (d)

5. (b)

II. ANSWERS TO DESCRIPTIVE QUESTIONS

1. **(a)** Mr. Harry Smith is a non-resident in India for A.Y.2020-21, since he has stayed in India only for 54 days in the P.Y.2019-20. Ms. Rita Smith would also be non-resident in India for A.Y.2020-21, since she has also stayed in India only for 54 days in the P.Y.2019-20.

Since Mr. Harry Smith is a non-resident sports person, who is not a citizen of India, the special provisions under section 115BBA would apply to him for income from participation in swimming competition in India, advertisement of product on TV and contribution of articles in newspaper. Income from horse races would, however, be taxable@30% under section 115BB.

Since Ms. Rita Smith is a non-resident entertainer, who is not a citizen of India, the special provisions under section 115BBA would apply to her for computation of income from music performances.

Computation of tax liability of Harry Smith for the A.Y.2020-21

Particulars	₹	₹
Income taxable under section 115BBA		
Income from participation in swimming competition in India	15,00,000	
Advertisement of product on TV	2,00,000	
Contribution of articles in newspaper	20,000	

Income taxable under section 115BB		
Income from horse races	25,000	
Total income	**17,45,000**	
Tax@ 20% under section 115BBA on ₹ 17,20,000		3,44,000
Tax@ 30% under section 115BB on income of ₹ 25,000 from horse races		7,500
		3,51,500
Add: Health & Education cess@4%		14,060
Total tax liability of Harry Smith for the A.Y.2020-21		**3,65,560**

Computation of tax liability of Rita Smith for the A.Y.2020-21

Particulars	₹	₹
Income taxable under section 115BBA		
Income from music performances given in India	2,00,000	
Total income	**2,00,000**	
Tax@ 20% under section 115BBA on ₹ 2,00,000		40,000
Add: Health & education cess@4%		1,600
Total tax liability of Rita Smith for the A.Y.2020-21		**41,600**

(b) Income chargeable to tax under section 115BBA is subject to tax deduction at source under section 194E. Income earned by Mr. Harry Smith from advertisement of products on TV is chargeable to tax@20.8% under section 115BBA and hence, is subject to tax deduction at source of an equivalent amount under section 194E.

Under section 271C, penalty equal to the amount of tax which the person responsible for deducting has failed to deduct, would be leviable. Accordingly, in this case, penalty of Rs. 41,600 would be attracted under section 271C for such failure.

However, section 271C requires such penalty to be imposed by Joint Commissioner. In this case, since penalty has been imposed by Assistant Commissioner, the same is not in accordance with the provisions of section 271C. Hence, the levy of penalty under section 271C in this case by an Assistant Commissioner of Income-tax is not in order.

2. **(a)** MNO Ltd. is a non-resident assessee during the previous year relevant to assessment year 2020-21. As per *Explanation 1(b)* of section 9(1)(i), no income shall be deemed to accrue or arise in India to a non-resident through or from operations which are confined to purchase of goods in India for the purpose of export. MNO Ltd. had purchased the goods in India and thereafter exported the same in total to China and accordingly no income of MNO Ltd. shall be subject to tax for assessment year 2020-21.

Note *- Section 2(26) defines an "Indian Company". The proviso to section 2(26) states that for a company to be an Indian company, the registered or principal office should be in India. In this case, since the registered office is in Country X, MNO Ltd. is not an Indian company.*

A company, other than an Indian company, would be considered as resident in India only if the place of effective management is in India in that year. In this case, since the board meetings in which key managerial decisions for the conduct of the company are taken, are held in Country X, the POEM of MNO Ltd. is not in India. Therefore, MNO Ltd. is not resident in India.

(b) Under section 44BBA, a sum equal to 5% of the aggregate of the following amount is deemed to be the profits and gains chargeable to tax under the head "Profits and gains of business or profession" in respect of a non-resident, engaged in the business of operation of aircraft, M/s. Pacific Airlines, in this case :

(i) the amount paid or payable, whether in or out of India, to the assessee on account of the carriage of, *inter alia*, passengers from any place in India; and

(ii) the amount received or deemed to be received in India by or on behalf of the assessee on account of the carriage of, *inter alia*, passengers from any place outside India.

In the present case, the income chargeable to tax of M/s Pacific Airlines is as follows

Particulars	**Fare for travel from Delhi to Country Y, whether received in India or not (₹)**	**Fare for travel from Country Y to Delhi**	
		Fare received in India (₹)	**Fare not received in India (₹)**
Fare	180 crores (280 crores – 100 crores)	40 crores	60 crores
Deemed income @5% u/s 44BBA	9 (180 crores × 5%)	2 (4 crores × 5%)	Nil

The business income chargeable to tax in the hands of M/s. Pacific Airlines is ₹ 11 crores. No deduction is allowable in respect of any expenditure incurred to earn such income.

MAY-2018 Exams Case Study- 50 Marks

About the assessee

The assessee is a famous movie actor Mr. Ajitabh Khan (AK). He has business interest in few other nations as well. He is a resident in India for the Assessment Year 2020-21.

About yourself

You are the CEO with CA background. You have sound knowledge of the Indian and Foreign tax laws. The date on which various events happened and have been summarized in this case study is 31-3-2020.

Phone call from Manager (Legal) 09.40 hours

A phone call has been received from the Manager (Legal) that a search is being conducted by the Income-tax department at one of the premises of the assessee. No further details are available now.

E-mail from Taxation Manager at 18.00 hours

The Taxation Manager has emailed you the summarized information of income earned by AK during the year ended 31-3-2020 as under: (₹ in crores)

Income from house property (Computed)	4.3
Business income:	
From being the owner of cricket team in Asian Premier League	12.4
Acting in movies	9.415

AK has paid PPF of ₹ 1.2 lakhs and Life Insurance Premium of ₹ 2 lakhs.

Phone call from Manager (Legal) 20.30 hours

The search conducted by the IT Department has come to an end. It appears that some incriminating documents have been unearthed. It is likely that it has come to the notice of the Department that the assessee has earned income of ₹ 12 crores (as converted into INR) in Dubai during the Financial Year 2017-18, which has not been reflected in the return of income filed by AK for the Assessment Year 2018-19 or in any other year.

Further, the presence of certain building, in Panama Islands, which are not appearing in the books of account and financial statements filed with the IT Department. These buildings were purchased for 35.2 million USD on 12-3-2016. For acquiring this asset, brokerage of 2% has been paid to a real estate agent.

Additionally, there are materials to show that the assessee owns 5 rare pieces of art work, acquired on 12-6-2018 in Macau Islands for a price of 3.8 million USD.

E-mail from International Division Manager at 21.00 hours

The International Division Manager has intimated details of income earned from two countries outside India, L and M, with which India does not have any Double Taxation Avoidance Agreement.

The summarized data are as under: (₹ in crores)

Type of Income	L	M
Loss from house property (Computed)	1.3	-
Business income:		
Own	7.2	2.9
Share income from partnership firm	4.8	-
Agricultural income	-	1.2

In country L, share income is not exempt and loss from house property is not eligible for being set off against other income. In country M, agricultural income is also chargeable to income-tax.

In country L, AK has paid income-tax of ₹ 2.16 crores and in country M ₹ 80 lakhs on the total income earned there.

Inputs from Forex Team (Email received at 21.15 hours)

The prevailing rates of exchange on various dates are as under:

Date	1-4-15	12-3-16	1-7-17	31-3-18	1-4-18	1-6-18	1-4-19
1 USD = INR	64.05	64.50	65.10	64.75	65.20	65.40	65.55

Email from Xavier LLP (Registered valuers) at 23.45 hours

The fair market value of the assets acquired abroad were indicated by the registered valuers on various dates are thus:

Sl. No.	Description of Asset	Date	Amount (million USD)
1	Buildings in Panama Island	01-07-2017	38

		31-03-2018	38
		01-04-2019	40
2	Art pieces in Macau	12-06-2018	4
		01-04-2019	4.2

Payment made to foreign player

Mr. Ajmal Kamal, a non-resident player, was called for one of the Asian Premier League Matches, for which ₹ 20 lakhs was paid to him. The withholding tax mentioned in the DTAA with the nation in which the said actor resides, is 15%.

Required:

(a) Find the most suitable alternative for the following (Option to be given in **capital letters A, B, C or D):**

(i) A shopping complex was purchased by the assessee in Colombo for ₹ 5 crores on 12-3-2017. Out of this, investment of ₹ 3 crores is from disclosed sources, which had been offered for tax. This asset comes to the knowledge of the Assessing Officer on 27-12-2019. If the fair market of the house as on the relevant date to be adopted is ₹ 8 crores, the undisclosed foreign income under the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 (BM Act) will be taken as (₹ crores)

(A) 5

(B) 3.2

(C) 3.8

(D) None of the above

(ii) Under the BM Act, the rate of exchange to be adopted for conversion purposes will be the rate specified by

(A) RBI

(B) SBI

(C) Central Government

(D) CBDT

(iii) The Assessing Officer has detected undisclosed foreign income of ₹ 3 crores earned during the year ended 31-3-2019. There is foreign loss of ₹ 1.2 crores also, hitherto not shown in the income-tax return filed for the Assessment Year 2019-20. The quantum of undisclosed foreign income assessed under the BM Act will be

(A) ₹ 1.8 crores

(B) ₹ 1.2 crores

(C) ₹ 3 crores

(D) None of the above

(iv) Unquoted shares acquired in Tokyo on 21-3-2018 came to the notice of the Assessing Officer on 12-3-2020. There is no explanation of the source for the same. The converted value of the shares on 21-3-2018, 1-4-2018, 1-4-2019 and 1-4-2020 are ₹ 12, 13, 14 and 15 crores, respectively. The undisclosed foreign income representing the value of the undisclosed foreign asset, as per the BM Act is

(A) ₹ 12 crores

(B) ₹ 13 crores

(C) ₹ 14 crores

(D) ₹ 15 crores

(v) Under the BM Act, a tax authority below the rank of Commissioner can retain the impounded books normally for a period of

(A) 120 days

(B) 90 days

(C) 60 days

(D) 30 days

(vi) In a typical Tax Convention based on OECD model or UN model, the definition of the term "national" is primarily relevant to the Article dealing with ___________.

(A) Persons covered / General scope

(B) Non-discrimination

(C) Resident

(D) Credit Method

(vii) Controlled Foreign Corporations (CFCs) are __________entities incorporated in an overseas low tax jurisdiction.

(A) Corporate

(B) Non-Corporate

(C) Both corporate and Non-corporate

(D) None of the above

(viii) Existence of a __________in a jurisdiction is a pre-requisite for the purpose of taxation of business profit of an enterprise in that jurisdiction, major Tax Convention:

(A) Business connection

(B) Permanent establishment

(C) Business or professional connection

(D) Any connection giving rise to the said profit

(ix) For the purpose of equalization levy, "specified service" means

(A) Online advertisement

(B) Any provision for digital advertising space or any other facility or service for the purpose of online advertisement.

(C) Specified Service also includes any other service as may be notified by the Central Government.

(D) All of the above.

(x) Following is not an anti-tax avoidance measure in the context of international taxation:

(A)TIEAS

(B) POEM

(C) GAAP

(D) Transfer pricing provisions **(1 x 10 =10 Marks)**

(b) Test the correctness of the following statements, with brief reasons :

(i) A tax authority under the BM Act shall be deemed to be a civil court for all intents and purposes. **(3 Marks)**

(ii) Any payment received for online advertisement will attract equalization levy of 6% **(3 Marks)**

(iii) ABC Ltd. is a domestic company. It has a foreign subsidiary FGH Inc., in a tax haven. If the place of effective management is found to be in India, under the CFC legislation, the entire income of can be taxed in India and FGH Inc., can be treated as a domestic company for several other purposes as well. **(4 Marks)**

(c) Discuss whether AK has fulfilled the requisite conditions for grant of relief under section 91. **(5 Marks)**

(d) AK wants to know the income-tax liability for the Assessment Year 2020-21, with workings.

You are required to provide the same. **(11 Marks)**

(e) Discuss briefly about the amount of TDS applicable for payment to Ajmal Kamal.

(3 Marks)

(f) In respect of the foreign income and foreign assets unearthed by the Department during the search, discuss the tax implications under the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 (BM Act). AK wants to know the year of taxability and the tax amount. Your answer should also cover discussion on the applicable provisions concerned. **(11 Marks)**

Answer

(a) (i) B

(ii) A

(iii) C

(iv) C

(v) D

(vi) B

(vii) A

(viii) B

(ix) D

(x) C

(b) **(i) The statement is not correct.**

A tax authority shall be deemed to be a civil court for the purposes of section 195 of the Code of Criminal Procedure, 1973, which provides for prosecution for contempt of lawful authority of public servants, for offences against public justice and for offences relating to documents given in evidence.

However, he would not be so deemed for the purposes of Chapter XXVI of the Code of Criminal Procedure, 1973, containing the provisions as to offences affecting the administration of justice.

Therefore, the statement that a tax authority shall be deemed to be civil court for all intents and purposes is not correct.

(ii) **The statement is not correct.**

Chapter VIII of the Finance Act, 2016, titled "Equalisation Levy", provides for an equalisation levy of 6% of the amount of consideration for specified services, which includes online advertisement, received or receivable by a non-resident not having permanent establishment in India, from a resident in India who carries out business or profession, or from a non-resident having permanent establishment in India.

Therefore, only if payment is received by a non-resident not having a PE in India, would provisions of equalization levy be attracted and not otherwise.

(iii) **The statement is partly correct.**

As per section 6(3), a foreign company FGH Inc. would be resident in India in any previous year, if, its place of effective management, in that year, is in India. Therefore FGH Inc. would be a resident in India by virtue of section 6(3) of the Income-tax Act, 1961 and its entire income would be taxable in India.

If FGH Inc. becomes a resident on account of its POEM being in India, the provisions of tax deduction at source under Chapter XVII-B as applicable to income received by a resident, would be attracted in respect of income received by FGH Inc.

The rate of tax applicable to FGH Inc. would be the tax rate applicable to a foreign company and not a domestic company. Further, the provisions of dividend distribution tax under section 115-O would not be attracted in the hands of FGH Inc. in respect of the dividend distributed by it, since FGH Inc. is not a domestic company.

In effect, the provisions of the Income-tax Act, 1961 relating to companies resident in India would apply to FGH Inc. However, it cannot be treated as a domestic company for the purposes of the Act.

(c) Conditions to be fulfilled to claim relief u/s 91

In the case of income arising to an assessee in countries with which India does not have any double taxation agreement, relief would be granted under section 91 provided all the following conditions are fulfilled:

(a) The assessee is a resident in India during the previous year in respect of which the income is taxable.

(b) The income accrues or arises to him outside India.

(c) The income is not deemed to accrue or arise in India during the previous year.

(d) The income in question has been subjected to income-tax in the foreign country in the hands of the assessee.

(e) The assessee has paid tax on the income in the foreign country.

(f) There is no agreement for relief from double taxation between India and the other country where the income has accrued or arisen.

Ajitabh Khan is resident for the A.Y. 2020-21. He has income accrues or arises in Country L and Country M and such income is not deemed to accrue or arise in India. The income earned in Country L and Country M is chargeable to tax there and AK has also paid incometax on such income there. India does not have a Double taxation avoidance agreement with Country L and Country M.

AK has fulfilled the necessary conditions for grant of relief u/s 91.

(d) Since Ajitabh Khan is resident in India for the P.Y.2019-20, his global income would be subject to tax in India. Therefore, income earned by him in Country L & M would be taxable in India. He is however entitled to deduction under section 91, since India does not have a DTAA with Country L & M, and all conditions under section 91 are satisfied.

Computation of Tax Liability :- Discussed in Classes

(e) Where any income referred to in section 115BBA is payable to a non-resident non-citizen sportsman, the person responsible for making payment is liable to deduct tax at source @20% on such income under section 194E.

Income referred to in section 115BBA includes income by way of participation in India in any game or sport.

Payment of ₹ 20 lakh by Ajitabh Khan to Mr. Ajmal Kamal[1], a non-resident, for participation in one of the Premier League Matches is income referred to in section 115BBA, hence, Ajitabh Khan is liable to deduct tax at source on such payment @20% under section 194E.

Since Ajmal Kamal is a non-resident, the amount of tax to be deducted would be increased by education cess @2% and secondary and higher education cess @1%. So, the effective rate of tax to be deducted by Mr. Ajitabh Khan is 20.6%

However, DTAA of India with the other Country in which Mr. Ajmal Kamal resides, provides for withholding tax at 15%.

[1] It is logical to assume that Mr. Ajmal Kamal is a non-citizen, since the question mentions that he is a foreign player

Section 90(2) of Income-tax Act, 1961 provides that where the Central Government has entered into a DTAA with a country outside India, then, in respect of an assessee to whom such agreement applies, the provisions of act shall apply to the extent they are more beneficial to the assessee.

Therefore, Mr. Ajitabh Khan is liable to deduct tax @15%, being the most beneficial rate contained in the DTAA, from payment of ₹ 20 lakhs made to Mr. Ajmal Kamal, a nonresident sportsperson.

(f) As per section 3(1) of Black Money and Imposition of Tax Act, 2015, every assessee would be liable to tax@30% in respect of his undisclosed foreign income and asset of the previous year.

However, an undisclosed asset located outside India shall be charged to tax on its value in the previous year in which such asset comes to notice of the Assessing Officer.

As per section 41, in case, where tax has been computed in respect of undisclosed foreign income and asset, the Assessing Officer may direct the assessee to pay by way of penalty, in addition to tax, if any, payable by him, a sum equal to three times the tax so computed.

As per section 43, if any person, being a resident other than not ordinarily resident in India, who has furnished the return of income for any previous year, fails to furnish any information in relation to an asset (including financial interest in any entity) outside India held as a beneficial owner or otherwise, or in respect of which such person was a beneficiary, or if such failure is in relation to any income from a source located outside India, at any time during such previous year, the Assessing Officer may direct such person to pay, by way of penalty, a sum of ₹ 10 lakh.

In this case, search by IT department is conducted on Mr. Ajitabh Khan's, a resident, premises on 31.3.2020 and undisclosed foreign income and assets were found. The undisclosed foreign income would be charged to tax@30% in the P.Y.2017-18. The undisclosed foreign asset would be charged to tax@30% in the P.Y.2019-20, being the year in which it came to the notice of the Assessing Officer. The Assessing Officer may direct penalty, in addition to tax payable by him, a sum equal to three times the tax so computed and ₹ 10 lakh for not disclosing foreign assets and income.

Undisclosed foreign income

Undisclosed foreign income of ₹ 12 crores earned in Dubai during the F.Y.2017-18 is chargeable to tax in the A.Y.2018-19.

The tax payable is 30% of ₹ 12 crores = ₹ 3.6 crores.

Undisclosed foreign assets

Though the building in Panama Islands was purchased in the P.Y.2015-16 and pieces of art work was acquired in the P.Y.2018-19 in Macau islands, the same is chargeable to tax in India under the Black Money Act in the A.Y.2020-21 only, since these assets came to the notice of the Assessing Officer in the P.Y.2019-20.

Particulars	Million $	₹ (in crores)
Undisclosed foreign assets:		
Building in Panama Islands		
Purchase price	35.200	
Add: Brokerage (2% of $ 35.2 million)	0.704	
Cost of acquisition	35.904	
Market value as on valuation date, being value on 1st April of the previous year i.e., on 01.04.2019	40.00	
Fair market value of building in Panama Islands [being higher of cost of acquisition and the price that the property shall ordinarily fetch if sold in the open market on the valuation date]	40.00	
Relevant rate of exchange for the purpose of conversion into Indian currency [being the rate of exchange on 1st April of the previous year i.e., on 01.04.2019] - 65.55		
Fair market value in Indian currency in crores (40 million x 65.55/10)		262.200
5 pieces of art work		
Cost of acquisition	3.80	
Market value as on valuation date, being value on 1st April of the previous year i.e., on 01.04.2019	4.20	
Fair market value [being higher of cost of acquisition and the price that the artistic work shall ordinarily fetch if sold in the open market on the valuation date]	4.20	

Relevant rate of exchange for the purpose of conversion into Indian currency [being the rate of exchange on 1st April of the previous year i.e., on 01.04.2019] **–** 65.55		
Fair market value in Indian currency in crores (4.2 million x 65.55/10)		27.531
Total undisclosed foreign assets		**289.731**
Tax payable @ 30%		**86.92**

CASE STUDY NO: 8 POEM MAY 2018 Exams - 50 Marks Case Study

About the company

Rup Ram Limited (RRL), is a domestic company, with its head office located at Mumbai. The company has several divisions dealing in manufacture, purchase and sale of several products.

RRL possesses the following assets as on 31-3-2020, whose book values are as under:

Type of asset	***(₹ in crores)***
Intangible assets	*20*
Land and Building	*250*
Plant and Machinery	*140*
Vehicles	*25*

The market value of these assets as on 31-3-2020 is ₹ 750 crores.

Information from Manager, HR

Manager, Human Resources (HR) Division informs you that as on 31-3-2020, there were 340 employees, in the rolls of RRL, resulting in wages/salary payments to the tune of ₹ 11.2 crores.

Subsidiary's presence in India

RRL has a foreign subsidiary Snow White & Co. Inc. (SWC), incorporated in Singapore.

The subsidiary has assets present in India. It has 40 godowns in India, whose market value as on 31-3-2020 is ₹ 40 crores, the book value being ₹ 25 crores, split into ₹ 10 crores for land component and balance for building portion. WDV as on 31-3-2020 for income-tax purposes is ₹ 13.2 crores.

Other fixed assets (all purchased on 14-6-2019) are to the tune of ₹ 10 crores (WDV for the purposes of the Income-tax Act, 1961 (Act) ₹ 8.6 crores). Besides these, there is no other asset in India.

At the beginning of the year, SWC had 22 godowns in India, whose market value was ₹ 15 crores, the book value being ₹ 10 crores, split into ₹ 7 crores for land component and balance for building portion. WDV for the Act purposes is ₹ 6.7 crores.

Assets position of SWC outside India

		As on 1-4-2019	***As on 31-3-2020***
No. of godowns owned		*10*	*11*
		(All values in ₹ Crores)	
Godowns : Land portion	*(Book value)*	*8*	*12*
	(Market value)	*20*	*25*
Godowns : Building part	*(Book value)*	*5*	*12*
	(Market value)	*4.5*	*11*
Godowns : Building part	*(WDV for taxation)*	*4.2*	*10.2*

Other assets: (Book value)	*12*	*20*
(Market value)	*14*	*22*
(WDV for taxation)	*4.2*	*10.2*

Employees strength of SWC

There are 30 persons employed in India, for whom annual payment of ₹ 1.2 crores is incurred by SWC. There are 10 other persons, who, though not directly employed by SWC, perform the work like other employees. Outlay to them is ₹ 34 lakhs. All these employees are residents in India,

SWC employs 42 employees outside India, for whom the total payroll expenditure involved is ₹ 3 crores (converted into INR)

Income pattern from Indian operations of SWC

The income earned by SWC during the year ended 31-3-2020 from its Indian operations as well as other operations is as under:

Type of Income	***(₹ in crores)***	
	In India	***Outside India***
From sale made to RRL	*42*	*-*
From purchases made from RRL and sold to third parties	*10*	*15*
Income from other trading operations with third parties	*5*	*70*
Dividends and interest	*8*	*5*

Technical know how

RRL has entered into a complicated technical know-how agreement with Jew Inc., of Israel. The tax rate applicable and the amount taxable are posing to be ticklish. The annual payment of the technical know-how is likely to be around ₹ 150 crores. Jew Inc., has entered into identical agreements with three other Indian companies.

Sponsorship activities

RRL utilized the services of Graham Stokes, a British cricketer for playing in an important cricket league matches for a team sponsored by the company. He was paid a sum of ₹ 25 lakhs for playing in such matches. In addition, RRL paid him a sum of ₹ 6.76 lakhs for appearing in company's advertisement for its product. Graham Stokes has incurred an expenditure of ₹ 1.2 lakhs in India for earning the said income.

Brian Thorpe, an ex-cricketer hailing from London, was used as a match referee in the said cricket tournaments. He was paid a sum of ₹ 5 lakhs for his services.

Required:

(a) Find the most suitable alternative to the following (option to be given in ***capital letters*** *A, B, C or D)*

(i) The person responsible for making payment of income by way of interest or dividends in respect of bonds or Global Depository Receipts referred to in section 115AC, shall deduct tax at the rate of

(A) 10%

(B) 10.3%

(C) 20%

(D) (B) or at the rate specified in the DTAA, whichever is lower.

(ii) The rate of deduction of tax from interest payable to a foreign company (located in a country with which there is no DTAA) by an Indian company on borrowings made on 12-6-2019 in foreign currency from sources outside India is

(A) 5.15%

(B) 10.3%

(C) 15.45%

(D) None of the above

(iii) Surcharge applicable to a foreign company whose total income is ₹ 1.2 crores is

(A) Nil

(B) 2%

(C) 7%

(D) 10%

(iv) Following income which is accruing or arising outside India, directly or indirectly, is not deemed to be income accruing or arising in India:

(A) Through or from any business connection in India.

(B) Through or from any property in India.

(C) Through transfer of capital asset located outside India.

(D) Through or from any asset or sources of income in India.

(v) Remuneration received for services rendered in India by a foreign national employed by foreign enterprise is exempt, if the number of days stay in India of such foreign national does not exceed

(A) 60 days

(B) 90 days

(B) 30 days

(D) None of the above

(vi) A resident in relation to his tax liability arising out of one or more transactions valuing ₹ ________ in total which has been undertaken or is proposed to be undertaken would be eligible to be an applicant for advance ruling:

(A) 60 crore or more

(B) 80 crore or more

(C) 100 crore or more

(D) 200 crore or more

(vii) An applicant, who has sought for an advance ruling, may withdraw the application within ____________.

(A) 30 days from the date of the application

(B) 30 days from the end of the month in which the application has been made

(C) 60 days from the date of the application.

(D) 60 days from the end of the month in which the application has been made

(viii) In case of a non-notified resident, the AAR will not allow an application in respect of certain matters. The following is not covered in the hit list:

(A) Matter pending with income-tax authorities/tribunal/court.

(B) Determination of fair market value of a property.

(C) Relates to a transaction or issue which is designed prima facie for avoidance of income-tax.

(D) Whether an arrangement, which is proposed to be undertaken by any person being a resident or a non-resident, is an impermissible avoidance arrangement as referred to in Chapter X-A or not.

(ix) The advance ruling given by the Authority for Advance Ruling (AAR) is not binding on the following person(s) :

(A) On the applicant who sought the ruling.

(B) On the other person to the transaction entered into by the applicant, if it is a non-resident.

(C) On the other person to the transaction entered into by the applicant, whether it is resident or non-resident.

(D) On the Principal Commissioner or Commissioner and the income-tax authorities subordinate to the Principal Commissioner or Commissioner who has jurisdiction over the application.

(x) Following income from 'Salaries' which is payable by ______would be deemed to accrue or arise in India:

(A) The Government to a citizen of India for services rendered outside India.

(B) *The Government to a non-resident for services rendered outside India.*

(C) *The Government to a non-citizen or non-resident for services rendered outside India.*

(D) *The Government or any other person to a non-citizen or non-resident for services rendered outside India.* ***(1 x 10 = 10 Marks)***

(b) *State* ***with reasons****, whether the following statements are true or false:*

(i) *When interest payable to a non-resident by the Government or a public sector bank within the meaning of section 10(23D), deduction of tax shall be made at the time of payment thereof in cash or by the issue of a cheque or draft or by any other mode, or at the time of credit of such interest to the account of the non-resident, whichever is earlier.* ***(2 Marks)***

(ii) *Where payment is made to a non-resident, even if such non-resident falls within the specified class notified by the CBDT, even if the payment is not chargeable to tax in India, the payer has to be make an application to the Assessing Officer, before making the impugned payment.* ***(5 Marks)***

(iii) *Where any interest is payable by a person resident in India, the same is deemed to accrue or arise in India* ***(3 Marks)***

(c) *Graham Strokes and Brian Thorpe wish to avail the special provisions applicable to non-residents. The Managing Director of RRL wants to know about the obligation to deduct tax at source from the payments made to the aforesaid two persons.*

If in both the situations above, there is an agreement between RRL and the two British persons that the tax payable on such income in India will be borne by RRL, then, what is the amount of tax to be deducted at source?

Assume that there is no DTAA provision, conferring a lower rate of withholding tax.

(7 Marks)

(d) *Jew Inc. has a sister concern, Silver LLC., which has obtained advance ruling on an identical technical know-how agreement with another Indian company. Can RRL make use of this ruling for its assessment proceeding? What course of action will you advise?*

(4 Marks)

(e) *RRL has made an application to the Assessing Officer for determination of the tax rate applicable for the technical know-how payment to be made to Jew Inc. When this is pending, Jew Inc., has filed an application before the AAR. Can the AAR reject the application on the ground that similar issue is pending before the Assessing Officer?*

(6 Marks)

(f) *The Board of Directors wish to know whether the foreign subsidiary SWC will be regarded as a company engaged in active business outside India for POEM purposes. Advise them suitably. The Board is also looking for your suggestions in this regard.* ***(13 Marks)***

Answer

(a) (i) D

(ii) A

(iii) B

(iv) C

(v) B

(vi) C

(vii) A

(viii) D

(ix) C

(x) A

(b) (i) The statement is false.

As per the proviso to section 195(1), in the case of interest payable by the Government or a public sector bank within the meaning of section 10(23D), deduction of tax shall be made **only at the time of payment thereof** in cash or by the issue of a cheque or draft or by any other mode.

(ii) The statement is true/partly true.

Under section 195(2), where the person responsible for paying any such sum chargeable to tax under the Act (other than salary) to a non-resident, considers that the whole of such sum would not be income chargeable in the hands of the recipient, he **may** make an application to the Assessing Officer to determine, by general or special order, the appropriate proportion of such sum so chargeable. When the Assessing Officer so determines the appropriate proportion, tax shall be deducted under section 195(1) only on that proportion of the sum which is so chargeable.

Section 195(7) provides that, notwithstanding anything contained in sections 195(1) and 195(2), the CBDT may, by notification in the Official Gazette, specify a class of persons or cases, where the person responsible for paying to a non-corporate non-resident or to a foreign company, any sum, whether or not chargeable under the provisions of this Act, shall make an application to the Assessing Officer to determine, by general or special order, the appropriate proportion of sum chargeable to tax. Where the Assessing Officer determines the appropriate proportion of the sum chargeable, tax shall be deducted under section 195(1) on that proportion of the sum which is so chargeable.

Consequently, where the CBDT specifies a class of persons or cases, the person responsible for making payment to a non-corporate non-resident or a foreign company in such cases has to mandatorily make an application to the Assessing Officer, whether or not such payment is chargeable under the provisions of the Act.

In other cases, the person responsible for making payment, if he considers that the whole of such sum would not be income chargeable to tax in the hands of the recipient, **may** make an application to the Assessing Officer.

(iii) The statement is true/partly true.

As per section 9(1)(v)(b), income by way of interest payable by a resident is deemed to accrue arise in India.

However, if interest is payable in respect of any debt incurred or money borrowed and used, for the purposes of a business or profession carried on by such person outside India or for the purposes of making or earning any income from any source outside India, such interest would not be deemed to accrue or arise in India.

(c) (i) As per section 115BBA, ₹ 25 lakhs earned by Graham Strokes, a non-resident sports person, who is not a citizen of India, from participation in cricket matches and ₹ 6.76 lakhs from advertisement i.e., ₹ 31.76 lakhs earned by him totally is chargeable to tax@20.8%.

No deduction is allowable in respect of any expenditure to earn such income.

Section 194E requires tax deduction at source @20.6% from such income paid to a non-resident sportsperson.

TDS = ₹ 31.76 lakhs x 20.8% = ₹ 6,60,608

Section 195A provides that if such tax is to be borne by the person by whom the income is payable, RRL, in this case, then the net amount of ₹ 31.76 lakhs payable has to be grossed up in the following manner:

₹ 31.76 lakhs x 100/79.2 (i.e., 100 – 20.8) = ₹ 40,10,101

TDS = ₹ 40.10 lakhs x 20.8% = ₹ 8,34,101

(ii) A match referee is, however, not a sportsperson. Therefore, he is not entitled to the benefit of section 115BBA. The rate at which the sum of ₹ 5 lakhs received by him would be taxable at normal rates.

Tax would be deductible under section 195 at the rates in force, i.e., 30.9%.

TDS = ₹ 5,00,000 x 31.2% = ₹ 1,56,000

Applying the grossing up provisions under section 195A,

₹ 5 lakhs x 100/68.8 (i.e., 100 – 31.2) = ₹ 7,26,744

TDS = ₹ 7,26,744 x 31.2% = ₹ 226744

(d) As per section 245S(1), the advance ruling pronounced under section 245R by the Authority for Advance Rulings shall be binding only on the applicant who had sought it and in respect of the transaction in relation to which advance ruling was sought. It shall also be binding on the Principal Commissioner/Commissioner and the income-tax authorities subordinate to him, in respect of the concerned applicant and the specific transaction.

In view of the above provision, RRL cannot use the advance ruling, obtained on an identical issue by Silver LLC, a sister concern of Jew Inc., in its assessment proceedings.

Hence, the best course would be to file a fresh application for advance ruling in respect of this agreement between RRL and Jew Inc.

Note *- The Madras High Court, in CIT v. P. Sekar Trust (2010) 321 ITR 305, observed that though the advance ruling pronounced does not become a precedent, it has persuasive value where the facts warrant such reference to the rulings of AAR. There is no legitimate bar for relying on the reasoning in an advance ruling.*

Accordingly, there is no legitimate bar in RRL relying on advance rulings obtained on an identical issue by Silver LLC in its assessment proceedings.

Therefore, based on the Madras High Court ruling, RRL may be advised to use the advance ruling pronounced in Silver LLC's case in its assessment proceedings.

(e) This issue came up before the AAR in, *Nuclear Power Corporation of India Ltd. In Re, [2012] 343 ITR 220*, wherein it was held that an advance ruling is not only applicant specific, but is also transaction specific. The advance ruling is on a transaction entered into or undertaken by the applicant. That is why section 245S specifies that a ruling is binding on the applicant, **the transaction** and the Principal Commissioner or Commissioner of Income-tax and those subordinate to him, and not only on the applicant.

What is barred by the first proviso to section 245R(2) of the Act in the context of clause (i) thereof is the allowing of an application under section 245R(2) of the Act where "the question raised in the application is already pending before any Income-tax authority, or Appellate Tribunal or any court". The significance of the dropping of the words, "in the applicant's case" with effect from June 1, 2000, cannot be wholly ignored.

On the basis of this view expressed by the AAR in the above case, explaining the impact of the dropping of the words "in the applicant's case" with effect from 1.6.2000, a view can be taken that the AAR can reject the application made by Jew Inc before the AAR on the ground that similar issue is pending before the Assessing Officer in respect of the same transaction i.e., provision of technical know to RRL.

Note *– The issue relates to the admission or rejection of the application filed before the Advance Rulings Authority on the grounds specified in clause (i) of the first proviso to sub-section (2) of section 245R of the Income-tax Act, 1961.*

The first proviso to section 245R(2) has been substituted by the Finance Act, 2000 with effect from 1.6.2000. Clause (i) of the first proviso, prior to and post amendment, reads as follows:

Prior to 1.6.2000	***On or After 1.6.2000***
Provided that the Authority shall not allow the application ***except in the case of a resident applicant*** *where the question raised in the application is already pending* ***in the applicant's case*** *before any income-tax authority, the Appellate Tribunal or any court;*	*Provided that the Authority shall not allow the application where the question raised in the application is already pending before any income-tax authority or Appellate Tribunal or any court.*

The words "except in the case of a resident applicant" and "in the applicant's case" has been removed in clause (i) of the first proviso with effect from 1.6.2000. However, the Explanatory Memorandum to the Finance Act, 2000, explaining the impact of the substitution, reads as follows "It is proposed to substitute the proviso to provide that the Authority shall not allow the application when the question raised is already pending in the applicant's case before any income-tax authority, Appellate Tribunal or any court in regard to a non-resident applicant and resident applicant in relation to a transaction with a non-resident". Therefore, according to the intent expressed in the Explanatory Memorandum, the AAR shall not allow the application both in the case of resident and non-resident applicant if the question raised is already ***pending in the applicant's case*** *before any income-tax authority. Thus, as per the Explanatory Memorandum, it is possible to take a view that even post-amendment, the Authority shall not allow the application where a question is* ***pending in the applicant's case*** *before any income-tax authority. Thus, an alternative view is possible on the basis of the AAR ruling in Ericsson Telephone Corporation India AB v. CIT (1997) 224 ITR 203, which continues to hold good even after the amendment, if we consider the intent expressed in the Explanatory Memorandum.* ***Accordingly, based on this view, the AAR can allow the application made by Jew Inc., even if the question raised in the application is pending before the Assessing Officer in RRL's case****.*

(f)

A company shall be said to be engaged in "active business outside India" for POEM, if

- the passive income is not more than 50% of its total income; **and**
- less than 50% of its total assets are situated in India; **and**
- less than 50% of total number of employees are situated in India or are resident in India; **and**
- the payroll expenses incurred on such employees is less than 50% of its total payroll expenditure.

Snow White & Co. Inc (SWC) shall be regarded as a company engaged in active business outside India for POEM purpose only if it satisfies all the four conditions cumulatively.

Condition 1: Passive income test

The passive income of SWC should not be more than 50% of its total income

Passive Income	Rs. in crores
From sales made by SWC to RRL [See Note below]	-
From purchases made from RRL and sold to third parties	-
Dividend and Interest	13
Total passive global income	**13**
Total income of SWC	**155**
Percentage of passive income earned	**8.4%**

Total income of SWC during the P.Y. 2019-20 is ₹ 155 crores, being ₹ 65 crores in India [₹ 42 crores + ₹ 10 crores + ₹ 5 crores + ₹ 8 crores] and ₹ 90 crores outside India [₹ 15 crores + ₹ 70 crores + ₹ 5 crores]

Since passive income of SWC i.e., 8.387% is less than 50% of its total income, **the first condition (Passive income test) is satisfied.**

Note *- Passive income, inter alia, includes income from the transactions where both the purchase and sale of goods is from/to its associated enterprises. In the facts of the case study, income of ₹ 42 crores earned from sales made to RRL is given, but whether these sales are made out of purchases from associated enterprises or out of third party purchases is not given in the question. This income of ₹ 42 crores is not included in the passive income assuming that the purchases have not been made from associated enterprises. However, if it is assumed that the sales are made out of the purchases made from associated enterprises ₹ 42 crores has to be included in computing passive income. In such a case, passive income and the percentage of passive income to total income would be ₹ 55 crores and 35.48%, respectively.*

Even in this case, since passive income of SWC is only 35.48% of total income (i.e., less than 50% of total income), the first condition is satisfied.

Condition 2: Assets Test

SWC should have less than 50% of its total assets situated in India

Value of assets is determined in the following manner:

In case of pool of fixed asset, being treated as a block for depreciation	The average of its value for tax purposes in the country of incorporation of the company at the beginning and at end of the year;
In case of any other asset	Value as per books of account

Value of assets of SWC:

Particulars	In India (₹ in crores)	Outside India (₹ in crores)
Godowns (building portion only), being depreciable asset, at average of its WDV as on 31.3.2019 and as on 31.3.2020	$\frac{6.7 + 13.2}{2}$ = **9.95**	$\frac{4.2 + 10.2}{2}$ = **7.20**
Other fixed assets, being depreciable assets, at average of its WDV as on 31.3.2019 and as on 31.3.2020	$\frac{0 + 8.6}{2}$ = **4.30**	$\frac{4.2 + 10.2}{2}$ = **7.20**
Land [Value as per books of account on 31.3.2020]	**10.00**	**12.00**
Total	**24.25**	**26.40**

Percentage of assets situated in India to total assets = ₹ 24.25 crores/₹ 50.65 crores x 100 = **47.88%**

Since the value of assets of SWC situated in India is less than 50% of its total assets, **the second condition (Assets test) is also satisfied.**

Condition 3: Number of employees test

Less than 50% of the total number of employees of SWC should be situated in India or should be resident in India

SWC employed 30 persons in India and 10 other persons, who are resident in India but not directly employed by SWC though they perform work like any other employee.

For counting the number of employees in India, the average of the number of employees as at the beginning and at the end of the year has to be considered and it would include persons, who, though not employed directly by the company, perform tasks similar to those performed by the employees.

Therefore, number of **employees situated in India or are resident in India is 40 i.e., 30+10**[1]

Total number of employees of SWC is 82, being 42 employed outside India and 40 in India or resident in India.

Percentage of employees situated in India or are resident in India to total number of employees is 40/82 x 100 = **48.78%**

[1] It is assumed that the number of employees are same throughout the year, in the absence of information to the contrary in the question.

Since employees situated in India or are residents in India of SWC are less than 50% of its total employees, **the third condition (Number of employees test) is satisfied** for active business outside India test.
Condition 4: Payroll expenses Test The payroll expenses incurred on employees situated in India or residents in India should be less than 50% of its total payroll expenditure
Payroll expenditure on employees situated in India or are residents in India is **₹ 1.54 crores** i.e., ₹ 1.20 crores ***plus*** ₹ 0.34 crores Total payroll expenditure of SWC is **₹ 4.54 crores** being expenditure on employees situated in India or are residents in India and expenditure on employees outside India [i.e., ₹ 1.54 crores + ₹ 3 crores]. Percentage of payroll expenditure on employees situated in India or are resident in India to total payroll expenditure is ₹ 1.54 crores/₹ 4.54 crores x 100 = **33.92%** Since payroll expenditure on employees situated in India or are residents in India of SWC is less than 50% of its total payroll expenditure, **the fourth condition (Payroll expenses test) is also satisfied**.
Conclusion: Since SWC satisfies all the above four conditions cumulatively, SWC will be **regarded as a company engaged in active business outside India**
Suggestions to the Board of Directors The following suggestions may be offered to the Board of Directors: (a) Income from transactions with associated enterprises like RRL should be scrupulously and constantly monitored, so that the conditions above continue to be satisfied in future years; (b) Steps may be taken to improve trade with unrelated third parties; (c) Percentage of Indian assets to total assets is almost 48%. If there is any plan to acquire assets in India, it must be ensured that this does not cross 50% (d) Percentage of employees situated in India or are resident in India to the total number of employees is 48.78%. In case of any future employment, this ratio has to be borne in mind.

CASE STUDY- 50 MARKS TRANSFER PRICING

Sigma Corporation Ltd. (SCL), is a company incorporated under the Companies Act, 2013, having factory and registered office in Mumbai. It is engaged in manufacture, purchase and sale of men's wear, selling various kinds of garment products according to the requirement of the buyers across the world. The company has sold different garment products in the Financial Year 2019-20 to different vendors in the Indian and outside Indian market, including sale of T-shirts to one its associated enterprises, namely, John Miller of UK, to whom it had sold 2,50,000 pieces at the rate of ₹ 1,000 per piece.

Major portion of the income of SCL is from sale of manufactured products. The company (SCL) maintains a gross profit margin of 30% on the selling price. However, it has purchased the T-shirts sold to its UK based associated enterprise John Miller from Mudra Garments Ltd. of Ahmedabad at a price of ₹ 840 per piece.

Following functional differences were noted between the transaction with the UK based customer and other parties:

(a) Sales to third parties had been made with a specialized packaging for which 3% margin is included in the selling price.

(b) Tagging on the product purchased is being required by the other clients for which cost was ₹ 3 per piece, whereas in case of sales made to John Miller of UK, no tagging is to be done.

(c) Products sold to third parties involve a credit period of 6 months for which 0.5% per month margin on selling price is ensured by Sigma Corporation Ltd.

SCL, for the purpose of diversification, is now contemplating to expand its business operations by establishing an affiliate in the Mediterranean. Two countries under consideration of the Board of SCL are Spain and Cyprus. SCL intends to repatriate all after-tax foreign source income from the affiliate to India. In India, the corporate income/may be taken as 30 percent.

At this point, Sigma Corporation Ltd. is not certain whether it would be better to establish the affiliate operation in two countries as a branch operation or a wholly-owned subsidiary of the parent company.

In Cyprus, the marginal corporate tax rate is 20 percent and the foreign branch profits are also taxed at the same rate. In Spain, the corporate income is taxed at 25 percent and additionally, foreign branch income is also taxed at the same rate of 25 percent.

The withholding tax treaty rates with India on dividend income paid from Cyprus is 15 percent and when paid from Spain is 20 percent.

The Chief Financial Officer (CFO) of the company appraised the Board of Directors that the matters of the company pending before the tax authorities are involving several issues for which a show cause notice for A.Y. 2017-18 has been issued by the A.O. The issues of concern as has been raised in this notice in brief are:

(i) The. company has not maintained proper records of the international transactions required under the Income-tax Act, 1961 (Act) and has also defaulted in not obtaining the report of the auditors within the prescribed time.

(ii) The transactions entered into with the associated enterprises during the previous year for determination of ALP have been referred by the AO to the TPO on 22.12.2019 for the reason of under-reporting.

(iii) The total international transactions carried out by the company during the previous year were of ₹ 200 crores and why penal action should not be taken against the company for the defaults stated in para-1.

The CFO further informed that the TPO to whom a reference was made by the A.O., had of his own, selected one more, party M/s Sun Apparels for determination of the ALP, which is an un-related person and not an associated enterprise but based at UK and whether it is resident or non-resident is also not known.

SCL is contemplating to file an application for advance ruling with the Authority for Advance Ruling.

The Board of SCL now asked you to help them by advising in determination in the context of taxation provisions contained under the Act, relating to international business as prevailing in India and other countries, as well as the expert opinion on the various issues raised in the show cause notice by the AO as appraised by the CFO.

Required:

(a) (i) Determine the Arm's Length Price (ALP) of the transactions of sale of T-shirts during the year to the AE John Miller of UK and its probable impact on the income of the company for A.Y.2020-21. ***(6 Marks)***

(ii) Can TPO invoke his powers in relation to an international transaction not referred to him? Is the action taken by the TPO in relation to determination of ALP of the transactions undertaken by the company with M/s Sun Apparels of UK justified?

(4 Marks)

(b) (i) Where and in which country should the new affiliate be situated and which organizational structure (i.e. wholly owned subsidiary or branch) is to be selected?

(7 Marks)

(ii) Discuss whether the total tax liability in Cyprus or in Spain would be the least for operating a foreign branch or a wholly owned subsidiary of the parent company.

(3 Marks)

(c) (i) What will be the consequences for the defaults specified by the Assessing Officer in the show cause notice of not maintaining the records, not obtaining of the report from the auditors and under reporting of ALP of the international transactions? ***(5 Marks)***

(ii) What will be the impact on the time limit for completion of assessment by the AO because of reference so made to the TPO and if the company gets a stay for a period of 30 days over the proceedings, then, what will be the fate of the assessment proceedings? ***(5 Marks)***

(d) Choose the most appropriate option for the following (option to be written in ***capital letters*** *A, B, C or D)*

(1) Two methods were found suitable for determination of the Arm's Length Price (ALP). As per CUP methods, it was found to be ₹ 1,200 per unit and as per resale price method, it was ₹ 1,250 per unit. The ALP per unit will be taken as

(A) ₹ 1,200 since it is more favourable to the assessee

(B) ₹ 1,250 since it is more favourable to the Department

(C) ₹ 1,225

(D) None of the above

(2) An assessee having specified domestic transactions covered by section 92BA, should furnish audit report, if the value ·of such transactions exceeds

(A) ₹ 2 crores

(B) ₹ 20 crores

(C) ₹ 10 crores

(D) None of the above

(3) An assesse deriving income from profits of business of an eligible industrial undertaking for which 100% deduction is available u/s 80-IB *has entered into international transactions with an associated enterprise for ₹ 200 crores. The TPO has made an addition of ₹ 15 crores in respect of the ALP. The normal GP margin is 10%. The additional deduction u/s 80-IB which can be claimed by the assessee on account of the increase in the ALP is*

(A) Nil

(B) ₹ 20 crores

(C) ₹ 25 crores

(D) ₹ 15 crores

(4) *The OECD member countries have accepted the concept of Arm's Length Price (ALP) for reaping the following benefit:*

(A) *Minimises double taxation*

(B) *Real taxable profits can be determined*

(C) *Artificial price distortion is reduced*

(D) *All the three above*

(5) *In the context of transfer pricing provisions, international transaction should be in the nature of*

(A) *Purchase, sale or lease of tangible or intangible property*

(B) *Provision of service*

(C) *Lending or borrowing money*

(D) *Any of the above*

(6) *Mr. Dhanush holds shares in both L Ltd., and M Ltd. In the context of transfer pricing provisions,*

(A) *L Ltd. and M Ltd. can never be associated enterprises.*

(B) *L Ltd. and M Ltd. are deemed associated enterprises if Mr. Dhanush holds 26% or more of voting power in each of these companies.*

(C) *L Ltd. and M Ltd. are deemed associated enterprises if Mr. Dhanush holds 26% or more of voting power in L Ltd., which in turn holds 26% or more of voting power in M Ltd.*

(D) *L Ltd. and M Ltd. are deemed associated enterprises if Mr. Dhanush holds totally 52% or more combined voting power in both these companies.*

(7) *The book value of assets of SCL is ₹ 200 crores, whereas the market value of the said assets is ₹ 80 crores. Sun Ltd. has advanced a loan of ₹ 45 crores. In the context of transfer pricing provisions, SCL and Sun Ltd. are*

(A) *Not associated enterprises*

(B) *Associated enterprises, considering the book value of assets of SCL and its borrowings from Sun Ltd.*

(C) *Deemed to be associated enterprises, considering the book value of assets of SCL and its borrowings from Sun Ltd.*

(D) *Deemed to be associated enterprises considering the market value of assets of SCL and its borrowings from Sun Ltd.*

(8) J Ltd. is controlled by Rajeev (HUF). K Ltd. is controlled by Raghav (sole proprietor of RR & Co.,), a close relative of Rajeev, a member of Rajeev (HUF). For the purpose of transfer pricing provisions,

(A) J Ltd. and K Ltd. are deemed associated enterprises.

(B) Rajeev HUF, J Ltd. and K Ltd., are deemed associated enterprises.

(C) RR & Co., Rajeev HUF, J Ltd. and K Ltd., are deemed associated enterprises.

(D) There is no associate enterprise relationship involved in this.

(9) There is an arrangement between SCL and Q Ltd., which are associated enterprises. Such arrangement is oral and is also not intended to be legally enforced. For transfer pricing purposes, such arrangement-

(A) is not treated as a "transaction" because it is not in writing.

(B) is not treated as a "transaction" because it is not intended to be legally enforced.

(C) is treated as a "transaction".

(D) is not treated as a "transaction" for (A) and (B) above.

(10) The ALP determined by the TPO for some product is ₹ 2,000 per unit sold by SCL. Considering the. tolerance band permitted by the CBDT, the tolerated international transaction price for a transaction with an associated enterprise can be upto

(A) ₹ 1,960

(B) ₹ 2,040

(C) ₹ 2,060

(D) None of the above

(11) Following can be an applicant for advance ruling:

(A) Non-resident entering into a transaction

(B) Resident entering into a transaction with a non-resident

(C) Resident entering into a transaction with another resident

(D) (A) or (B)

(12) An applicant for advance ruling may withdraw an application within days from the date of the application.

(A) 30

(B) 60

(C) 90

(D) 120

(13) Composition of AAR is as under:

(A) A Chairman, Vice-Chairman and Revenue Member

(B) A Chairman, Vice-Chairman and Law Member

(C) A Chairman and such number of Vice-Chairman, Revenue Members and Law Members as the Central Government may, by notification, appoint.

(D) Chairman, Vice-Chairman, Law Member and Revenue Member

(14) Following can make an application for advance ruling:

(A) Department

(B) Applicant

(C) Central Government

(D) All above

(15) Application for advance ruling is not allowed in the following situations:

(A) When the question involved is already pending before any income-tax authority.

(B) Where it is for determining the fair market value of a property.

(C) Excepting in exceptions, where the transaction in question is designed for avoidance of tax.

(D) Any one of the above ***(1 x 15 = 15 Marks)***

(e) Fill up blanks :

(i) The applicant desiring roll back of the APA may furnish the request for rollback provision in Form No. 3CEDA with proof of payment of an additional fee of _______.

(ii) The transfer pricing provisions contained in Section 92 shall not apply if the same has the effect of ________________ chargeable to tax.

(iii) If there is an arrangement between SCL and TFL (an associate enterprise) for mark up of a semi-finished product and sale thereafter, the ideal method for determining the ALP is __________ method.

(iv) In a case where the aggregate value of international transactions exceeds ₹______ , it will be obligatory for the assessee to maintain the stipulated information and documents required for transfer pricing purposes.

(v) Where SCL has maintained proper records and documents, and the TPO has made some adjustments to the ALP, thereby increasing the total income by, say, ₹ 2.68 crores, the penalty leviable u/s 270A will be ₹_________. ***(1 x 5 = 5 Marks)***

Answer

(a) (i) Sigma Corporation Ltd. (SCL) maintains a gross profit margin of 30% on the selling price. It purchased T-shirts from an unrelated enterprise which are sold to its UK based AE at a price of ₹ 840 per piece. Under comparable uncontrolled transactions, the sale price of T-shirts would be ₹ 1,200 [₹ 840/(100-30)].

Such sale price has to be adjusted by taking into consideration the functional differences existing between the transactions with the Associated enterprise and other unrelated parties. Accordingly, the arm's length price has to be computed in the following manner:

Computation of Arm's Length Price

Particulars	₹	₹
Sale price of T-shirt	1,200	
Less: **Differences to be adjusted**		
- Margin on specialized packaging (1,200 x 3%)	36	
- Margin for providing 6 months' credit facility [₹1200 x (0.5% x 6 months)]	36	
- Cost of tagging of ₹ 3 per piece	3	
Adjusted sale price per T-shirt	1,125	
Arm's Length value of the sale transaction (₹ 1,125 x 2,50,000)		**28,12,50,000**
Less: Transaction value of sales to AE (₹ 1,000 x 2,50,000)		25,00,00,000
Total Income of SCL Ltd to be increased by		**3,12,50,000**

(ii) Yes; The TPO can generally do so in respect of international transactions.

As per section 92CA(2A), the Transfer Pricing Officer (TPO) can also determine the ALP of other international transactions not referred to him and identified subsequently in the course of proceedings before him.

As per section 92CA(2B), where in respect of an international transaction, the assessee has not furnished the report under section 92E and such transaction comes to the notice of the TPO during the course of proceeding before him, the transfer pricing provisions shall apply as if such transaction is referred to the TPO by the Assessing Officer under section 92CA(1).

As per section 92B, "International transaction" means a transaction between two or more associated enterprises, either or both of whom are non-residents, in the nature of, *inter alia,* purchase, sale or lease of tangible or intangible property.

The transaction entered into by the company, SCL, with M/s Sun Apparels of UK, is not an international transaction, since it is with an un-related person, not being an associated entity.

Therefore, the action taken by the TPO in relation to determination of ALP of the transactions undertaken by the company with M/s Sun Apparels of UK is **not** justified.

(b) (i)

Particulars	Cyprus		Spain	
	Branch	**Subsidiary**	**Branch**	**Subsidiary**
Tax rate in the foreign country	20%	20%	25%	25%
Tax on profit repatriations/withholding tax on dividend	-	15% of 80% = 12%	-	20% of 75% = 15%
Total tax paid in the foreign country	**20%**	**32%**	**25%**	**40%**
Tax payable in India	**30%**	**12%**	**30%**	15% of 75% = **11.25%**

<u>Situation 1 : Assuming that Foreign Tax Credit is available in respect of branch profit tax</u>

Particulars	Cyprus		Spain	
	Branch	**Subsidiary**	**Branch**	**Subsidiary**
Foreign Tax Credit	20%, if such credit is available in respect of branch profit tax (assuming that full credit is available in respect of branch profit tax)	12%	25%, if such credit is available in respect of branch profit tax (assuming that full credit is available in respect of branch profit tax)	11.25%
Net tax payable	**30%**	**32%**	**30%**	**40%**

In Situation 1, where FTC is available in respect of the entire branch profit tax, it would be advisable to establish a branch in the place of subsidiary. The branch can be established either in **Cyprus or in Spain.**

<u>Situation 2 : Assuming that Foreign Tax Credit is not available in respect of branch profit tax</u>

Foreign Tax Credit	0%, assuming such credit is not available in respect of branch profit tax	12%	0%, assuming such credit is not available in respect of branch profit tax	11.25%

Net tax payable	**50%**	**32%**	**55%**	**40%**
In Situation 2, where FTC is not available in respect of branch profit tax, it would be advisable to establish a subsidiary in Cyprus				

Note *- The answer to this question may be based on either of the situations given above or on the basis of the following other factors, which also need to be considered for selecting the new affiliate as branch and subsidiary:*

Particulars	Branch	Subsidiary
Separate Legal Entity	It is not a separate legal entity; the parent company would be liable to tax in respect of profits attributable to the branch, which is a permanent establishment.	A subsidiary is a separate legal entity from the parent, although owned by the parent corporation. A subsidiary qualifies as a "resident" for treaty benefits in the other Contracting State. Its profits are independently taxed in its hands
Taxability of profits repatriated	The profits repatriated by the branch to the head office do not suffer double taxation.	The profits from which the dividend is distributed may be subject to double taxation. In the country in which the subsidiary company is incorporated, corporate income-tax is leviable in respect of its profits. The profits distributed would be subject to tax on dividends in the hands of the holding company in India.
Set-off of loss incurred	The losses from branch can be offset against the profits of the company.	The losses of the subsidiary are not eligible for setoff against the profits of the parent company.
Compliance cost	Relatively lower compliance cost.	Greater compliances to be met.

(ii) Total tax liability

In Situation 1, where FTC is available in respect of the entire branch profit tax, it would be advisable to establish a branch in the place of subsidiary.

The branch can be established either in Cyprus or in Spain. The tax liability would be 30% (plus applicable surcharge and cess)

Hence, from the tax incidence point of view, the tax liability will remain the same. Choice of the country has to be determined based on other factors.

Where alternative view has been taken for Qn. 1(b)(i)

In Situation 2, where FTC is not available in respect of the entire branch profit tax, it would be advisable to establish a subsidiary in Cyprus.

The tax liability would be 32% (plus applicable surcharge and cess)

(c) (i) Consequences for the defaults specified by the AO in the show cause notice

(i)	**Not maintaining the records** Section 271AA provides that the Assessing Officer or Commissioner (Appeals) may direct SCL, i.e., the person entering into an international transaction in this case, to pay penalty@2% of the value of the international transaction entered into by it, if SCL fails to keep and maintain any such document and information as required by section 92D(1) and section 92D(2). No penalty will be leviable under this section, if SCL can show that there was reasonable cause for the failure.
(ii)	**Not obtaining the report from the auditors** As per section 271BA, if SCL fails to furnish a report from an accountant as required by section 92E, the Assessing Officer may direct SCL to pay, by way of penalty, a sum of ₹ 1 lakh. No penalty will be leviable under this section, if SCL can show that there was reasonable cause for the failure.
(iii)	**Under reporting of ALP of the international transaction** Under section 270A, penalty@50% of tax payable on under-reported income is leviable. In this case, SCL has not maintained proper records of international transaction, the under-reported income will not be excluded for levy of penalty.

(ii) Where a reference is made to the TPO under section 92CA(1) during the course of proceeding for assessment or reassessment, an additional time period of 12 months is available for completion of assessment/ reassessment in such cases over and above the time limit given u/s 153.

In computing the above period of limitation, the period during which the assessment proceeding is stayed by an order or injunction of any court, shall be excluded.

Section 92CA(3A) provides that where reference is made to the Transfer Pricing Officer for determination of arm's length price of international transactions, the Transfer Pricing Officer shall make an order at least 60 days before the expiry of the time limit for making an order of assessment by the Assessing Officer.

Where assessment proceedings are stayed by any court and the time available to the Transfer Pricing Officer for making an order is less than 60 days, then, such remaining period shall be extended to 60 days.

Accordingly, for the A.Y. 2017-18 (in the present case) the Assessing Officer has to complete the assessment proceedings by 30.1.2021, within 33 months (plus the stay period of 30 days) from the end of assessment year i.e., 31.3.2018.

The TPO is required to make the order for determination of Arm's Length Price 60 days prior to 30.1.2021 i.e., by 1.12.2020.

(d) (1) D

(2) B

(3) A

(4) D

(5) D

(6) B

(7) A

(8) A

(9) C

(10) D

(11) D

(12) A

(13) C

(14) B

(15) D

(e) (i) ₹ 5 lakh

(ii) Reducing the income

(iii) Profit split

(iv) ₹ 1 crore/₹ 99,99,999

(v) Nil

PAPER 6C: INTERNATIONAL TAXATION

Case Study 1

Alpha Co Ltd. (ACL), having its registered office in Delhi, is engaged in multiple businesses. It has a Knowledge Process Outsourcing (KPO) service unit at Bengaluru, trading centre at Mumbai and manufacturing unit at Chennai. It has borrowed ₹ 200 crores from a leading bank in India for which 100% guarantee was given by the parent company, Gama Inc. of USA. The total borrowings of ACL was ₹ 1,000 crores.

Mumbai Unit

The unit in Mumbai buys mobile handsets from Gama Inc. The handsets are branded for which royalty at ₹ 100 per handset sold is paid to Gama Inc. Similar handsets to other customers in India are also sold by Gama Inc. The credit period offered to Alpha Co Ltd. is 2 months, whereas for the other customers, the credit period is 1 month. During the year, 15,00,000 handsets were bought for an aggregate sum of ₹ 2,400 crores from Gama Inc. The purchase could be assumed as uniform throughout the financial year 2019-20. The cost of capital may be adopted as 12% per annum. Similar handsets when supplied to other customers, Gama Inc. would have billed ₹ 2,640 crores (excluding interest component for the delay beyond 1 month). It may be assumed that the entire purchase has been sold out by 31st March, 2020.

Bengaluru Unit

The KPO unit in Bengaluru has been doing services to Gama Inc. The aggregate value of international transaction during the financial year 2019-20 is ₹180 crores. The unit incurred employee cost which is 50% in relation to operating expenses. The profit margin declared by the unit is 20%. (Note: The benchmark under Safe Harbour Rules is 21% for operating margin with employee cost ranging between 40% and 60%).

Kolkata Liaison Office

Gama Inc. has a liaison office at Kolkata (opened with the permission of RBI), where the orders are booked for supply of mobile handsets directly to customers in India. The liaison office has no connection with any other unit of ACL. The salary and administrative expenses of liaison office are met directly by Gama Inc. During the financial year 2019-20, the liaison office procured orders for 1,00,000 handsets from various customers and by that Gama Inc. made a profit at 20% amounting to ₹ 50 crores (rupee translated). Assume that the exchange fluctuation did not impact the profit of Gama Inc.

Chennai unit

The manufacturing unit at Chennai is engaged in manufacture of automobile spare parts. It paid technical fee of ₹ 100 crores to Gama Inc. during the financial year 2019-20; tax was deducted at source and remitted in May, 2020. The unit also paid commission to overseas agents for booking export orders amounting to ₹ 25 crores for which no tax was deducted at source. It also employed persons for after-sales service in Europe and South Asia, for which salary was paid from India. The total salary payment to overseas employees was ₹ 40 crores and though the payments were made from Chennai, no tax was deducted at source. The payments of commission to the overseas agents were made outside India in foreign currency.

Other information

The assessment of the assessee, i.e. ACL, for assessment year 2019-20 is pending before the Assessing Officer who referred the matter to Transfer Pricing Officer (TPO) for determination of arm's length price (ALP) in respect of the manufacturing unit at Chennai. The TPO, however, expanded the scope of his work by calling for details in respect of all other units of ACL.

Aggrieved with the expanded scope of work carried out by the TPO, ACL wants to approach the Dispute Resolution Panel (DRP), as similar issues for the assessment years 2017-18 to 2018-19 are pending before the Appellate Tribunal. The management of ACL also wants to enter into Advance Pricing agreement (APA) with rollback mechanism.

ACL presently proposes to commence a garment manufacturing unit at Kanpur. It wants to by raw materials from Beta Inc. Singapore. The agreement envisages a monthly supply of goods worth ₹ 30 crores for a period 3 years. It wants to seek advance ruling in this regard.

REQUIRED

As tax auditor of the company, you are requested to answer the following:

(a) (i) Determine the arm's length price (ALP) of the transaction of sale of mobile handsets by Gama Inc. USA to the assessee and its impact on the assessable income for the assessment year 2020-21 *(5 Marks)*

(ii) Explain the procedures to be followed by the Assessing Officer before making reference to TPO. State whether the TPO can enlarge his scope of work by calling for details of KPO unit, Bengaluru and trading activity at Mumbai, when the

Assessing Officer has made reference only in respect of the manufacturing unit at Chennai. *(5 Marks)*

(b) (i) *Discuss the impact of non-deduction of tax at source on salary paid to employees outside India and commission paid to overseas agents by the manufacturing unit at Chennai. Also, state the consequence of delayed deduction of tax on fees for technical services paid to Gama Inc.* *(3 Marks)*

(ii) *Will the profit earned attributable to opening a liaison office at Kolkata by Gama Inc. be chargeable to tax in India? Will the 'Force of Attraction Rule' apply in this case?* *(4 Marks)*

(iii) *State the rate at which tax would have been deducted at source on to the royalty payment to Gama Inc. If the royalty payment was disallowed to the extent of ₹ 20 crores, decide whether the company can seek refund of the excess tax deducted at source on the said royalty payment.* *(2 Marks)*

(c) (i) *What is Safe Harbour Rules? Can the assessee avail the benefit of these Rules in respect of the KPO unit?* *(3 Marks)*

(ii) *Advise the company on the possibility of approaching Dispute Resolution Panel (DRP) and state how it must be carried out.* *(4 Marks)*

(d) *Advise whether the company can go for APA. Would the rollback mechanism of APA help the company to avoid appeal proceedings which are pending at present?* *(4 Marks)*

(e) *Choose the most appropriate alternative for the following MCQs:* *(10 x 2 = 20 Marks)*

(i) *Alpha Co. Ltd. is required to carry out secondary adjustment if the primary adjustment exceeded*

(A) *₹ 50 Lakhs*

(B) *₹ 100 lakhs*

(C) *₹ 200 lakhs*

(D) *₹ 500 lakhs*

(ii) *Time limit available to ACL for filing modified return after advance pricing agreement (APA) is _________ (where the APA was entered into on 1-5-2020).*

(A) *31-8-2020*

(B) *31-7-2020*

(C) *30-11-2020*

(D) *None of the above*

(iii) *The sale price of mobile handsets by Gama Inc. to ACL would have been taken as deemed ALP, if the ALP determined under section 92 by applying the most appropriate method does not exceed -*

(A) ₹ 2,520 crores

(B) ₹ 2,472 crores

(C) ₹ 2,424 crores

(D) Insufficient/irrelevant data.

(iv) ACL can seek advance ruling for the supplies made to Beta Inc., Singapore in relation to its tax liability when the said transaction value is _____ or more.

(A) ₹ 10 crores

(B) ₹ 50 crores

(C) ₹ 100 crores

(D) ₹ 500 crores.

(v) The time limit for AAR to pronounce its ruling from the date of receipt of application of ACL is -

(A) 12 months

(B) 9 months

(C) 6 months

(D) 3 months

(vi) The advance ruling of the AAR is binding on -

(A) The applicant i.e. ACL

(B) Beta Co Ld. for whom the transaction is proposed by ACL

(C) CBDT

(D) Appellate Tribunal

(vii) Gama Inc. availed digital advertising space from Monaco Inc. of Japan for marketing its mobile handsets in India. Gama Inc. paid in Japan, US dollar 10,000 to Monaco Inc. (Assume the Indian rupee value as 6,50,000). The amount of equalisation levy payable by Gama Inc. is -

(A) @6% ₹ 39,000

(B) @10% ₹ 65,000

(C) @40% ₹ 2,60,000

(D) NIL

(viii) The penalty payable for failure to remit equalisation levy is -

(A) ₹ 100 for every day during which the failure continues

(B) ₹ 1,000 for every day during which the failure continues

(C) ₹ 10,000

(D) None of the above

(ix) ACL would not be liable for equalisation levy if it was -

(A) situated in North Eastern States

(B) situated in the Union Territory of Pondicherry

(C) situated in Jammu & Kashmir

(D) a domestic company in which public are not substantially interested

(x) When a foreign company deputed its employees for rendering service in India, a PE would have been automatically established as per U.N. Model Tax Convention, where the employees stay in India during the previous year is

(A) less than 90 days

(B) more than 90 days

(C) less than 180 days

(D) more than 183 days

Solution to Case Study 1

(a) (i) Alpha Co Ltd. (ACL), an Indian company and Gama Inc., a USA based company are associated enterprises as per section 92A, since Gama Inc. is the parent company of ACL. Thus, the transaction of purchase of mobile handsets by ACL from Gama Inc. would be an international transaction. The value of international transaction is to be worked out on the basis of Arm's Length Price (ALP).

Gama Inc. is selling mobile handsets to unrelated customers, which would be the comparable uncontrolled transaction in this case. Such purchase price to unrelated customers has to be adjusted by taking into consideration the functional differences existing between the transactions of Gama Inc. with associated enterprise (ACL) and other unrelated parties.

Accordingly, the arm's length price for purchase of mobile handsets has to be computed for working out the impact on assessable value as per CPU method.

Computation of Arm's Length Price

Particulars	₹ in crores
Purchase price of mobile handsets by unrelated parties from Gama Inc.	2,640
Adjustments for functional differences	
Add: Royalty payable by ACL [₹ 100 per mobile set x 15,00,000]	15
Add: Cost of capital for 1 month credit which is not given to	24

unrelated party [12% x ₹200 crore (monthly average sales i.e., ₹2,400 crore /12 months]	
Arm's Length Price of 15,00,000 sets	**2679**

As per section 92(3), transfer pricing provisions shall not apply in cases where such application results in reduction of income chargeable to tax or increase in loss of the Indian entity. In the given case, if we consider ₹ 2,679 crores as purchase cost of ACL, the same would result in increase in the expenditure of ACL and consequent reduction in profits. Thus, transfer pricing provisions under the Income-tax Act, 1961 will not apply in this case. Consequently, there would be no impact on the assessable income of ACL for the A.Y.2020-21.

Note *– In case it is assumed that ₹ 15 crores is not included in the price of ₹ 2400 crores, the adjustment of royalty of ₹ 15 crores paid/payable is not required. The ALP in such a case would be ₹ 2,664 crores. In such a case also, there will be no impact on the assessable income of ACL for the A.Y.2020-21.*

(ii) As per section 92CA(1), where the Assessing Officer considers it necessary or expedient so to do, he may refer the computation of the arm's length price in relation to the international transaction entered by any person, being an assessee, to the Transfer Pricing Officer (TPO).

However, the Assessing Officer has to take the prior approval of the Principal Commissioner of Income-tax (PCIT)/Commissioner of Income-tax (CIT) before making such a reference.

As per section 92CA(2A), the Transfer Pricing Officer (TPO) can also determine the ALP of other international transactions which comes to his notice subsequently in the course of proceedings before him, even though the same were not referred to him by the Assessing Officer.

In this case, the Assessing Officer has made reference to the TPO for determination of ALP in respect of the manufacturing unit at Chennai which shall be taken as the proceedings before him (TPO). The TPO can enlarge his scope of work during the course of proceedings before him pertaining to the Chennai unit, by calling for details of KPO Unit, Bengaluru and trading activity at Mumbai, since the same is within the powers conferred by section 92CA(2A),

(b) (i) <u>Non-deduction of tax at source on salary paid to employees:</u>

As per section 9(ii), income falling under the head "Salaries" would be deemed to accrue or arise in India if it is earned in India. Income payable for service rendered in India would be regarded as income earned in India.

Salary paid to employees (non-residents) outside India, would not be chargeable to tax in India, since such income is neither deemed to accrue or arise in India (as the employees had not rendered services in India) nor is such income received in India.

Thus, no liability to deduct tax at source under section 192 would arise. Consequently, disallowance under section 40(a)(iii) would not be attracted.

Non-deduction of tax at source on commission paid to overseas agents:

Commission paid in foreign currency for booking export orders to overseas agents, who remain outside India, is not subject to tax in India, since no part of income would be deemed to accrue or arise in India. Consequently, there is no liability for deduction of tax at source. However, section 195(6) requires information relating to payment of such commission to the furnished in the prescribed form.

Consequences of delayed deduction of tax on fees for technical services paid to Gama Inc.

Fees for technical services has been paid during the previous year 2019-20 without deduction of tax at source. Since tax has not been deducted during the previous year 2019-20, the whole of the amount of technical fees which is chargeable to tax under the Income-tax Act, 1961 in the hands of Gama Inc. would be disallowed under section 40(a)(i) while computing income under the head "Profits and Gains of Business or Profession" for the P.Y. 2019-20 in the hands of ACL.

Subsequent deduction of tax at source would be possible by grossing up. Accordingly, the grossed up amount of fees for technical services would be disallowed during the previous year 2019-20, while computing income under the head "Profits and Gains of Business or Profession" in the hands of ACL

Since tax has been deducted and remitted during the previous year 2020-21, such sum (the grossed up amount) would be allowed as deduction in that previous year.

(ii) The term **"permanent establishment" means a fixed place of business** through which the business of an enterprise is wholly or partly carried on.

However, the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity of a preparatory or auxiliary character would not constitute a permanent establishment.

In the present case, the liaison office of Gama Inc. would constitute permanent establishment, since its activities are not of preparatory or auxiliary character but for procuring orders for supply of mobile handsets directly to customers in India.

In the case of *Jebon Corporation India,* the Karnataka High Court held that securing and processing orders have led to the liaison office forming a PE in India. Consequently, the profits attributable to the PE would be chargeable to tax in India.

The Force of Attraction Rule implies that when a foreign enterprise sets up a PE in the State of Source, it brings itself within the fiscal jurisdiction of that State (State of Source) to such a degree that all profits that the enterprise derives from State of Source, whether through the PE or not, can be taxed by it (State of Source).

In the present case, since Gama Inc. is a USA based company, it is logical to assume that the taxability of profits attributable to the PE would be determined based on India-US DTAA, which has a Force of Attraction Rule. Since the India-US DTAA contains the Force of Attraction Rule, the same will apply in the present case

Note - *Relevant extract of the India-US tax treaty is not given in the question. It may be noted that the US Model Convention does not contain Force of Attraction Rule. Accordingly, from the examination point of view, the conclusion may also be given on the basis of the US Model Convention, i.e., since the US Model Convention does not contain the Force of Attraction Rule, it cannot be applied in the present case.*

(iii) As per section 195, Alpha Co. Ltd. is required to deduct tax at source at rates in force, being 43.68% (i.e., @40% *plus* surcharge@5% (since the royalty exceeds ₹ 10 crores) and Health & education cess @4%) on the royalty amount paid to Gama Inc.

The CBDT *Circular No.07/2007 dated 23.10.2007,* as modified by *Circular No.7/2011 dated 27.9.2011,* allowed refund to the person making payment under section 195 in the circumstances indicated therein as the income does not accrue to the non-resident or if the income is accruing, no tax is due or tax is due at a lesser rate. The amount paid to the Government in such cases to that extent does not constitute tax. Since in the present case, there is disallowance of royalty payment, which does not fall under any of the situations listed in the said Circular, the company would not be eligible to claim refund of the excess tax deducted at source on the said royalty payment.

Note - *As per second proviso to section 92C(4), the income of Gama Inc. cannot be recomputed as a result of determination of ALP of ACL. Consequently, Gama Inc. also is not eligible for any refund of tax.*

(c) (i) Section 92CB provides that determination of arm's length price under section 92C or section 92CA shall be subject to Safe Harbour Rules. Section 92CB(2) empowers the CBDT to prescribe Safe Harbour Rules.

'Safe Harbour' means circumstances in which the income-tax authorities shall accept the transfer price declared by the assessee. Accordingly, the CBDT has prescribed safe harbour rules.

Since the value of international transaction entered does not exceed ₹ 200 crore and the employee cost in relation to the operating expenses is 50% (i.e., more than 40% but less than 60%), ACL should have declared an operating profit margin of not less than 21% in relation to operating expense, to be covered within the safe harbour rules.

<u>NOTE: FOR AY 20-21 SHR not notified till now so student may IGNORE this question.</u>

However, since ACL has declared an operating profit margin of only 20%, the same is not in accordance with the circumstance mentioned in Rule 10TD. Hence, ACL cannot avail the benefit of Safe Harbour Rules in respect of the KPO Unit.

(ii) As per section 144C(15), the following assessees are eligible for filing their objections before the Dispute Resolution Panel (DRP):-

- Any foreign Company
- Any person in whose case variation arises on account of order of Transfer Pricing Officer

In this case, since the assessment of ACL is pending before the Assessing Officer who has referred the matter to TPO for determination of arm's length price and had not passed the draft assessment order, it cannot approach the Dispute Resolution Panel (DRP) on the ground that TPO has expanded the scope of work. The draft order of assessment is a pre-requisite for ACL to approach the DRP with its objections.

If the Assessing Officer proposes to make, any variation in the income or loss returned which is prejudicial to the interest of ACL, he has to forward a draft order of assessment to the ACL. After receipt of the draft order containing variation in the income returned, ACL has to file its objections against such order before the DRP and the Assessing Officer within thirty days of receipt of the draft order from the Assessing Officer.

The DRP has to issue directions within 9 months from the end of the month in which the draft order is forwarded to ACL. The direction issued by the DRP would be ultimately binding on the Assessing Officer.

(d) In the facts of the case study, it is stated that the management of ACL wants to enter into the Advance Pricing Agreement (APA) with rollback mechanism. In this background, the advice as to whether ACL can go for APA is to be given.

APA may, subject to such prescribed conditions, procedure and manner, provide for determining the ALP or for specifying the manner in which ALP is to be determined in relation to an international transaction entered into by a person during any period not exceeding four previous years preceding the first of the previous years for which the APA applies in respect of the international transaction to be undertaken.

However, as per Rule 10MA, rollback provision shall not be provided in respect of an international transaction for a rollback year, if,-

(i) the determination of arm's length price of the said international transaction for the said year has been subject matter of an appeal before the Appellate Tribunal and the Appellate Tribunal has passed an order disposing of such appeal at any time before signing of the agreement; or

(ii) the application of rollback provision has the effect of reducing the total income or increasing the loss, as the case may be, of the applicant as declared in the return of income of the said year.

In case of ACL, though similar issues for A.Y. 2017-18 to A.Y. 2018-19 are pending with the Appellate Tribunal, since the Appellate Tribunal has not passed an order disposing appeal, ACL can go for APA with roll back mechanism.

Rule 10RA(4) provides that if any appeal filed by the applicant is pending before the Commissioner (Appeals), Appellate Tribunal or the High Court for a rollback year, on the issue which is subject matter of the rollback provision for that year, the said appeal to the extent of the subject covered under the agreement shall be withdrawn by the applicant.

Rule 10RA(5) provides that if any appeal filed by the Assessing Officer or the Principal Commissioner or Commissioner is pending before the Appellate Tribunal or the High Court for a rollback year, on the issue which is subject matter of the rollback provision for that year, the said appeal to the extent of the subject covered under the agreement, shall be withdrawn by the Assessing Officer or the Principal Commissioner or the Commissioner, as the case may be, within three months of filing of modified return by the applicant.

The rollback mechanism of APA would help in avoiding pending appeal proceedings, since in both the cases (i.e., a case where appeal is filed by the applicant and a case where appeal is filed by the Revenue), the appeal pending before the Appellate Tribunal has to be withdrawn.

(e)

Q. No.	Answer
(i)	(B)
(ii)	(A)
(iii)	(D)
(iv)	(C)
(v)	(C)
(vi)	(A)
(vii)	(A)
(viii)	(B)
(ix)	(C)
(x)	(D)

Case Study 2

Mr. Ram, born in India in the year 1960, left for employment in the United States in October, 1990. His family members, viz; his wife (Smt. Sita) and two sons were then residing at Chennai. He remitted US $ 50,000 to his wife's joint bank account in Chennai on 16th April, 2013. She invested in her name, ₹ 14.45 lakhs in the shares of domestic companies on 14th April, 2014 and ₹ 17 lakhs on 25th March, 2017. The consideration for purchase of shares on both the occasions was met in foreign exchange (USD) and the values, as translated in INR terms, have been furnished. On 28.03.2020, the shares purchased in April, 2014 were sold for ₹ 14 lakhs and the shares purchased in March, 2017 were sold for ₹ 17.50 lakhs. For both purchase and sale of shares, STT of ₹ 1,200 was paid.

Date	*Average of Telegraphic Transfer buying rate and selling rate of 1 US Dollar in Indian rupees.*
14.03.2014	₹ 60
25.03.2017	₹ 65
28.03.2020	₹ 70

Mr. Ram owned a vacant site at Chennai which had been acquired on 14.10.2011 for ₹ 7,40,000. It was sold on 20.03.2020 for ₹ 35 lakhs to Mr. Laxman, his younger brother (a resident at Chennai). The stamp duty valuation of the property was ₹ 40 lakhs. The entire sale proceeds of vacant site and shares were used for acquiring a residential property at Malaysia. He owns only one residential house in Mumbai and a commercial apartment at Singapore, owned since October, 2012.

Note: *Cost inflation indices:*

F. Y. 2011-12 - 184; F. Y. 2013-14 - 220; F. Y. 2014-15 - 240;

F. Y. 2016-17 - 264; F.Y. 2017-18 - 272; and F.Y. 2019-20 - 289.

Smt. Sita (born and brought up in India) returned to India permanently in 2008. She has assets outside India in the form of immovable property, jewellery and bank deposits in Cayman Islands. Proceedings were initiated under Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 ("BM Act") in June 2019. She owns a residential house property at Chennai besides an apartment in the United States occupied by Mr. Ram. She had been moving between India and USA frequently.

Mr. Ram's first son Mr. Lava (born in India in 1985), an engineer, left India in May 2014 for permanently settling down in Australia. He acquired 50,000, 8% debentures of ₹ 100 each in a listed company in India, by remitting foreign exchange in May, 2016. He received debenture interest on 28.03.2020 for the year. He remitted ₹ 1 lakh by way of premium of life insurance policy taken in the year 2008 with capital sum assured of ₹ 12 lakhs. He has dividend income from listed domestic companies of ₹ 25,000 for the year.

Mr. Ram's second son Mr. Kushwah (born in the year 1987 in India) is engaged in textile business at Surat. He has not filed return of income in India since assessment year 2012-13. He has a joint bank account in the United States along with Mr. Ram, with operating rights. The Assessing Officer has issued notice under section 148 for the assessment year 2012-13 onwards on 20th March, 2020.

Mr. Ram, his second son Mr. Kushwah and Mr. Ram's four non-resident friends formed a company by name Bitra Inc. in the United Kingdom on 01.04.2017, which was engaged in trading business. The registered office of company is in Leicester (UK). The company has a branch in India since 01.06.2017. The company is a subsidiary company of Tatla Inc., Singapore in which the four non-resident friends hold 100% shareholding. The entire goods traded by Birta Inc. in the UK and in India are purchased from Tatla Inc., Singapore.

The total activity profile of Birta Inc. is given below:

Financial year / ***Particulars***	***2017-18***	***2018-19***	***2019-20***
Average value of total assets in India (₹ in Crores)	*180*	*220*	*300*
Total income of the company (₹ in Crores)	*90*	*100*	*180*
Total payroll expenses incurred by the company (₹ in Crores)	*180*	*200*	*200*
Average value of total assets of the company (₹ in Crores)	*400*	*450*	*500*
Total average number of employees in India	*1,000*	*1,200*	*1,500*
Total turnover (₹ in Crores)	*1,000*	*1,300*	*1,700*
Dividend from Indian companies (₹ in Crores)	*50*	*60*	*100*
Payroll expenses in India (₹ in Crores)	*100*	*105*	*110*
Total average number of resident employees in India	*900*	*1,100*	*1,300*
Turnover in India (₹ in Crores)	*400*	*700*	*900*
Total average employees of the company for the year	*2,000*	*2,200*	*2,200*

Note: *All the Board meetings of the company were held outside India during the financial year 2019-20.*

Ms. Karuna Kapoor born in the USA was appointed as the CEO of Birta Inc. in India. She joined duty on 01.09.2019 at Mumbai. She was paid salary of ₹ 140 lakhs upto 31.03.2020. Tax was deducted on salary before 31.03.2020 but was remitted only on 14.08.2020.

Ms. Karuna Kapoor was born and brought up in the USA, but her grandparents were born in Karachi before the year 1940. She has never visited India previously.

REQUIRED

You are requested to answer the following issues arising from the above facts:

(a) (i) Mr. Ram wants you to compute his total income and tax thereon, including capital gains tax payable by him for the assessment year 2020-21. *(6 Marks)*

(ii) Mr. Laxman seeks your advice as regards deduction of tax at source on the payment made to Mr. Ram and tax implication of the transaction of purchase of land from brother Mr. Ram. *(4 Marks)*

(b) (i) Compute the total income of Mr. Lava and advise on the possibility of availing the benefits of Chapter XII-A deductions. *(4 Marks)*

(ii) Mr. Kushwah wants to know whether the Assessing Officer can issue notice under section 148 for the assessment year which is beyond 6 years? Advise him. *(2 Marks)*

(c) (i) Apply POEM test on Birta Inc. for the assessment year 2020-21 and briefly discuss the consequences thereof. *(5 Marks)*

(ii) After the POEM test, discuss briefly the legal procedure to be followed by the Assessing Officer for making assessment of Birta Inc. *(2 Marks)*

(iii) Will Birta Inc. be liable for book profit tax under section 115JB for the assessment year 2020-21? State the exceptions from the applicability of book profit tax in the case of foreign companies. *(4 Marks)*

(d) Determine the residential status of Ms. Karuna Kapoor for the Assessment Year 2020-21. *(3 Marks)*

(e) Choose the most appropriate alternative for the following MCQs: *(10 x 2 = 20 Marks)*

(i) When Smt. Sita has undisclosed asset located outside India, what is the time limit within which it is chargeable to tax under Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 ("BM Act")?

(A) Within 16 years from the end of the financial year in which it was originally acquired.

(B) Within 10 years from the end of the financial year in which it was originally acquired.

(C) Within 6 years from the end of the financial year in which it was originally acquired.

(D) No time limit and it would be chargeable to tax when it comes to the notice of the Assessing Officer.

(ii) *When Smt. Sita owns an undisclosed asset outside India being immovable property, its value for the purpose of assessment under BM Act, would be*

(A) Fair market value as on 01.04.1981

(B) Fair market value as on 01.04.2001.

(C) Higher of cost of acquisition or open market value on the valuation date as per valuation report from a valuer recognized by the foreign country.

(D) Lower of cost of acquisition or open market value on the valuation date as per valuation report from a valuer recognised by the foreign country.

(iii) *When Smt. Sita owned a property/asset outside India but has not disclosed the same for income-tax purpose, she can be prosecuted under the BM Act for -*

(A) 3 months

(B) Not less than 6 months but which may extend to 7 years

(C) Not less than 3 months but which may extend to 3 years

(D) None of the above

(iv) *The time limit for completion of assessment of Smt. Sita under the BM Act, is_______.*

(A) 1 year from the end of the financial year i.e. 31.03.2021.

(B) 2 years from the end of the financial year i.e. 31.03.2022

(C) 1 year from the end of the impugned month i.e. 30.06.2020.

(D) None of the above

(v) *When Smt. Sita files appeal before the Appellate Tribunal under the BM Act, the appeal fee payable by her is -*

(A) ₹ 5,000

(B) ₹ 10,000

(C) ₹ 25,000

(D) ₹ 50,000

(vi) *The time limit for filing appeal before the CIT (Appeals) under BM Act, is_________ from the date of service of the notice of demand.*

(A) 30 days

(B) 21 days

(C) 15 days

(D) 60 days

(vii) The four tie-breaker tests to be applied to determine the residence for Smt. Sita are (a) habitual abode; (b) national; (c) permanent home; and (d) centre of vital interests. The correct sequence of tests is -

(A) (d), (c), (a), (b)

(B) (c), (a), (d), (b)

(C) (a), (c), (b), (d)

(D) (c), (d), (a), (b)

(viii) In case Birta Inc. is an international group having Indian parent, the threshold limit of group revenue in order to be liable for Country by Country (CbC) reporting is ₹

(A) 1,000 crores

(B) 2,000 crores

(C) 5,500 crores

(D) 5,000 crores

(ix) Tatle Inc., Singapore is the holding company of Birta Inc., A foreign company having following income is chargeable to tax in India even in the absence of PE:

(A) Interest

(B) Dividend

(C) Royalty

(D) All the above

(x) The tax deducted on salary paid to Ms. Karuna Kapoor which was remitted in May 2020 is eligible for -

(A) 100% disallowance U/s. 40(a)(i)

(B) 30% disallowance U/s. 40 (a)(ia)

(C) Fully allowable

(D) 50% disallowance U/s. 40(a)(ii)

Solution to Case Study 2

(a) (i) Mr. Ram is a non-resident in India during the P.Y. 2020-21 since he is residing in United States since 1990 and does not fulfil either of the basic conditions for being a resident.

In case of a non-resident, only the following incomes are chargeable to tax:

(i) Income received or deemed to be received in India; and

(ii) Income accruing or arising or deemed to accrue or arise in India.

Computation of total income and tax liability of Mr. Ram for A.Y.2020-21

Particulars	Amount in ₹	
Income from house property		
Residential house at Mumbai [Annual Value would be Nil, assuming that the property is unoccupied and no other benefit is derived from such property]		Nil
Commercial apartment in Singapore and residential property at Malaysia [Annual value of house properties outside India is not subject to tax in India, since Mr. Ram is a non-resident]		Nil
Capital Gains		
Long term capital gains on sale of shares of listed companies [As per section 64(1)(iv), income arising to Smt. Sita from transfer of listed shares is includible in the hands of her husband, Mr. Ram, since there has been a transfer of money to a joint account without any consideration, out which Smt. Sita has purchased listed shares in her own name.		
However, since long-term capital gains of ₹ 44,667 **[See Working Note]** on transfer of STT paid listed shares arising to Smt. Sita is exempt under section 10(38), there is no income includible in the hands of Mr. Ram.		
Long term capital gain on sale of vacant site at Chennai (long term, since it is held for more than 24 months)		
Full value of consideration	40,00,000	
As per section 50C, the full value of consideration would be higher of actual consideration of ₹ 35,00,000 and stamp duty value of ₹ 40,00,000		
Less: Indexed cost of acquisition (₹ 7,40,000 x 289/184)	11,62,283	
	28,37,717	
Less: Exemption under section 54F [Not available since investment in residential house in India is only eligible for exemption]	-	28,37,717

Gross Total income/Total Income		**28,37,717**
Tax on total income		
Tax@20% on long-term capital gains of ₹ 28,37,717		5,67,543
Add: Health & Education cess @4%		22,702
Tax liability		**5,90,245**

Working Note:

Computation of long-term capital gains on transfer of shares of listed companies in the hands of Smt. Sita

Particulars	Amount in ₹
Long term capital gain on transfer of shares purchased on 14.4.2014, since held for more than 12 months	
Sale Consideration	14,00,000
Less: Cost of acquisition	14,45,000
Long term capital gain	(45,000)
Long term capital gain on transfer of shares purchased on 25.3.2017, since held for more than 12 months	
Sale Consideration	17,50,000
Less: Cost of acquisition	17,00,000
Long term capital gain	50,000
Long term capital gain [₹ 50,000 - ₹ 45,000]	5,000

***Note** – Since long-term capital gains on transfer of listed shares has to be computed first in the hands of Smt. Sita who is a resident, the benefit of conversion into foreign currency will not be available & benefit of indexation would also not be available in case of Section 112A. Such long-term capital gains on sale of listed shares, on which STT is paid at the time of acquisition and sale, is Taxable only in excess of 1,00,000 @ 10%*

(ii) Requirement of tax deduction at source on payment made by Mr. Laxman to Mr. Ram

As per section 195, any person responsible for paying interest (other than interest referred to in section 194LB or section 194LC or section 194LD) or any other sum chargeable to tax (other than salaries) to a non-corporate non-resident is liable to deduct tax at source at the rates prescribed by the relevant Finance Act.

Hence, since Mr. Ram is a non-resident, Mr, Laxman is required to deduct tax at source at the rates in force i.e., 20% (*plus* cess@4%) in this case, under section 195, in relation to consideration for transfer of vacant site at Chennai.

Since, in this case, the whole of the sale consideration payable to Mr. Ram is not chargeable to tax, Mr. Laxman has to make an application to the Assessing Officer for determining the appropriate proportion of such sum so chargeable; accordingly, tax has to be deducted at the rate of 20.8% only on that proportion of the sum which is so chargeable.

Tax implication of purchase of land in the hands of Mr. Laxman

In case immovable property is received for inadequate consideration, the difference between the stamp duty value and actual consideration would be taxable under section 56(2)(x) in the hands of the recipient, if such difference exceeds ₹ 50,000. However, if immovable property is received from a relative, section 56(2)(x) would not be attracted. Brother falls within the definition of "relative". Hence, the difference of ₹ 5 lakhs [₹ 40 lakhs – ₹ 35 lakhs] would not be taxable in Mr. Laxman's hands.

(b) (i) Mr. Lava is a non-resident in India during the P.Y. 2019-20 since he left India permanently in May, 2014. He does not fulfil either of the basic conditions for being a resident for the P.Y.2019-20.

In case of a non-resident, only the following incomes are chargeable to tax:

(i) Income received or deemed to be received in India; and

(ii) Income accruing or arising or deemed to accrue or arise in India.

Computation of Total income of Mr. Lava for A.Y. 2019-20 under normal provisions

Particulars	Amount
Income from Other Sources	
Interest on debentures in a listed company in India [50,000x100x8%]	4,00,000
Dividend from listed domestic companies [Exempt u/s 10(34)]	-
Gross Total Income	**4,00,000**
Less: Deduction under section 80C in respect of LIC premium (since premium does not exceed 20% of actual capital sum assured)	1,00,000
Total Income	**3,00,000**

Income under Chapter XII-A

As per the provisions of Chapter XII-A, investment income i.e., any income derived (other than dividends referred to in section 115-O) from any specified asset in foreign currency, shall be charged to tax at a flat rate of 20%. Debentures of listed company in India fall under the category of "specified assets".

In computing the investment income of non-resident Indian, no deduction is to be allowed under any provision of the Act in respect of any expenditure or allowance in relation thereto. Accordingly, no deduction under Chapter VI-A shall be allowed, where the gross total income consists only of investment income.

In this case, total income of Mr. Lava would be ₹ 4,00,000 and it would be charged to tax at a flat rate of 20%.

Accordingly, it is more beneficial to Mr. Lava to be governed by the regular provisions of the Act, as per which he would be able to claim deduction of ₹ 1 lakh in respect of LIC premium paid under section 80C. Further, he can avail the benefit of basic exemption limit of ₹ 2,50,000. Therefore, only ₹ 50,000 would be subject to tax@5%.

(ii) Income chargeable to tax shall be deemed to have escaped assessment for the purpose of section 147, where a person is found to have any asset (including financial interest in any entity) located outside India.

Further, section 149 prescribes an extended time limit of 16 years for issue of notice under section 148, in case income in relation to such assets located outside India has escaped assessment.

In this case, since Mr. Kushwah has a joint bank account in the United States along with Mr. Ram, income is deemed to have escaped assessment for A.Y.2012-13. Notice under section 148 issued to Mr. Kushwah on 20th March 2020 in respect of A.Y.2012-13 is valid, since the extended time limit of 16 years from the end of the relevant assessment year has not expired.

(c) (i) For determining the POEM of a company, the important criteria is whether the company is engaged in active business outside India or not.

A company shall be engaged in "Active Business Outside India" (ABOI) for POEM, if

- the passive income is not more than 50% of its total income; **and**
- less than 50% of its total assets are situated in India; **and**
- less than 50% of total number of employees are situated in India or are resident in India; **and**
- the payroll expenses incurred on such employees is less than 50% of its total payroll expenditure.

Birta Inc. shall be regarded as a company engaged in active business outside India for P.Y. 2019-20 for POEM purpose only if it satisfies all the four conditions cumulatively.

Condition 1: The passive income of Birta Inc. should not be more than 50% of its total income

Total income of Birta Inc. during the P.Y. 2019-20 is ₹180 crores

Passive income is the aggregate of, -

(i) income from the transactions where both the purchase and sale of goods is from/to its associated enterprises; and

(ii) income by way of royalty, dividend, capital gains, interest or rental income;

Passive Income of Birta Inc. is ₹100 crores, being dividend income

Percentage of passive income to total income = ₹100 crore/ ₹180 crore x 100 = 55.56%

Since passive income of Birta Inc. i.e., 55.56% is more than 50% of its total income, the first condition is not satisfied.

Note *– Since only purchases are from an associated enterprise i.e., Tata Inc., Singapore, and the sales are to unrelated parties (so assumed in the absence of specific information), no passive income arises from such transactions*.

Condition 2: Birta Inc. should have less than 50% of its total assets situated in India

Value of total assets of Birta Inc. during the P.Y. 2019-20 is ₹ 500 crores.

Value of total assets of Birta Inc. in India during the P.Y. 2019-20 is ₹300 crores

Percentage of assets situated in India to total assets = ₹300 crores/₹500 crores x 100 = 60%

Since the value of assets of Birta Inc. situated in India is not less than 50% of its total assets, the second condition for ABOI test is not satisfied.

Condition 3: Less than 50% of the total number of employees of Birta Inc. should be situated in India or should be resident in India

Number of employees situated in India or are resident in India is 1,500[2]

Total number of employees of Birta Inc. is 2,200.

Percentage of employees situated in India or are resident in India to total number of employees is 1,500/2,200 x 100 = 68.18%

Since employees situated in India or are residents in India of Birta Inc. are not less than 50% of its total employees, the third condition for ABOI test is not satisfied.

[2] It is assumed that "1,500" average number of employees in India includes "1,300" average number of resident employees in India.

Condition 4: The payroll expenses incurred on employees situated in India or residents in India should be less than 50% of its total payroll expenditure

Payroll expenditure on employees situated in India or are residents in India is ₹ 110 crores

Total payroll expenditure of Birta Inc. is ₹200 crores.

Percentage of payroll expenditure on employees situated in India or are resident in India to total payroll expenditure is ₹110 crores/₹200 crores x 100 = 55%

Since payroll expenditure on employees situated in India or are residents in India of Birta Inc. is not less than 50% of its total payroll expenditure, the fourth condition for ABOI test is not satisfied.

Since Birta Inc. does not satisfy all the above four conditions cumulatively, Birta Inc. has not passed the Active Business Outside India (ABOI) test.

Note: *This conclusion can be arrived at on non-satisfaction of any one of the four conditions. There is no need to check satisfaction of other conditions, since even if one condition is not satisfied, the company would not pass the active business outside India (ABOI) test.*

Determination of POEM

There are two-stage process for determination of POEM in case of companies not engaged in active business outside India are:

First stage: Identifying the person(s) who actually make the key management and commercial decisions for the conduct of the company as a whole.

Second stage: Determining the place where these decisions are, in fact, being made.

If the persons who actually make the key management and commercial decisions for the conduct of the company as a whole and the place where these decisions are, in fact, being made is in India, POEM of the foreign company would be considered to be in India. In this case, assuming that such decision making power has been delegated by the Board of Directors to Ms. Karuna Kapoor, who is the CEO of Birta Inc. in India, and she actually makes such key management and commercial decisions in the P.Y.2019-20, then the POEM of Birta Inc. would be in India during that year. Otherwise, the POEM of Birta Inc. would be considered to be outside India.

Consequences

As per section 6(3), a foreign company would be resident in India in any previous year, if its POEM, in that year, is in India.

Note: In this question ICAI Consider data of PY 19-20 but as per Circular we should take AVG of 3 years

If the POEM of Birta Inc. is in India in the P.Y.2019-20, Birta Inc. would be resident in India for A.Y. 2020-21 and its global income would be taxable in India. However, the applicable rate of tax would be that rate of tax applicable to a foreign company.

If the POEM of Birta Inc. is not in India in the P.Y.2019-20, Birta Inc. would be non-resident in India for A.Y. 2020-21 and only the income attributable to its permanent establishment (PE) would be taxable in India.

(ii) The Assessing Officer has to seek the prior approval of the Principal Commissioner or the Commissioner before initiating any proceedings for holding a company incorporated outside India, i.e., Birta Inc., in this case, as being resident in India on the basis of its POEM.

Further, in case the Assessing Officer proposes to hold a company incorporated outside India, on the basis of its POEM, as being resident in India, then, any such finding shall be given by the Assessing Officer after seeking prior approval of the collegium of three members consisting of the Principal Commissioners or the Commissioners, as the case may be, to be constituted by the Principal Chief Commissioner of the region concerned. The collegium so constituted shall provide an opportunity of being heard to the company before issuing any directions in the matter.

(iii) As per section 92F, "Permanent establishment" includes a fixed place of business through the business of the enterprise is wholly or partly carried on. A branch in India would, therefore, constitute a PE.

Since Birta Inc. is a foreign company having a PE in India i.e., branch, it is liable for book profit tax under section 115JB for the A.Y. 2020-21

Explanation 4 to section 115JB provides that the provisions of MAT under section 115JB would not be applicable to a foreign company, in the following cases:

(i) Where the foreign company is a resident of a country or a specified territory with which India has a DTAA under section 90(1) or the Central Government has adopted any agreement between specified associations for double taxation relief under section 90A(1), if such country does not have a permanent establishment in India in accordance with the provisions of DTAA.

(ii) Where the foreign company is a resident of a country with which India does not have an agreement of the nature referred to in clause (i) above, it should not be required to seek registration under any law for the time being in force relating to companies.

(d) An individual is said to be resident in India in any previous year, if she satisfies any one of the following conditions:

(i) She has been in India during the previous year for a total period of 182 days or more, or

(ii) She has been in India during the 4 years immediately preceding the previous year for a total period of 365 days or more and has been in India for at least 60 days **in** the previous year.

If she satisfies any one of the conditions mentioned above, she would be a resident. If both the above conditions are not satisfied, she would be a non-resident.

In the present case, Ms. Karuna Kapoor joins duty on 1.9.2019 in India. Her stay in India during the P.Y. 2019-20 is 213 days (i.e., 30+31+30+31+31+29+31 days). Since her stay in India during the previous year 2019-20 is 182 days or more, her residential status for A.Y.2020-21 is Resident.

An individual is said to be a resident but not ordinarily resident if she satisfies any of the following conditions

(i) If such individual has been non-resident in India in any 9 out of the 10 previous years preceding the relevant previous year, or

(ii) If such individual has during the 7 previous years preceding the relevant previous year been in India for a period of 729 days or less.

If the individual satisfies neither of the conditions mentioned above, she is a resident and ordinarily resident.

Since Ms. Karuna Kapoor was born and brought up in the USA and has never visited India previously, she satisfies both the additional conditions for being a resident but not ordinarily resident. Hence, Ms. Karuna Kapoor is resident but not ordinarily resident in India for the A.Y. 2020-21

(e)

Q. No.	Answer
(i)	(D)
(ii)	(C)
(iii)	(B)
(iv)	(B)
(v)	(C)
(vi)	(A)
(vii)	(D)
(viii)	(C)
(ix)	(D)
(x)	(C)

Case Study 3

ABC LLP is a firm of Chartered Accountants providing services for diversified activities in the fields of Audit, Accounts and Taxation. The International Taxation division of the firm is known for having the expertise in issues and matters relating to International Taxation and Transfer Pricing. The firm has been contacted for seeking their expert opinion on the issues and matters relating to International Taxation and on Transfer Pricing by various constituents/entities and the professional Chartered Accountants. Some of the matters/ issues referred by different entities/constituents/ professionals for obtaining their expert opinion are:-

A. Matters referred by a small firm of Chartered Accountants

The partners of the firm have sought opinion in respect of the matters of their clients for giving reply to the tax authorities relating to the show cause notice issued to tax the income earned by each of the following clients and opinion on other matters so raised by them under the provisions of the Income-tax Act, 1961:-

(i) Techno Engineering, GMBH, a German foreign company entered into an agreement for the execution of electrical work in India for Super Thermal Power Ltd. Separate payments were made towards drawings and designs by Super Thermal Power Ltd. to the German Company which were termed as "Engineering Fee".

The German Company is not having any permanent establishment (PE) in India for doing the business and operates from Germany only.

(ii) Engineers and Engineers Pvt. Ltd. (EEPL) of the UK, a non-resident foreign company, entered into a collaboration agreement on 25.06.2019 with TMT (India) Ltd., an Indian Company. The UK Company was issued debentures by TMT (India) Ltd. for ₹ 120 lacs on 1.07.2019 bearing interest @ 10% p.a. in consideration for providing the technical know-how to TMT (India) Ltd. by the UK Company.

TMT (India) Ltd. also paid the interest on the debentures to EEPL which was due for the relevant period ended on 31.03.20.

(iii) XYZ Ltd. is an Indian Company located in Special Economic Zone (SEZ) in which Qilla Inc., a US company is holding 32% shares and voting power. Following transactions were effected between these two companies during the year 2019-20:-

(a) XYZ Ltd. sold 1,50,000 pieces of T-shirts at $ 3 per T-shirt to Qilla Inc. The identical T-shirts were sold by XYZ Ltd. to an unrelated party, namely, Konny Inc. at $ 4 per T-shirt.

(b) XYZ Ltd. borrowed loan of $ 5,00,000 from a foreign lender on the strength of guarantee given by Qilla Inc. and for the purpose of giving guarantee, XYZ Ltd. paid $ 20,000 as guarantee fee to Qilla Inc. However, for the same amount of loan taken by an unrelated party, Qilla Inc. had charged guarantee fees of $ 15,000.

(c) *XYZ Ltd. paid $ 20,000 to Qilla Inc. for getting the details of various potential customers to improve its business outside India in global market. Qilla Inc. provided the same services and details to an unrelated party for $ 15,000.*

(iv) *During the previous year 2019-20, Mohammed Suleman (MS) was treated as resident in India and also in 'X', a foreign county, with which India had entered into Double Taxation Avoidance Agreement (DTAA). The particulars of assets and income of MS for the year ended 31.3.20 are:-*

(a) *He owns immovable properties (including residential house) in both India and country 'X'.*

(b) *He earned business income of ₹ 50 lacs from rubber estates in the foreign country 'X' during the financial year 2019-20. No business income was earned in India.*

(c) *He sold a house property situated in foreign country 'X' which had resulted in short-term capital gain of ₹ 20 lacs during the year to him and was subject to tax in 'X' country.*

(d) *He has derived rental income of ₹ 6 lacs from the property located in India which was let-out during the year.*

(e) *He was also having a residential house at Lucknow besides the let out property in India which was used by him for his stay when he was visiting India.*

MS had not carried out any business in India and was also not having any permanent establishment in India during the year.

Article 4 of the Double Taxation Avoidance Agreement between India and the foreign country 'X' where also MS in a resident, provides:

"Where an individual is a resident of both the Contracting States, then, he shall be deemed to be resident of the Contracting State in which he has permanent home available to him. If he has permanent home in both the Contracting States, he shall be deemed to be a resident of the Contracting State with which his personal and economic relations are closer (centre of vital interests)".

B. *Matter referred by a Company*

Central India Offshore Pvt. Ltd. (CIOP) is registered under the Companies Act, 2013 and having its registered office located at Hyderabad, provided the following information:

- *The company CIOP is a wholly owned subsidiary (WOS) of CCPI, a company incorporated in UK which was having two other subsidiaries in the US and Canada (collectively referred to as "overseas entities"). The two subsidiaries of US and Canada were engaged in the business of supplying gas and electricity to consumers across US and Canada.*
- *Overseas entities had outsourced their back office support functions such as consumers billings/ debt collections/monthly job reporting to third party service providers (vendors) in India [Central India Offshore Pvt. Ltd. (CIOP)].*

- *CIOP entered into a Service Agreement with the overseas entities to provide locally based interface between the overseas entities and the vendors in India, and was required to (a) ensure that the vendors complied with the requisite quality guidelines; (b) provide management assistance, including advice on expanding the scope of potential service in India. CIOP was compensated for all such activities on cost plus a fixed mark-up basis.*
- *CIOP and the overseas entities entered into a Secondment Agreement under which the overseas entities seconded some of their employees (assignees) with the requisite knowledge and experience to work with CIOP in India.*

The key terms of the Secondment Agreement are as under:-

1. *Overseas entities would second the assignees to CIOP at their request as and when being made.*
2. *The assignees will integrate into CIOP's organisation.*
3. *Rules of service of CIOP will be applicable to the assignees.*
4. *The assignees would work under the direct control and supervision of CIOP.*
5. *The overseas entities would not be responsible for any error or omission on the part of the assignees.*
6. *CIOP would bear the risks and rewards of the work of assignees.*
7. *CIOP was empowered to specify the scope and nature of the assignees' work and the requisite results to be achieved by them.*
8. *Assignees to retain their entitlement to participate in CCPI retirement/social security plans and other benefits in accordance with the policies of CCPI and the regulations of the Country.*
9. *CIOP would bear the monthly costs of employment of assignees, including their basic salary, cost of participation in retirement/social security plans, other compensation and benefits as applicable and any other costs as agreed between CIOP and the overseas entities.*

10 *CIOP could terminate the Secondment Agreement after a notice.*

11 *Each assignee would enter into an individual agreement with CIOP which would provide for specific terms of work in India.*

12 *The salary of all the assignees will be disbursed overseas by the overseas entities and all such amounts to be recovered from CIOP on actual basis.*

REQUIRED

In the backdrop of the aforesaid matters referred to ABC LLP which are being entrusted by them to you, provide your expert opinion/views in the context of provisions contained under Income-tax Act, 1961 supported with workings to the following questions on the matters so referred by the firm of Chartered Accountants and by the Company:-

(a) (i) Will the payment made towards drawings and designs by Super Thermal Power Ltd. to Techno Engineering be subject to tax in India, and if so, why? (4 Marks)

(ii) What treatment shall be given to the debentures of ₹ 120 lacs issued by TMT (India) Ltd. to Engineers and Engineers Pvt. Ltd. of UK on 1.7.2019? Will the interest earned on such debentures be taxed in India in A.Y. 2020-21 and if so, on what amount, the tax shall be charged? Answer to be based only on statutory provisions and ignoring the provisions of Double Taxation Avoidance Agreement (DTAA) between India and UK. (4 Marks)

(iii) Explain the relationship of the companies XYZ Ltd. and Qilla Inc. of US and the nature of various transactions entered into between them during the year 2019-20. Compute the adjustments, if required to be made to the total income of XYZ Ltd. under transfer pricing provisions. Take the value of one US dollar as ₹ 70. (7 Marks)

(iv) Examine with reasons and provide detailed opinion as to whether the business income arising in foreign country 'X' from the rubber estate and the capital gains in respect of sale of the property situated in that foreign country can be taxed in India in the hands of MS during the A.Y. 2020-21. State further as to taxability of the income derived by him in India of the let out and other house property. (7 Marks)

(b) (i) Who will be considered as the employer of the employees (assignees) seconded by the overseas group entities to Central India Offshore Pvt. Ltd. (CIOP) in India and who shall be responsible for making payment of salary to these seconded employees for working with CIOP in India? What will be the nature of payment made by CIOP for the assignees in the hands of overseas entities under the Act and whether such payments made by CIOP on cost plus mark-up basis shall be subject to provisions of TDS? (4 Marks)

(ii) In the context of provisions contained under the Income-tax Act, 1961, and by analysing the terms and conditions as specified in the secondment agreement so entered into amongst the overseas entities and CIOP, examine whether there exists any permanent establishment (PE) in India of the overseas entities and if so, what will be its nature? (4 Marks)

(c) Choose the most appropriate alternative for the following MCQs: (10 x 2 = 20 Marks)

(i) Mr. A holds 40% of shareholding in XYZ Ltd., and 55% in ABC Ltd. However, XYZ Ltd. and ABC Ltd., do not have any shareholding in each other. Select which shall be treated as an associate enterprise or deemed associate enterprises, with reference to specified international transactions with Mr. A:

(A) ABC Ltd.

(B) XYZ Ltd.

(C) Both ABC Ltd and XYZ Ltd.

(D) None of the above

(ii) The excess money determined because of primary adjustments is required to be repatriated within the stipulated time and if not done so, then, the same is treated as an advance subject to charge of interest; where the international transaction is denominated in foreign currency the rate of interest to be charged on such advance amount shall be at LIBOR as on 30th September of the relevant previous year plus:-

(A) 3.25%

(B) 3%

(C) 2.75%

(D) 2%

(iii) In respect of transactions/arrangement between XYZ Ltd. and Quilla Inc., if the Department wants to apply GAAR, the tax benefit arising to ________ must be seen, the threshold limit being ₹_______

(A) XYZ Ltd. only, 3 crore

(B) Both XYZ Ltd. and Quila Inc., 2 crore

(C) Quila Inc. only, 2 crore

(D) Both XYZ Ld. and Quila Inc., 3 crore

(iv) XYZ Ltd., had acquired an office building in Spain on 22-4-2015 for a consideration (as stated in INR) of ₹ 360 lakhs. Of this, ₹ 90 lakhs was from sources on which taxes had been properly paid. This asset comes to the knowledge of the Assessing Officer on 14-7-2017. The FMV of the house as on 1-4-2017 is ₹ 500 lakhs and as on 14-7-2017 is ₹ 600 lakhs. As per the provisions of Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 [BM Act], the FMV to be adopted is the one prevailing as on

(A) 22-4-2015

(B) 1-4-2017

(C) 14-7-2017

(D) None of the above

(v) Continuing the earlier problem/MCQ, the quantum of tax payable under the BM Act will be ₹

(A) 108 lakhs

(B) 81 lakhs

(C) 112.5 lakhs

(D) None of the above

(vi) The factor/factors to be considered in taking the decision or deciding whether a country is being tax haven or not is/are:

(i) Nil rate of tax

(ii) Lack of transparency

(iii) Limited regulatory supervision

(iv) Exchange of information

(A) (i), (ii) & (iii)

(B) (i), (ii) & (iv)

(C) (ii) & (iv)

(D) (i), (ii), (iii) & (iv)

(vii) EEPL has sought to obtain an advance ruling from the Authority for Advance Ruling Such ruling is

(A) Applicant specific

(B) Transaction specific

(C) Both (A) and (B)

(D) Neither (A) nor (B)

(viii) Assuming (only for this MCO) that EEPL, for receiving trade inquiries from customers has set up a liaison office in India. Work of the liaison office is to forward the trade inquiries to them as well as to negotiate and enter into contracts on behalf of ABC LLC with customers. The existence of liaison office for the purpose of taxability of income of ABC LLC is having:

(A) Neither existence of business connection nor of PE

(B) Liaison office is having independent status

(C) Existence of business connection

(D) Services of a dependent agent

(ix) The following BEPS Action Plan seeks to neutralize the effects of hybrid mismatch arrangements:

(A) Action Plan 2

(B) Action Plan 4

(C) Action Plan 5

(D) None of the above

(x) The residential status of an individual who is treated as resident in India as well as in the foreign country with which India had entered into Double Taxation Avoidance

Agreement (DTAA) is to be determined as per Article contained in the DTAA between both the contracting States. The rule applied to judge the individual's closer personal economic relations is known as:

(A) Tax benefit rule

(B) Rule of examination of vital interest

(C) Rule under OECD Model

(D) None of the above

Solution to Case Study 3

(a) (i) Separate payments made towards drawings and designs (described as "engineering fee") are in the nature of fees for technical services[3]. Fees for technical services payable by a resident (Super Thermal Power Ltd., an Indian company, in this case) would be deemed to accrue or arise in India under section 9(1)(vii) in the hands of the non-resident recipient (Techno Engineering GMBH, the German company).

The payment made is not in respect of services utilized for a business or profession outside India or for the purpose of making or earning income from any source outside India and, therefore, is deemed to accrue or arise in India as per section 9(1).

Further, as per *Explanation* to section 9, where income is deemed to accrue or arise in India under section 9(1)(vii), such income shall be included in the total income of the non-resident German company, regardless of whether it has a residence or place of business or business connection in India, and even if such services are rendered from outside India.

Accordingly, in this case, payments towards drawings and designs would taxable in India in the hands of Techno Engineering GMBH, the German company.

(ii) ₹ 120 lakhs, being the value of debentures issued by an Indian company, TMT (India) Ltd., in consideration of providing technical know-how, is in the nature of fee for technical services, deemed to accrue or arise in India to Engineers and Engineers Pvt. Ltd., a foreign company, under section 9(1)(vii). Hence, it is taxable in India.

Further, as per section 9(1)(v), income by way of interest payable by a person who is a resident in India is deemed to accrue or arise in India except if the debt incurred is used for its business purposes outside India or for making or earning any income from any source outside India.

Therefore, in this case, interest income from debentures of TMT (India) Ltd., an Indian company, is deemed to accrue or arise in India in the hands of Engineers

[3] It was so held in *Aeg Aktiengesllschaft v. CIT (2004) 267 ITR 209 (Kar.)*

and Engineers Pvt. Ltd. by virtue of section 9(1)(v), since the debt incurred is not used for a business outside India or for earning income from a source outside India.

Hence, interest for 9 months ₹120 lacs of ₹ 9 lacs shall be taxable in A.Y.2020-21.

(iii) XYZ Ltd, the Indian company and Qilla Inc., the US company are deemed to be associated enterprises as per section 92A(2)(a), since Qilla Inc. holds shares carrying 32% of voting power (which is not less than 26% of the voting power) in XYZ Ltd.

As per *Explanation* to section 92B, the transactions entered into between these two companies for sale of product, lending or guarantee and provision of services relating to market research are included within the meaning of "international transaction".

Accordingly, transfer pricing provisions would be attracted and the income arising from such international transactions have to be computed having regard to the arm's length price.

In this case, from the information given, the arm's length price has to be determined taking the comparable uncontrolled price (CUP) method to be the most appropriate method.

Particulars		**₹ in lakhs**
Amount by which total income of XYZ Ltd. is enhanced on account of adjustment in the value of international transactions:		
(i)	Difference in price of T-Shirt @ $ 1 each for 1,50,000 pieces sold to Qilla Inc. [$ 1 ($ 4 - $ 3) x 1,50,000 x ₹70)	105.00
(ii)	Difference for excess payment of guarantee fee to Qilla Inc. for loan borrowed from foreign lender [$ 5,000 ($ 20,000 - $ 15,000) x ₹70]	3.50
(iii)	Difference for excess payment for services to Qilla Inc. [$ 5,000($ 20,000 - $ 15,000) x ₹70]	3.50
		112.00

XYZ Ltd. cannot claim deduction under section 10AA in respect of ₹112 lakhs, being the amount of income by which the total income is enhanced by virtue of the first proviso to section 92C(4), assuming that the above adjustments are made by the Assessing Officer to determine the arm's length price.

(iv) Section 90(2) provides that where the Central Government has entered into an agreement with the Government of any other country for granting relief of tax or for avoidance of double taxation, then, in relation to the assessee to whom such agreement applies, the provisions of the Income-tax Act, 1961 shall apply to the extent they are more beneficial to that assessee. In effect, the provisions of the Income-tax Act, 1961 or the DTAA, whichever is more beneficial, would be applicable.

The DTAA with Country X provides that where an individual is a resident of both India and Country X, he shall be deemed to be resident of that country in which he has a permanent home and if he has a permanent home in both the countries, he shall be deemed to be resident of that country, which is the centre of his vital interests i.e., the country with which he has closer personal and economic relations.

MS has residential houses both in India and in Country X. Thus, he has a permanent home in both the countries. Mohd. Suleman (MS) owns rubber estates in Country X from which he derives business income. However, MS has no permanent establishment of his business in India. Therefore, his personal and economic relations with Country X are closer, since Country X is the place where –

(a) the property is located and

(b) the business of rubber estates is being carried on.

Therefore, he shall be deemed to be resident of Country X for A.Y. 2020-21.

The fact of the case and issues arising there from are similar to that of *CIT vs. P.V.A.L. Kulandagan Chettiar (2004) 267 ITR 654*, where the Supreme Court held that if an assessee is deemed to be a resident of a Contracting State where his personal and economic relations are closer, then, in such a case, the fact that he is a resident in India to be taxed in terms of sections 4 and 5 of the Income-tax Act, 1961 would become irrelevant, since the DTAA prevails over sections 4 and 5.

However, as per section 90(4), in order to claim relief under the agreement, MS has to obtain a certificate [Tax Residency Certificate (TRC)] declaring that he is a resident of Country X from the Government of Country X. Further, he also has to provide such other documents and information, as may be prescribed.

Therefore, in this case, MS would not be liable to income-tax in India for assessment year 2020-21 in respect of business income and capital gains arising in Country X provided he furnishes the Tax Residency Certificate and provides such other documents and information as may be prescribed.

Rental income of ₹ 6 lacs from let-out property located in India would be taxable in India in the hands of MS, since it has accrued and arisen to him in India. Deduction of 30% of Net Annual Value would be allowable under section 24 in computing income from house property.

The Annual Value of residential house at Lucknow, which he uses for his stay while in India, would be Nil, assuming that the house is not let out for the rest of the year and no other benefit is derived therefrom by him.

(b) (i) As per the secondment agreement, the seconded employees retain their entitlement to participate in the overseas holding company's (CCPI) retirement and social security plans and other benefits in terms of their applicable policies, and the salary is payable to them by the overseas entities, which later on claims the money from the Indian entity, CIOP.

Though the Indian entity, CIOP has to the right to terminate the Secondment Agreement, the services of the assignee *vis-à-vis* the overseas entities could not be terminated. Thus, CIOP does not have the right to terminate, or even modify, the employment relationship between the assignee and the overseas entities.

Accordingly, the real employer of the seconded employees continued to be the overseas entities. The overseas entities, being the real employer, would be ultimately responsible for making payment of salary to the seconded employees working in India.

The overseas entities have, through their employees, provided technical services to the Indian entity, CIOP. The seconded employees with requisite knowledge and work were provided by the overseas entities to assist CIOP in conducting the business of quality control and management. The services provided by the overseas entities were, thus, provision of technical services through the assignees i.e., seconded employees.[4] Therefore, payment made by CIOP on cost plus mark up basis would be subject to TDS at the rates in force under section 195.

(ii) Section 92F(iiia) of the Income-tax Act, 1961 defines permanent establishment to include a fixed place of business through which the business of the enterprise is wholly or partly carried on.

In this case, on perusal of the key terms of the Secondment Agreement, it is evident that there is neither any business conducted by the overseas entities in India through the seconded employees nor any income is derived by them through the activities of such employees.

Consequently, there is no fixed place permanent establishment constituted by the overseas entities through the seconded employees.

Note – *The above answer is framed solely on the basis of the provisions of the Income-tax Act, 1961 as per the requirement of the question.*

If the India-US DTAA and India-Canada DTAA are considered, the definition of PE would include service PE as well, where the employees of one Contracting State stay for more than 90 days in the other Contracting State to render services, other than included services. If fees for technical services is not considered as included service, then, the concept of service PE may apply in the above case, consequent

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[4]It was so held by the Delhi High Court in *Centrica India Offshore Private Limited v. CIT and Others (2014) 364 ITR 336.*

to which the overseas entities may be subject to tax in respect of income attributable to the PE.

(c)

Q. No.	Answer
(i)	C
(ii)	B
(iii)	D
(iv)	B
(v)	C
(vi)	A or D
(vii)	C
(viii)	C
(ix)	A
(x)	B

***Note** – In Q. No. (vi), option (iv) is Exchange of Information. The first three options are Nil Rate of tax, Lack of transparency, Limited regulatory supervision. Since option (iv) alone is worded positively, it is possible to take a view that if there is exchange of information, the country cannot be a tax haven, in which case the answer would be "(A) (i), (ii) & (iii)".*

However, the question requires the factors to be considered in taking the decision of whether a country is a tax haven. Exchange of information is also a factor along with the other three factors. Hence, on the basis of this rationale, the correct answer is "(D) (i), (ii), (iii) & (iv)".

In view of the language of the question, the correct answer may be either (A) or (D).

PAPER 6C: INTERNATIONAL TAXATION

Case Study 1

Good Day Inc of USA and its associates:

Good Day Inc of USA is engaged in multiple trading and manufacturing activities throughout the world. It has a liaison office at Mumbai meant for sourcing raw materials in India for the purpose of carrying out manufacturing activity at USA. It also provided plant and machinery on hire to be used for extraction of mineral oils in India. During the previous year 2019-20, it received mobilization advance of ₹ 2 crores from an Indian company for movement of rigs from a foreign country to an offshore site at Mumbai and subsequently they were put to use (i.e.) for extraction of mineral oil. It also received ₹ 5 crores by way of hire towards provision of plant and machinery for the previous year 2019-20 in India. Good Day Inc. has a subsidiary company by name Kite Inc. at Portugal, which is engaged in supply of electronic goods worldwide.

Good Day Inc. also has another subsidiary by name Becker Inc. at Germany. On 01.04.2019, Becker Inc. advanced ₹ 2 crores to Manna Dey (P) Ltd. of Mumbai by remitting the amount directly from Germany to the bank account of Manna Dey (P) Ltd. For the previous year 2019-20, interest is receivable from Manna Dey (P) Ltd @ 9%. For the Assessment Year 2020-21, Becker Inc. having significant activities in India became resident assessee because of POEM.

On 01.07.2019, Manna Dey (P) Ltd borrowed ₹ I0 crores from Jimmy Connors Ltd, United Kingdom for which interest is payable at 9% per annum. The pre-tax profit of Manna Dey (P) Ltd. was ₹ 160 lakhs before deducting depreciation of ₹ 40 lakhs and interest on moneys borrowed by it. The total borrowing of Manna Dey (P) Ltd is ₹ 12 crores, which is 80% of its total assets.

Democrat (P) Ltd, Chennai

Democrat (P) Ltd is a subsidiary of Giant Trade Ltd of UK. It is engaged in manufacturing and trading of consumer durables both by import and export. It is also engaged in executing turnkey projects. It had 4 directors viz. Ashok Chatterjee, Mithun Banerjee, Dr Deepak Mitra and Meenakshi Jain. The director, Ashok Chatterjee, sold 30% of the shares owned by him to his son, Santhosh Chatterjee, in June 2016 and resigned from the directorship of the company. The whereabouts of Ashok Chatterjee are not known to the company.

Democrat (P) Ltd. gave loan of ₹ 6 crores on 01.07.2019 to its associated concern in Australia without charging interest. For giving the said advance, Democrat (P) Ltd. mobilized funds by issuing 8% Debentures on 01.06.2019.

Kite Inc. of Portugal entered into an agreement for supply of electronic goods to Democrat (P) Ltd. of Chennai on regular basis. As per agreement, it supplied goods worth ₹ 10 crore every month from April, 2019 onwards and the supply is to be made for 42 months continuously.

Democrat (P) Ltd. permitted yet another of its associated enterprise by name Maxwell (P) Ltd. registered in South Africa to use the hired machineries for exploration of mineral oil in Kenya. Democrat (P) Ltd. paid ₹ 5 crores to Dusseldorf Inc. of Germany towards hire charges of plant and machinery for the previous year 2019-20. The usage of Maxwell (P) Ltd. is equal to 55% of the total hire charges paid and the balance was for the use by Democrat (P) Ltd. Maxwell (P) Ltd. did not share or pay any hire charges and the entire amount was paid by Democrat (P) Ltd.

During the Previous Year 2019-20, Democrat (P) Ltd. sponsored a football tournament in India. Mr. Dickie Bird, a citizen of UK but resident of India (for Assessment Year 2020-21), a famous international referee received ₹ 4,50,000 for acting as referee in the tournament from Democrat (P) Ltd.

Income-tax assessment of Democrat (P) Ltd.

The income-tax return of the Assessment Year 2019-20 was filed by Democrat (P) Ltd on 20.12.2019 declaring total income of ₹ 52.50 crores. The assessee obtained report in respect of international transactions from the 'Accountant' (as mentioned in the *Explanation* below section 288(2) and the report contained information about the international transactions of the assessee. The Assessing Officer referred the international transactions to Transfer Pricing Officer (TPO) for determination of arm's length price without providing an opportunity of hearing to Democrat (P) Ltd. The TPO wanted the documents and information in respect of the international transactions and the assessee could not furnish information and documents for the transactions of the value of ₹ 4.50 crores. The Assessing Officer passed the order of assessment based on the TPO report subsequently. (**Note:** The law as regards scope of work and power of TPO are the same for the Assessment Years 2019-20 and 2020-21. There is no change in legal provision.)

Proposed joint venture between Democrat (P) Ltd and Good Day Inc.

The Democrat (P) Ltd jointly with Good Day Inc. bid for a turnkey project worth ₹ 500 crores in India. It was Democrat (P) Ltd who solicited the association of Good Day Inc. in executing the turnkey project. The parties have agreed to enter into an agreement to specifically allot the scope of work between them and to bear the profits and losses arising thereon respectively. There would be no common risk sharing in the arrangement between the companies. However, they apprehend that they could be assessed as an AOP during the income-tax assessment.

Whereabouts of Ashok Chatterjee

Ashok Chatterjee, one of the directors of Democrat (P) Ltd., left India on 05.06.2016 and his whereabouts were unknown. There is income-tax arrears of ₹ 40 lakhs relating to his personal assessment of the Assessment Years 2013-14 to 2016-17. Only in December, 2019, it came to light that Ashok Chatterjee has settled in Canada. He has properties in Canada and one vacant land at Siliguri, West Bengal whose value as per State stamp valuation authority is ₹ 10 lakhs.

Purchase of land from non-resident

Democrat (P) Ltd acquired a vacant site at Mysore from Ms. Kousalya, a non-resident settled in Germany, for expansion of its manufacturing activity. The land was acquired by Ms. Kousalya in April, 2006, when she was a resident of India. Now, Democrat (P) Ltd acquired the said land for ₹ 48 lakhs on 10th March, 2020. Ms. Kousalya does not have permanent account number and has also not furnished tax residency certificate. The tax was deducted at source out of the purchase price and was remitted to the exchequer on 20th March, 2020. The balance amount of purchase price has not yet been remitted to Ms. Kousalya as the approval for remittance is pending from RBI.

Activity profile of Dr. Deepak Mitra

Dr. Deepak Mitra (age 50), yet another director of Democrat (P) Ltd residing at Palghat, Kerala, earned royalty income of ₹ 50 lakhs from Gobar Gas Inc. of Canada for the year ended 31.03.2020. However, he received only ₹ 20 lakhs during the previous year 2019-20, and the balance is outstanding as on 31.03.2020. Dr. Deepak Mitra maintains cash system of accounting of royalty income and hence, admitted only ₹ 20 lakhs for the assessment year 2020-21. The DTAA between India and Canada provides for tax@15% in Canada without prejudice to taxation of the same income in India. The other income of Dr. Deepak Mitra is by way of income from house property (computed) ₹ 4.5 lakhs and dividend income from Democrat (P) Ltd of ₹ 8 lakhs. He paid premium to LIC of India of ₹ 1.5 lakhs in respect of a life insurance policy of his son who is studying in Australia.

Rajesh Mitra son of Dr. Deepak Mitra, shareholder in Democrat (P) Ltd

Rajesh Mitra son of Dr. Deepak Mitra born and brought up in India acquired 10,000 equity shares of Democrat (P) Ltd on 10.06.2011 for ₹ 9 lakhs. He left India for employment in USA in January, 2012 and settled there. He has never visited India subsequently. His entire shareholdings in Democrat (P) Ltd were sold for ₹ 28.80 lakhs on 10.01.2020. The amounts were repatriated to his bank account in USA subsequently.

The exchange rates are given below:

On 10.06.2011	1$= ₹ 45;
On 10.01.2020	1$ = ₹ 72.

Cost inflation index P.Y.2011-12 = 184; P.Y. 2019-20 = 289.

Fair Market Value (FMV) of each equity share as on 31.01.2018 = ₹ 300

Activity profile of director Mithun Banerjee

Director Mithun Banerjee is a renowned technocrat, and is one of the directors of the company

Democrat (P) Ltd since 01.06.2015. He is a partner in Lilly LLP, New York. A notice for assessment of his income under Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 was served on 01.05.2019 for the alleged undisclosed income / assets held in USA. The initial capital contribution in the firm was made in the previous year 2006-07 was his only contribution and the accumulations are by way of profits which were not disclosed by him for income-tax assessment, in India. He has not withdrawn any amount from the firm at any time.

The Balance Sheet of Lilly LLP is given below:

	01.04.2019	01.10.2019	31.03.2020
	In US$		
Cash on hand (as per books)	10,000	12,000	15,000
Cash at Bank (as per books)	20,000	18,000	15,000
Stock in trade (as per books)	30,000	30,000	30,000
Vacant site FMV as on 1.4.2019 $ 40,000	20,000	50,000 (FMV)	60,000 (FMV)
Plant and machinery	75,000 (As per books)	50,000 (FMV	40,000 (FMV)
Bullion FMV as on 01.04.2019 $ 25,000	15,000	30,000 (FMV)	35,000 (FMV)
	1,90,000	**1,90,000**	**1,95,000**
Liabilities			
Sundry Creditors (as per books)	50,000	55,000	60,000
Partners' Capital			
Mithun Banerjee (25%)	30,000	No fresh capital introduction.	
Bimal (50%)	50,000	No fresh capital introduction.	
Senthil (25%)	60,000	No fresh capital introduction.	
	1,90,000		

The partnership agreement provides that in the event of dissolution, the net worth exceeding the capital of the partners is to be shared in the profit sharing ratio.

The reference rate of RBI of 1 US $ as against Indian Rupee on various dates are as under:

01.04.2019 = ₹ 65; 01.05.2019 = ₹ 68; 31.03.2020= ₹ 72

Celebrity for annual function of the company

Democrat (P) Ltd celebrated its anniversary by inviting Mr. Ricky Ponting, a famous Australian cricketer who is not a citizen of India. He came to India for the first time in April, 2019 on the invitation of Democrat (P) Ltd. He was paid ₹ 25 lakhs for his presence in the anniversary celebrations of Democrat (P) Ltd.

Choose the most appropriate alternative for the following MCQs: (2 x 10 = 20 Marks)

1.1 What is the 'due date' within which the liaison office of Good Day Inc. has to submit the annual statement to the Income-tax authority for the year ended 31st March, 2020?

(A) 30-05-2020

(B) 31-07-2020

(C) 30-09-2020

(D) 31-03-2021

1.2 Compute the amount of capital gain/loss in the hands of Rajesh Mitra on sale of shares of Democrat (P) Ltd.

(A) Long-term capital loss ₹ 1,20,000

(B) Long-term capital gain ₹ 13,71,020

(C) Long-term capital gain ₹ 19,80,000

(D) Long-term capital gain ₹ 2,70,000

1.3 Under what section tax is deductible at source on the payments made to Mr. Dickie Bird who acted as referee in the football tournament for the amounts received from Democrat (P) Ltd ?

(A) under section 194E

(B) under section 194J

(C) under section 115BBA

(D) under section 195

1.4 Kite Inc of Portugal in December, 2019, after the monthly supply of goods, applied for advance ruling. How much fee would it need to pay for obtaining the advance ruling?

(A) ₹ 10 lakhs

(B) ₹ 5 lakhs

(C) ₹ 2 lakhs

(D) ₹ 10,000

1.5 At what rate Democrat (P) Ltd must deduct tax at source on the amount paid to Ms. Kousalya for purchase of vacant land?

(A) 20.8%

(B) 31.2%

(C) 30.9%

(D) 20.6%

1.6 For Democrat (P) Ltd, the GAAR provisions will apply as the value of transactions made with two of its associated enterprises was

(A) ₹ 11 crores in aggregate

(B) ₹ 3.11 crores in aggregate

(C) ₹ 2.75 crore in respect of transaction with Maxwell P Ltd.

(D) ₹ 36 lakhs by way of interest from associate concern in Australia

1.7 How much is the penalty payable by Democrat (P) Ltd for non-maintenance of documents and information relating to international transaction?

(A) ₹ 1,00,000

(B) ₹ 9,00,000

(C) ₹ 22,50,000

(D) ₹ 1,50,000

1.8 For the assessment year 2020-21, at what rate and under what section, tax is deductible at source on the interest payment made by Manna Dey (P) Ltd to Becker Inc?

(A) At 10% under section 194A

(B) At 20% under section 195

(C) At 30% under section 195

(D) None of the above

1.9 How much of interest paid by Manna Dey (P) Ltd. to its associated enterprise, Jimmy Connors Ltd of United Kingdom, is liable for disallowance taking note of its income from business ?

(A) ₹108 lakhs

(B) ₹ 90 lakhs

(C) ₹ 31.50 lakhs

(D) ₹ 49.50 lakhs

1.10 The time limit for assessment of Mithun Banerjee under the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 is

(A) 31.03.2020

(B) 31.3.2021

(C) 31.12.2021

(D) 31.03.2022

You are required to answer the following issues:

1.11 Compute the income of Good Day Inc. in respect of providing plant and machinery on hire for extraction of mineral oils as per the applicable presumptive provisions of the Income-tax Act, 1961. ***(3 marks)***

1.12 Will your answer be different if Good Day Inc. spent only ₹ 1.50 crore out of ₹ 2 crore mobilization advance received for movement of rigs to offshore site at Mumbai? ***(2 marks)***

1.13 State the legal correctness of the action of the Assessing Officer as regards making reference to the Transfer Pricing Officer without providing an opportunity of hearing to the assessee i.e., Democrat (P) Ltd. ***(3 marks)***

1.14 Is the passing of assessment order by the Assessing Officer based on TPO's report without passing draft assessment order, tenable in law? ***(3 marks)***

1.15 As Chartered Accountant, what would be your advise as regards joint venture between Good Day Inc. and Democrat (P) Ltd. with specific allocation of work between them and the possibility of assessment as AOP. ***(3 marks)***

1.16 State the procedure to be followed by the Tax Recovery Officer for recovery of tax arrears of non-resident Ashok Chatterjee. ***(2 marks)***

1.17 Can the Assessing Officer treat Democrat (P) Ltd as agent of non-resident Ms. Kousalya, if there are any tax arrears pending against her name? Will your answer be different, if Ms. Kousalya opts for Chapter XII-A of the Act? ***(3 marks)***

1.18 Compute the undisclosed income / asset of Mithun Banerjee under Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015. Also, compute the tax liability of Mithun Banerjee. ***(4 marks)***

1.19 Compute the tax liability of Dr. Deepak Mitra and the amount of eligible foreign tax credit and the amount of foreign tax credit to be carried forward to future assessment years. ***(4 marks)***

1.20 At what rate, tax is deductible at source on the payment made to Mr. Ricky Ponting? Is Mr. Ricky Ponting liable to file his income-tax return in India? In case he has no PAN, at what rate tax is deductible at source and what would be the consequences of filing or non-filing of income tax return? ***(3 marks)***

Solution to Case Study 1

Q. No.	Answer
1.1	(A)
1.2	(C)
1.3	(B)
1.4	(A)
1.5	(A)

Q. No.	Answer
1.6	(B)
1.7	(B)
1.8	(D)
1.9	-[1]
1.10	(D)

[1] The correct answer is nil, since interest payable to non-resident associated enterprise does not exceed ₹ 1 crore.

Answer to Q. 1.11

The presumptive provisions applicable in this case are those contained in section 44BB.

As per this section, the profits and gains shall be deemed to be equal to 10% of the following amounts:

- paid or payable to the taxpayer on account of the provision of such services or facilities or supply of plant & machinery for the aforesaid purposes in India; and
- received or deemed to be received in India by the assessee on account of such service or facilities or supply of plant and machinery used or to be used in prospecting for, or extraction or production of mineral oils outside India

Computation of income of Good Day Inc. as per section 44BB

Particulars	Amt (₹ in crore)
Amount received for movement of rigs from foreign country to an offshore site at Mumbai	2
Amount received by way of hire charges towards provision of plant and machinery in India	5
Amount to be considered for purposes of section 44BB	7

Income from business under section 44BB at 10% of ₹ 7,00,00,000 is ₹ 70,00,000, which is the income of Good day Inc. chargeable to tax in India under the head "Profits and gains of business or profession" for the A.Y. 2020-21

Note - The mobilization fee of ₹ 2 crore received by Good Day Inc. is also includible in the gross receipts for the purpose of computing the income chargeable under section 44BB [*Sedco Forex International Inc vs. CIT (2017) 399 ITR 1 (SC)].*

Answer to Q.1.12

No, the answer would be the same. The mobilization fee received by Good Day Inc. is liable to tax under section 44BB regardless of the actual amount of expenditure incurred for movement of rigs to the offshore site.

The quantum of expenditure incurred in relation to mobilization fee is immaterial and regardless of the amount of expenditure incurred, the entire fee of ₹ 2 crore is to be included for the purposes of section 44BB. Hence, the answer will not change.

Answer to Q.1.13

As per section 92CA(1), where an assessee has entered into an international transaction in any previous year, and the Assessing Officer considers it necessary or expedient so to do, then, he may refer the computation of the arm's length price in relation to the said international transaction to the Transfer Pricing Officer.

The Assessing Officer has to take the prior approval of the Principal Commissioner of Income-tax (PCIT)/Commissioner of Income-tax (CIT) before making such a reference.

There is no requirement under the Act to provide an opportunity of being heard to the assessee before making reference to the Transfer Pricing Officer.

Therefore, the action of Assessing Officer to refer the international transaction to Transfer Pricing Officer for determination of arm's length price without providing an opportunity of hearing to Democrat (P) Ltd. is **correct.**

Note *– The CBDT has, vide Instruction No.3/2016 dated 10.3.2016, stipulated that the Assessing Officer must, before making reference to the TPO, provide an opportunity of being heard to the assessee before recording his satisfaction or otherwise, in the following cases:*

(i) The assessee has not filed accountant's report u/s 92E but has undertaken an international transaction which comes to the notice of the Assessing Officer;

(ii) The assessee has not declared one or more international transaction(s) in the accountant's report filed u/s 92E and the said transaction(s) come to the notice of the Assessing Officer; and

(iii) Where the assessee has declared international transaction in the accountant's report filed u/s 92E but certain qualifying remarks were made to the effect that the said transactions are not international transactions or they do not impact the income of the taxpayer.

In respect of other cases, such opportunity of hearing need not be given before making reference to the TPO.

Answer to Q.1.14

As per section 144C(1), the Assessing Officer is required to forward a draft order of assessment to the eligible assessee if he proposes to make any variation in the income or loss returned which is prejudicial to the interest of such assessee.

Eligible assessee means, *inter alia*, any person in whose case variation arises on account of order of Transfer Pricing Officer.

In the present case, Democrat (P) Ltd. is an eligible assessee and the Assessing Officer is required to forward a draft assessment order to Democrat (P) Ltd.

Therefore, the action of Assessing Officer in passing an assessment order without forwarding a draft assessment order to Democrat (P) Ltd. is not tenable in law.

Note - *In Asstt. CIT vs. Vijay Television P Ltd (2018) 407 ITR 642 (Mad) (decision rendered on 23.04.2018) it was held that the passing of assessment order without forwarding the draft assessment order to the assessee is an incurable illegality and that such illegality could not be protected by section 292B.*

Answer to Q.1.15

As per the Circular[2] issued by the CBDT, it has been clarified that consortium arrangement for executing Turnkey project which has the following attributes may not be treated as an AOP –

1. Each member is independently responsible for executing its part of work through its own resources and also bear the risk of its scope of work
2. Each member earns profits or incurs losses, based on performance of the contract falling strictly within its scope of work.
3. Each member is responsible for the men and material used in their area of work.
4. The control and management of the consortium is not unified and common management is only for the *inter-se* coordination between the consortium and members for administrative convenience.

The benefit of this circular cannot be availed, if the members of the Consortium are associated enterprises, as per section 92A.

In the present case, Democrat (P) Ltd. and Good Day Inc., which are not associated enterprises, form a joint venture for turnkey project. They entered into an agreement to specifically allot the scope of work between them and to bear the profits and losses arising thereon, respectively. Also, there would be no common risk sharing in the arrangement between the two. They are not associated enterprises, at present. Hence, the joint venture between Good Day Inc. and Democrat (P) Ltd. may not be treated as an AOP.

My advice as a CA would be that:

(i) till the completion of the turnkey project, it must be ensured that Good Day Inc. and Democrat (P) Ltd., do not become associated enterprises;

(ii) the conditions stated in the Circular are strictly complied with, during the entire duration of the turnkey project.

Answer to Q.1.16

In the present case, Ashok Chatterjee has one vacant land in India of stamp duty value of ₹10 lakhs and income-tax arrears of ₹ 40 lakhs. As per section 173, the Tax Recovery Officer can recover income-tax arrears of ₹10 lakhs from such land in India.

Since India has a DTAA with Canada and Ashok Chatterjee has properties in Canada, Tax Recovery Officer may forward to the CBDT a certificate drawn up by him under section 222 for balance income-tax arrears of ₹ 30 lakhs and the CBDT may take such action thereon as it may deem appropriate having regard to the terms of the agreement with such country.

Answer to Q.1.17

As per section 163(1), "agent" in relation to a non-resident includes, *inter alia,* any person in India from or through whom the non-resident is in receipt of any income, whether directly or indirectly.

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[2] **Circular F.No.225/2/2016/ITA.II dated 7.3.2016**

In the present case, Kausalya, a non-resident, is in receipt of income (in the nature of capital gains) from Democrat (P) Ltd. Democrat (P) Ltd. can be treated as an agent of non-resident, Ms. Kousalya, for any tax arrears pending against her name provided it has been given an opportunity of being heard as to its liability to be treated as such.

Alternative Answer

As per section 163(1), "agent" also includes any other person, who, whether a resident or a non-resident, has acquired by means of a transfer, a capital asset in India.

In the present case, since, Democrat (P) Ltd. has purchased a vacant site at Mysore from Ms. Kousalya, for which it is yet to remit the purchase price to her, it can be treated as an agent of non-resident, Ms. Kousalya, for any tax arrears pending against her name provided it has been provided an opportunity of being heard as to its liability to be treated as such.

Ms. Kousalya cannot opt for the provisions of Chapter XII-A, and hence there is no possibility of change in view.

Answer to Q.1.18

Value of interest of Mithun Banerjee in Lilly LLP is chargeable to tax in India under the Black Money Act in the A.Y.2020-21, since these assets came to the notice of the Assessing Officer in the P.Y.2019-20.

For computing the value of interest in Lilly LLP, market value as on valuation date, being value on 1st April of the previous year i.e., on 01.04.2019 is to be considered.

Computation of undisclosed income/asset of Mithun Banerjee

Particulars	Amount (In US $)
Cash in hand (as per books)	10,000
Cash at bank (as per books)	20,000
Stock-in-trade (as per books)	30,000
Plant and machinery (as per books)	75,000
Total of book value of above assets (A)	**1,35,000**
Vacant site (FMV as on 1.4.2019)	40,000
Bullion (FMV as on 1.4.2019)	25,000
Total of FMV of above assets (B)	**65,000**
Sundry creditors (as per books) (C)	50,000
Net worth of Lilly LLP (A+B – C)	**1,50,000**
Value of interest in Lilly LLP	
Net worth portion equal to capital contribution (D)	30,000

Balance Net worth portion after capital contribution as per partnership deed in profit sharing ratio [10,000 (1,50,000 – 1,40,000) x 25%] (E)	2,500
Value of interest of Mithun Banerjee in Lilly LLP (D + E)	**32,500**
Value of interest of Mithun Banerjee in Lilly LLP in ₹[32,500 x 65, being exchange rate as on 1st April of the previous year i.e., on 1.4.2019]	**21,12,500**

As per section 3(1) of Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015, every assessee would be liable to tax@30% in respect of his undisclosed foreign income and asset of the previous year.

Tax liability of Mithun Banerjee would be ₹ 6,33,750, being 30% of ₹ 21,12,500.

Answer to Q.1.19

Since Dr. Deepak Mitra is resident in India for the P.Y.2019-20, his global income would be subject to tax in India. Therefore, income earned by him in Canada would be taxable in India. He is, however, entitled to deduction under section 90, since India has a DTAA with Canada.

Computation of tax liability of Dr. Deepak Mitra for A.Y.2020-21		
Particulars	**₹**	**₹**
Profits and gains from business or profession		
Royalty income (following cash system of accounting)		20,00,000
Income from house property (computed)		4,50,000
Income from other Sources		
Dividend income from Democrat (P) Ltd.	8,00,000	
Less: Exempt under section 10(34)	8,00,000	-
Gross Total income		**24,50,000**
Less: Deduction under Chapter VI-A		
Section 80C – LIC premium of his son		1,50,000
Total income		**23,00,000**
Computation of tax liability		
Upto ₹ 2,50,000	Nil	
₹ 2,50,001 – ₹ 5,00,000	12,500	
₹ 5,00,001 – ₹ 10,00,000	1,00,000	
₹ 10,00,001 – ₹ 23,00,000	3,90,000	
		5,02,500
Add: Health and education cess@4%		20,100
Tax liability		**5,22,600**
Less: Foreign tax credit **[See Working Note below]**		3,00,000
Net Tax liability		**2,22,600**

Working Note: Computation of Foreign Tax Credit		
Particulars		
Doubly taxed income	₹ 20,00,000	
Rate of tax in Canada	15%	
Average rate of tax in India [5,22,600/23,00,000 x 100]	22.72%	
Lower of Indian rate of tax and rate of tax in Canada		15%
Deduction u/s 90 = 15% x ₹ 20,00,000		₹ 3,00,000
Foreign tax credit allowed to be carried forward is ₹ 4,50,000 [₹ 30,00,000, being royalty income not received x 15%]		

***Note** – Sub-rule 5(ii) of Rule 128 provides that Foreign Tax Credit shall be determined by conversion of the currency of payment of foreign tax at the telegraphic transfer buying rate on the last day of the month immediately preceding the month in which such tax has been paid or deducted. However, in this case, in the absence of relevant information in the question, Foreign Tax Credit has been computed applying the provisions of Rule 128 other than sub-rule 5(ii) thereof.*

Answer to Q. 1.20

Where any income referred to in section 115BBA is payable to a non-resident non-citizen sportsman, the person responsible for making payment is liable to deduct tax at source @20% on such income under section 194E.

Income referred to in section 115BBA includes income by way of advertisement.

Payment of ₹ 25 lakh by Democrat (P) Ltd. to Mr. Ricky Ponting, a non-resident, for advertisement is income referred to in section 115BBA, hence, Democrat (P) Ltd. is liable to deduct tax at source on such payment @20% under section 194E. Since Mr. Ricky Ponting is a non-resident, the amount of tax to be deducted would be increased by health and education cess @4%. Therefore, the effective rate of tax to be deducted by Democrat (P) Ltd. is 20.8%

Section 115BBA provides that if the total income of the non-resident sportsman comprises of only income referred to in that section and tax deductible at source has been fully deducted, it shall not be necessary for him to file his return of income. Accordingly, Mr. Ricky Ponting is not liable to file his income-tax return in India if tax has been fully deducted on advertisement charges by Democrat (P) Ltd.

If Mr. Ricky Ponting has no PAN, in such a case also, tax shall be deducted @20.8%, being the rate higher of the following rates

(i) Rate specified in the relevant provisions of the Act i.e., 20%

(ii) At the rate in force

(iii) At the rate of 20%

There would be no consequence of filing or non-filing of income-tax return as he is not required to file his return of income as per section 115BBA.

PAPER – 6C: INTERNATIONAL TAXATION

Case Study 2

Introductory

Harivallabh Pvt. Ltd., (HPL) is a private limited company, incorporated in India in 1990. It is engaged in several activities, important one being manufacture of accessories for mobile phones.

This company is a part of a group called Dow Group. A company called DAS Martin, which is also a part of the Dow group, has acquired 10 lakh shares of ₹ 100 each in HPL, 18 years ago, for a consideration of ₹ 50.3 crores. The investment made in HPL was with the prior approval of Department of Industrial Policy & Promotion (DIPP) and RBI permission was also obtained.

About DAS Martin

DAS Martin holds 70% of the share capital of HPL.

DAS Martin does not have an office, or employee or agent in India and hence, no Permanent Establishment (PE) in India as per Article 5 of the India Nation L Double Taxation Avoidance Agreement (called India Nation L DTAA). As far as Indian taxation is concerned, it is a non-resident, as it is not covered under the provisions of section 6(3) of the Income-tax Act, 1961. DAS Martin is a resident of Nation L and is engaged in trading activities for the last two decades, with annual turnover of 2 million USD.

DAS Martin proposes to transfer in February, 2020, above 70% of the shareholding to another Singapore company called DAS Singapore, which is part of the Dow group, pursuant to Group reorganisation. Assume that this Case Study is being given to you for your opinion in January, 2020.

Objectives of transfer of shares in HPL by Dow Group

(i) Dow Group is a large and complex group having presence in several countries across the world. In order to reduce complexities, improve efficiency and reduce costs in group companies worldwide, Dow Group is transforming its holding model. The group reorganization will change the business model of the group giving the capability to support more diverse, growing business that is also expected to be more profitable in the long-term.

(ii) Prior to 2020, Dow group was divided in the following 5 areas depending on its geographical locations

- North America
- South America
- Europe
- Asia Pacific
- India, Middle East and Africa (Dow IMEA group)

(iii) In the beginning of year 2020, the IMEA group was dismantled and countries in IMEA group were realigned to other regions as per geographical convenience. The Asia pacific region now consists of countries like India, China and other South East Asian countries. The

Europe region, *inter alia*, consists of Mauritius, United Kingdom, Germany and other European countries.

(iv) In order to achieve objective of operational excellence and administrative convenience, it became necessary for the Dow groups to re-align the holding model of HPL.

(v) It is contemplated that the holding company of HPL would be shifted to Singapore, to achieve better control. Singapore is one of the upcoming countries in the Asia Pacific region. Keeping in view the above facts, Dow group is contemplating to shift the shareholding of HPL from Nation L to Singapore.

(vi) The Group believes that such re-alignment would help the Group to focus on customer service including support for new product launches, strong compliance culture, commitment to health, safety and the environment, and commitment to developing people that deliver strong results for the Group even as the external environment has become more demanding.

Related facts and aftermath of proposed transfer of shares

(i) Dow group proposes to achieve the above objective through its entity in Singapore i.e., DAS Singapore. DAS Singapore will be a 70% subsidiary of DAS Martin.

(ii) DAS Martin proposes to contribute shares held in HPL as its capital in DAS Singapore. By virtue of this, HPL India would become 70% subsidiary of DAS Singapore.

(iii) In view of above, DAS Martin proposes to transfer the shareholding (10 lakh shares) of HPL to DAS Singapore by way of capital contribution.

(iv) The value of DAS Singapore's shares recorded in the books of DAS Martin (equivalent amount in INR being 182.3 crores) would be considered as the sales consideration for transfer of shares of HPL.

(v) The cost at which DAS Martin has obtained the shares of HPL would be the cost of acquisition.

Payments made by HPL for advertisements

HPL has made the following payments to DAS Martin from April 2019 to December 2020:

(i) ₹ 43 lakhs for advertisements in foreign web sites;

(ii) ₹ 8 lakhs for space booking in foreign newspapers.

Installation projects undertaken by KTS Singapore in India

Another group company of DOW group, KTS Singapore, a company incorporated in Singapore 10 years back and having its tax residency there, has carried out four installation projects in India during the P.Y.2019-20.

These four projects are independent of each other and secured through four independent work orders. These are installation projects and executed using its two cranes which were imported from Singapore in November, 2018. To carry out the installation work, four to five key personnel from Singapore are deployed, along with the local manpower. Prior to the present installation projects, the cranes were used for executing installation projects for XYZ Pvt. Ltd., India, in the Godavari basin.

The scope of work under these projects is similar and requires the Singapore entity to provide ground preparation details for the movement of cranes and obtain approval to the scheme under which erection is to be executed. The Load Movement Test on the crane is required to be organized. The holding of the equipments after erection before completion of welding of the column sections is required to be carried out. Setting up, fitting, placing, positioning of the fabricated equipments at the site is, thus, required to be carried out.

One of these four projects was from 1st April, 2019 and was for a period of 173 days. Another project, undertaken for some other client, was from 1st August, 2019 and was for 170 days. The other two projects were for a period of 90 days each, falling within the above periods only.

Exhibit 1

Article 13 of the India Nation L DTAA which deals with the taxation of capital gains arising to the resident of contracting state, reads thus:

"ARTICLE 13 - Capital Gains -

1. Gains from the alienation of immovable property, as defined in paragraph (2) of article 6, may be taxed in the Contracting State in which such property is situated.
2. Gains from the alienation of movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State or of movable property pertaining to a fixed base available to a resident of a Contracting State in the other Contracting State for the purpose of performing independent personal services, including such gains from the alienation of such a permanent establishment (alone or together with the whole enterprise) or of such a fixed base, may be taxed in that other State.
3. Notwithstanding the provisions of paragraph (2) of this article, gains from the alienation of ships and aircraft operated in international traffic and movable property pertaining to the operation of such ships and aircraft, shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated.
4. Gains derived by a resident of a Contracting State from the alienation of any property other than those mentioned in paragraphs (1), (2) and (3) of this article shall be taxable only in that State.

For the purposes of this article, the term "alienation" means the sale, exchange, transfer, or relinquishment of the property or the extinguishment of any right therein or the compulsory acquisition thereof under any law in force in the respective Contracting States."

Exhibit 2

India Singapore DTAA

ARTICLE 5: "PERMANENT ESTABLISHMENT:

1. For the purposes of this Agreement, the term "permanent establishment" means a fixed place of business through which the business of the enterprise is wholly or partly carried on.
2. The term "permanent establishment" includes especially: ……………………………
3. A building site or construction, installation or assembly project constitutes a permanent establishment only if it continues for a period of more than 183 days in any fiscal year.
4. An enterprise shall be deemed to have a permanent establishment in a Contracting State and to carry on business through that permanent establishment if it carries on supervisory activities in that Contracting State for a period of more than 183 days in any fiscal year in connection with a building site or construction, installation or assembly project which is being undertaken in that Contracting State.
5. Notwithstanding the provisions of paragraphs 3 and 4, and enterprise shall be deemed to have a permanent establishment in a Contracting State and to carry on business through that permanent establishment if it provides services or facilities in that Contracting State for a period of more than 183 days in any fiscal year in connection with the exploration, exploitation or extraction of mineral oils in that Contracting State."

ARTICLE 7: BUSINESS PROFITS:

"The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as is directly or indirectly attributable to that permanent establishment."

2. (a) **Multiple choice questions** ***(10 x 2 = 20 Marks)***

Choose the most appropriate alternative for the following:

(Alternative to be given only in capital letters A, B, C or D):

(i) In respect of payments effected by HPL to DAS Martin, the total withholding tax (ignoring DTAA provisions) required to be made is

(A) ₹ 5,07,600

(B) ₹ 5,17,920

(C) ₹ 4,24,400

(D) Insufficient data/information to compute

(ii) Relating to the installation projects, KTS Singapore offered payment of ₹ 1,20,000 to CA Akash Kumar, who did not receive it, but directed the company to give it to Children India, an unregistered entity engaged in charitable' activities. The said amount of ₹ 1,20,000 is

(A) Taxable in the hands of CA Akash Kumar only;

(B) Taxable in the hands of CA Akash Kumar as well as Children India;

(C) Taxable only in the hands of Children India;

(D) Taxable neither in the hands of CA Akash Kumar nor Children India.

(iii) The provisions relating to taxation of indirect transfer of shares of an Indian company were introduced vide Finance Act, 2012, as an aftermath of the decision of the Apex Court in

(A) McDowell & Co. Ltd. *vs.* CTO;

(B) Union of India *vs.* Azadi Bachao Andolan;

(C) Vodafone International Holdings B.V. *vs.* UOI;

(D) CIT *vs.* Yokogawa India Ltd.

(iv) If, in the given Case Study, DAS Singapore happens to be a subsidiary of DSA USA (A US company), the transfer of shares in HPL to DAS Singapore will be governed by the provisions of

(A) India US DTAA;

(B) India Nation LDTAA;

(C) India Singapore DTAA;

(D) USA Singapore DTAA.

(v) If it is held that the transfer of shares in HPL by DAS Martin to DAS Singapore is chargeable to tax in India, ignoring the DTAA provisions, the rate of tax applicable (without surcharge or cess) is

(A) 30%;

(B) 10%;

(C) 20%;

(D) None of the above

(vi) Assuming that the FMV of the shareholding in HPL in the hands of DAS Martin is ₹ 192.3 crores, regardless of the taxability of the capital gain in India.

(A) DAS Singapore alone will be liable to tax in India for ₹ 10 crore u/s 56(2) in respect of the difference between FMV and the consideration given to DAS Martin;

(B) DAS Martin alone will be liable to tax u/s 56(2) in India for ₹ 10 crore in respect of the difference between FMV and the consideration received by DAS Martin;

(C) DAS Singapore will not be liable to tax in India u/s 56(2) for ₹ 10 crore in respect of the difference between FMV and the consideration given to DAS Martin;

(D) Neither DAS Martin nor DAS Singapore will be liable to tax in India under section 56(2).

(vii) HPL is bound to report details with respect to transfer of shares by DAS Martin to DAS Singapore in the following Form:

(A) Form 49D;

(B) Form 3CT;

(C) Form 3CTA;

(D) There is no reporting requirement on HPL to report the transfer of the shareholding.

(viii) If DAS Martin happens to be a resident of two Contracting States, namely, Nation L being the place of effective management and also Nation M being the place of incorporation, then, it will be treated as resident of Country L as per the

(A) US Model Convention;

(B) OECD Model Convention;

(C) UN Model Convention;

(D) Both options (B) as well as (C)

(ix) In order to determine the residence of an individual, the following factor is not taken cognizance of under the OECD Model Convention:

(A) Centre of vital interests;

(B) Habitual abode;

(C) Own house in Chennai given on rent for the past twelve years;

(D) Flat taken on rent in Noida where the individual is living for the last twelve years.

(x) If DAS Martin happens to be a resident of two Contracting States, namely, Nation L, being the place of effective management, and also Nation M, being the place of incorporation, then, it will be treated as resident of either Nation L or Nation M, as per the -

(A) US Model Convention only

(B) OECD Model Convention

(C) UN Model Convention

(D) Both options (B) and (C)

(b) Descriptive questions:

(i) The management of DAS Martin wishes to know whether the proposed transfer of shares in HPL to Das Singapore can be regarded as a device or scheme to avoid income-tax in India and whether GAAR can be invoked. ***(5 marks)***

(ii) Examine whether the gains arising from the transfer will be taxable in India, when the former does not have a PE in India, per Article 13 - India Nation L DTAA (Exhibit 1) and in light of the provisions of Article 13 of the said Treaty. ***(4 marks)***

(iii) State whether the provisions of section 92 to section 92F of the Income-tax Act, 1961 ("the Act") relating to transfer pricing would still be applicable in respect of the transfer of shares by DSA Mauritius to DSA Singapore[3]. ***(3 marks)***

(iv) Examine whether the sale consideration receivable by DAS Martin should suffer any withholding tax in India as per section 195 of the Act. ***(3 marks)***

(v) Is DAS Martin required to file return of income in India under section 139(1) of the Act? ***(4 marks)***

(c) In respect of the payments made by HPL to DAS Martin, discuss the applicability of equalization levy. ***(5 marks)***

(d) Can KTS Singapore be considered to have a PE in India, in terms of the India Singapore DTAA and can the profits from the installation projects undertaken in India be taxed in India ? ***(6 marks)***

Solution to Case Study 2

Answer to Q.(a)

Q. No.	Answer
(i)	(D)
(ii)	(B)
(iii)	(C)
(iv)	(B)
(v)	(B)

Q. No.	Answer
(vi)	(A)
(vii)	(D)
(viii)	-[4]
(ix)	(C)
(x)	(D)

[3] To be read as DAS Martin to DAS Singapore

[4] As per para 3 of Article 4 of the OECD and UN Model Convention, 2017, if DAS Martin happens to be a resident of two contracting states, the competent authorities of the Contracting States, i.e., Nation M and Nation L shall endeavour to determine by mutual agreement the Contracting State of which such person shall be deemed to be a resident for the purposes of the Convention, having regard to its place of effective management, the place where it is incorporated and any other relevant factor. As per para 4 of Article 4 of the US Model Convention 2016, where by reason of the provisions of paragraph 1 of this Article, a company is a resident of both Contracting States, such company shall not be treated as a resident of either Contracting State for purposes of its claiming the benefits provided by this Convention. Therefore, none of the options are correct.

Answer to Q.(b)

(i) As per section 95, an arrangement entered into by an assessee may be declared to be an impermissible avoidance arrangement and the consequence in relation to tax arising therefrom may be determined subject to the provisions of GAAR, if the main purpose or one of the main purposes of which is to obtain a tax benefit and which satisfies any of the following tests:

- creates rights, or obligations, which are not ordinarily created between persons dealing at arm's length;
- results, directly or indirectly, in the misuse, or abuse, of the provisions of this Act;
- lacks commercial substance or is deemed to lack commercial substance under section 97, in whole or in part or
- is entered into, or carried out, by means, or in a manner, which are not ordinarily employed for bona fide purposes

In the present case, in the absence of the DTAA between India and nation L, the capital gains arising in the hands of DAS Martin would be chargeable to tax in India, since such income would be deemed to accrue or arise in India on account of capital assets (70% shares in HPL), being situated in India.

Moreover, the transfer of shares in HPL by DAS Martin to another Singapore company i.e., DAS Singapore is pursuant to group reorganisation and to achieve the objectives like reducing complexities, achieving operational excellence, etc.

The shares were acquired 18 years back for a substantial cost of about ₹ 50.3 crores. The investment made in the HPL was with the prior approval of Department of Industrial Policy & Promotion (DIPP) and RBI permission was also obtained.

From the above facts, it is evident that the arrangement of transferring the shares held in HPL, an Indian company, to DAS Singapore by way of capital contribution is not for the purpose of obtaining any tax benefit, since such capital gains are chargeable to tax in India, in the absence of beneficial provisions of the DTAA.

Further, the purpose of entering into such arrangement does not satisfy any of the objectives due to which arrangement would be deemed as impermissible avoidance arrangement.

Thus, in the present case, the proposed transfer of shares in HPL to DAS Singapore cannot be regarded as device or scheme to avoid income-tax in India and hence, GAAR cannot be invoked.

(ii) The capital gains arising in the hands of DAS Martin would be chargeable to tax in India, since such income would be deemed to accrue or arise in India on account of capital assets (70% shares in HPL), being situated in India.

Article 13(4) of the India-Nation L DTAA provides that gains derived by a resident of a contracting State (DAS Martin, resident of Nation L) from the alienation of any property (Shares in HPL) would be taxable only in that State i.e., Nation L.

Section 90(2) provides that where a double taxation avoidance treaty is entered into by the Government, the provisions of the Income-tax Act, 1961 would apply to the extent they are more beneficial to the assessee. In other words, if the DTAA provisions are more beneficial, the same will apply.

Thus, applying Article 13(4) of the tax treaty between India and Nation L, capital gains arising in the hands of DAS Martin would be taxable only in Nation L and hence, such capital gains would not be taxable in India.

(iii) Unless the transaction is taxable in India, there would be no application of transfer pricing provisions under sections 92 to 95. Section 92 is not an independent charging section and would be applicable only if there is any chargeable income arising from the international transaction.

Since by virtue of Article 13(4) of the DTAA between Nation L and India, the capital gains arising from transfer of shares of HPL by DAS Martin to DAS Singapore are taxable only in Nation L, the same would not be subject to tax in India. Accordingly, the transfer pricing provisions contained under sections 92 to section 95 would not apply.

Hence, the transfer pricing provisions contained in sections 92 to 95 would not be applicable in respect of transfer of shares of HPL by DAS Martin to DAS Singapore.

Note: *The aforesaid view has been taken in Dana Corporation [2010] 321 ITR 178 (AAR), Praxair Pacific Limited 326 ITR 276 and Vanenburg Group B.V. vs. CIT 289 ITR 464.*

(iv) Under section 195(1), the obligation to deduct tax at source from interest and other payments to a non-resident, which are chargeable to tax in India, is on "any person responsible for paying to a non-resident or to a foreign company".

For section 195 to apply, there should be income chargeable to tax in India, in the given situation.

Explanation 2 to Section 195(1)clarifies that the obligation to comply with section 195(1) and to make deduction thereunder applies and shall be deemed to have always applied and extends and shall be deemed to have always extended to all persons, resident or non-resident, whether or not the non-resident has:

(a) a residence or place of business or business connection in India; or

(b) any other presence in any manner whatsoever in India.

However, by virtue of the DTAA between India and Country L, in this case, the capital gains would be chargeable to tax only in Country L. The same would not be taxable in India.

Thus, in the present case, DAS Singapore, being a non-resident foreign company is not required to withhold tax on the sale consideration payable to DAS Martin, since capital gains is not taxable in India as per the DTAA between India and Country L.

(v) As per section 139(1), every person, *inter alia*, being a company, is required to furnish a return of income of his income during the previous year, in the prescribed form and verified in the prescribed manner and setting forth such other particulars as may be prescribed, on or before the due date specified thereunder.

Unlike individuals, in the case of firms/companies, there is no stipulation that such obligation will arise only where the total income exceeds the maximum amount not chargeable to tax. Even if the total income is nil, a company, including foreign company, will have to furnish the return of income.

By virtue of section 9(1)(i), capital gain arising on transfer of shares held in HPL, an Indian company, would be deemed to accrue or arise in India in the hands of DAS Martin during the previous year 2019-20.

There is no specific exemption provided under any provisions of the Income-tax Act, 1961 in respect of such income or allowing a foreign company from not filing the return of income under certain circumstances like the present situation where the income is not chargeable to tax in India due to DTAA provisions.

Hence, it is required to furnish return of income on or before the due date, even though DAS Martin is non-resident in India.

The aspect that such income is not taxed in India in the hands of DAS Martin by virtue of the India Country L DTAA does not remove the obligation of DAS Martin to file its return of income in India. In fact, for claiming the benefit of section 90, DAS Martin has to file its return of income in India.

Answer to Q.(c)

Chapter VIII of the Finance Act, 2016, "Equalisation Levy", provides for an equalisation levy of 6% of the amount of consideration for specified services received or receivable by -

- a non-resident not having permanent establishment in India: here, DAS Martin is a non-resident which does not have a PE in India;
- from a resident in India who carries out business or profession, or from a non-resident having permanent establishment in India: here, HPL is a resident in India carrying on business.

"Specified Service" means

(1) online advertisement;

(2) any provision for digital advertising space or any other facility or service for the purpose of online advertisement and

(3) any other service as may be notified by the Central Government.

Since only online advertisement or any provision for digital advertising space for the purpose of online advertisement included within the meaning of specified services, the equalisation levy @6% would be applicable only on the amount of ₹ 43,00,000, paid for advertisements in foreign websites, to DAS Martin, a non-resident not having a PE in India.

Hence, equalisation levy would not apply on the payment of ₹ 8 lakhs made by HPL to DAS Martin for space booking in foreign newspapers.

Answer to Q.(d)

As per Article 5(3) of India Singapore DTAA, a building site or construction, installation or assembly project constitutes a PE only if continues for a period of more than 183 days in any fiscal year.

Further, as per Article 7, the profits of an enterprise of a Contracting State (Singapore, in the present case) shall be taxable only in that State i.e., Singapore, unless the enterprise carries on business through PE situated therein in the other Contracting State (India, in the present case).

The nature and purpose of the activities undertaken in the four projects relates to installation and assembly projects and are covered under Article 5.3 of the DTAA. The controversy whether Article 5.3 or 5.4 will apply does not exist, as it is clear that the activities of KTS Singapore relates to installation and assembly projects.

During the previous year 2019-20, KTS Singapore has carried out four independent installation projects in India. One of these projects was continued for a period of 173 days, another project continued for 170 days and other two projects were continued for a period of 90 days each.

All these are independent projects and there is no inter-connection and inter-dependence amongst them. None of them appears to be an extension of another. Therefore, the duration test for installation and assembly projects provided under Article 5.3 of the DTAA cannot be construed to be read for all the projects that do not pass the test of cohesiveness, inter-connection and inter-dependence.

Since none of the installation projects undertaken by KTS Singapore continued for a period of more than 183 days, such projects cannot constitute PE for KTS Singapore.

Consequently, profits from such installation projects undertaken in India would not be taxed in India and will only be taxed in Singapore.

Case Study 3

FMG Associates is a firm of Chartered Accountants at Jaipur. It has received queries from its clients and for which it has to provide solutions. All the facts relate to A.Y.2020-21.

Resident Ramji with income outside India

Mr. Ramji an individual resident in India furnished details of his global income for the previous year 2019-20.

Income from business carried on in India ₹ 8,00,000

Agricultural income in Sri Lanka (in Sri Lanka Rupee) 1,00,000

Dividend income from a company incorporated in USA (declared on 10.1.2020) US $ 20,000

Royalty income from a detective novel published in country Sri Lanka (in Sri Lanka Rupee) 7,00,000

Income from house property in the country USA US $ 10,000 Business income from Sri Lanka (in Sri Lanka Rupee) 4,00,000

***Note**: All the foreign incomes were repatriated to his bank account in India in April, 2020 except business income earned outside India. Assume the accounting year is uniform for all the countries and tax payable in foreign country was paid, wherever it was taxable.*

The **synopsis** of the relevant Article of the **DTAA between India and USA** regards taxation of property income and dividend income is given below:

(1) Income derived by a resident of a Contracting State from immovable property, situated in the other Contracting State may be taxed in that other State.

Assume rate of tax in USA 30% and in India at slab rate.

(2) Dividends paid by a company which is a resident of a Contracting State to a resident of the other Contracting State may be taxed in that other State. However, such dividends may also be taxed in the Contracting State of which the company paying the dividends is a resident.

Assume rate of tax in USA@25% and in India at slab rate.

The **synopsis** of the relevant Article of the **DTAA between India and Sri Lanka** as regards taxation of agricultural income, business income and royalty income are given below :

(1) Income derived by a resident of a Contracting State from immovable property (including income from agricultural land) situated in the other Contracting State may be taxed in that other Contracting State.

(2) The profits of an enterprise of a 'Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profit of the enterprise may be taxed in the other State but only so much as is attributable to that permanent establishment.

Assume rate of tax in Sri Lanka @20% and in India @ slab rate.

(3) Royalties arising in a Contracting State and paid to resident of the other Contracting State may be taxed in that other State. However, such royalties may also be taxed in the Contracting State at a rate not exceeding 10% of the gross amount of royalty.

Assume rate of tax in Sri Lanka @10% and in India @10% for non-residents and regular rate for residents.

Exchange rates

TT Buying Rate	Sri Lanka Rupee	US Dollars
31.03.2020	INR 1 = 2.54 LKR	1 US dollar = 70 INR
31.12.2019		1 US dollar = 71 INR

Ramji's son Pramod (age 23) is employed in ESS Softwares Ltd, Bengaluru. He was sent on deputation to USA on 10.01.2018 to attend to onsite duties and he returned to India on 05.01.2020. He was paid per diem allowance at USA which was adequate enough to meet his living expenses there. His salary of ₹ 27 lakhs after deducting his PF contribution of ₹ 1,80,000, was credited to his bank account at Bengaluru during the previous year 2019-20.

Non-Resident company seeking AAR

PQR Inc. of Germany is supplying technical know-how to be used by Mayur Co Ltd, Mumbai for manufacture of combustion engine at Nagpur. The agreement for supply of technical know-how is in return for royalty and was signed on 10.05.2018. The royalty exceeded ₹ 10 crore for the assessment year 2018-19. Mayur Co Ltd filed its return of income on 30th August, 2019 and approached AAR in September, 2019 as regards withholding tax on royalties paid to PQR Inc., Germany. The application of Mayur Co Ltd was admitted by AAR in November, 2019. The Assessing Officer issued a notice under section 143(2) on 10.01.2020. The foreign company PQR Inc. also applied for advance ruling on 20.01.2020 to know its tax liability in respect of its royalty income received from Mayur Co Ltd.

Mayur Co Ltd has a branch office in Sri Lanka. It exported goods worth ₹ 5 crores by raising invoice for ₹ 4.40 crores. It gave advance of ₹ 1 crore to its branch in Sri Lanka out of the loan obtained by it from State Bank of India. It did not charge any interest though the borrowing cost attributable for the advance is ascertained at ₹ 7,40,000 for the year ended 31.03.2020.

PQR Inc. has the following incomes in India for the year ended 31st March, 2020:

(i) Dividend income from Indian listed companies ₹ 12,50,000;

(ii) Royalty income from Roger Moore (P) Ltd, Cochin ₹ 8,40,000. The royalty agreement was made in accordance with the policy of the Government of India. The DTAA between India and Germany provides for taxing the royalty at 10%;

(iii) Interest ₹ 5,50,000 received on global depository receipts purchased in foreign currency from ABC Ltd; and

(iv) Interest ₹ 3,20,000 received from an infrastructure debt fund referred to in section 10(47).

Mayur Co Ltd. has 30% shareholding by way of 3 lakh equity shares of € 10 each in Botham Ltd of Spain. In December, 2019, Botham Ltd. declared dividend at 10% on the face value of shares. Mayur Co Ltd. received ₹ 22 lakhs on repatriation of the dividend amount to its bank account in India.

Mayur Co Ltd. is contemplating to transfer the shareholding in Botham Ltd. to a subsidiary company to be incorporated in yet another country and by virtue of the DTAA between that country and Spain, such dividend income will become tax-free. Presently, such dividend income is taxable in India as per DTAA between India and Spain. This plan of transferring the shares by forming the subsidiary company in foreign country is in nascent stage.

Tax dispute of Vijay Jain

Vijay Jain, a resident of India, exported goods to foreign country by under invoicing the sale consideration and accumulated wealth outside India. Based on Tax Information Exchange Agreement between India and Bermuda, a notice for assessment of the undisclosed foreign income under The Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 was issued in March, 2018. The assessee disputed the issue of notice. The Assessing Officer called for details and proceeded with the assessments. There was change in incumbent and the successor continued the assessment proceedings without issuing a fresh notice to the assessee. Vijay Jain moved writ before the High Court in March, 2019 for quashing the proceedings. The Court, vide its order dated 31.03.2019, stayed the proceedings up to 31.12.2019. Vijay Jain had to pay ₹ 8 lakhs towards tuition fees and hostel expenses of his son studying in USA.

Proposal for e-sale of books in India

XY Co Publishers Ltd, United Kingdom, is a reputed scientific book publisher with global presence. The company decided to penetrate the Indian market by procuring orders online. The company anticipates the online booking to pick up in due course of time. It is planning to dispatch goods from the warehouse in Kolkata based on the orders received. There would be no direct sale to any of the customers in India from the warehouse in Kolkata. The amounts have to be paid online by the buyers directly to the bank account of XY Co Publishers Ltd maintained in London. It is contemplating to have a website and server in India owned by it or avail the same of an outside entity for its online business in India.

Advertisement expenditure of Chetan Ltd

Chetan Ltd, Mysore is a 100% subsidiary of Beijing Ltd of Chicago, USA. It acted as the distributor of world famous mobile handsets by brand name "Chicago" manufactured by parent company viz. Beijing Ltd. During the previous year 2019-20, Chetan Ltd remitted the amounts due to Beijing Ltd in settlement of the invoices by furnishing necessary forms prescribed under Income-tax Rules, 1962. The agreement between the companies envisages that 5% of the sale consideration realized by Chetan Ltd. must be spent towards advertisement of "Chicago", being the brand name of the mobile handsets.

Each handset was invoiced @ ₹ 15,000 for Chetan Ltd. and whereas it was invoiced at ₹ 13,000 to unrelated parties. Chetan Ltd. sold 40,000 handsets in the previous year 2019-20 at the average price of ₹ 16,000 per handset. The credit period allowed by Beijing Ltd was 3 months for Chetan Ltd and whereas for other dealers, it was given against full payment. The cost of capital may be taken as 12% per annum and the purchases as uniform throughout the year. Beijing Ltd. charged ₹ 1500 per handset as warranty charges and whereas for unrelated parties it charged ₹ 2000. The assessee selected Beijing Ltd as tested party for comparing controlled and uncontrolled transactions.

Chetan Ltd spent ₹ 3 crores towards advertisement expenses in India. The Assessing Officer applied "Bright Line Test" and wants to add back 50% of the expenditure as towards brand building of parent company's product while determining the arm's length price.

BB Co Ltd. of Chennai is an associated enterprise of Chetan Ltd. It exported the semi-finished textile goods to Pick Inc, Singapore. The goods were further processed and sold to yet another 100% subsidiary of BB Co Ltd viz. Sea Ltd. at Sydney, Australia for reaching the customers therein. BB Co Ltd wants to apply for advance pricing agreement to" protect itself and its subsidiaries.

Choose the most appropriate alternative for the following MCQs : ***(10 x 2 = 20 Marks)***

3.1 The objective of Tax Information Exchange Agreements entered into by the Central Government with various countries is to enable -

(A) certainty in tax levy between countries

(B) concessional levy of tax for the same income between them

(C) investigation of cases of tax evasion or avoidance

(D) mobilization of tax from non-residents

3.2 What is the time limit within which the assessment of Vijay Jain has to be completed under the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 from the facts given?

(A) 31.03.2020

(B) 31.12.2020

(C) 31.12.2021

(D) 31.03.2022

3.3 The amount of dividend income earned by Mayur Co Ltd. from Botham Ltd. of Spain is chargeable to tax in India @________ and it is covered by action plan of BEPS.

(A) 10% and 4

(B) 15% and 4

(C) 15% and 3

(D) 20% and not covered

3.4 How will DTAAs prevent treaty shopping / abuse such as the one contemplated by Mayur Co Ltd.?

(A) Protocols in DTAA

(B) Provision in domestic law

(C) Limitation of Benefit clause in DTAA

(D) Conduit rulings

3.5 The APA that would be applicable to BB Co Ltd for protecting itself and its two subsidiaries in Singapore and Australia for avoiding litigation in transfer pricing regulations, would be

(A) Multi-lateral APA

(B) Bilateral APA

(C) Unilateral APA

(D) None, as it is not possible

3.6 The selection and rejection of comparable in India is carried out through

(A) Deductive approach

(B) Detective approach

(C) Additive approach

(D) Primitive approach

3.7 How much is the penalty payable by Vijay Jain for failure to furnish the prescribed form for remittance of tuition fees to his son?

(A) Nil

(B) ₹10,000

(C) ₹ 50,000

(D) ₹1,00,000

3.8 What is the residential status of Pramod for the assessment year 2019-20?

(A) Non-resident

(B) Resident and ordinarily resident

(C) Resident but not ordinarily resident

(D) None of the above

3.9 How much is to be adjusted to the total income of the Mayur Co Ltd. by applying transfer pricing regulations for the transactions carried out with its Sri Lanka branch office?

(A) ₹ 60,00,000

(B) ₹ 7,40,000

(C) ₹ 67,40,000

(D) Nil

3.10 Which part of Form No.15CA is to be filled up and filed by Chetan Ltd for import of handsets from Beijing Ltd.?

(A) Part A and B

(B) Part B and C

(C) Part A and C

(D) Part D

You are required to answer the following issues:

3.11 Compute the total income of resident Ramji for the assessment year 2020-21 by allowing foreign tax credit wherever applicable in the light of DTAA provisions. ***(6 marks)***

3.12 Pramod claims the salary income earned outside India up to 05.01.2020 is not chargeable to tax in India. Decide the validity of his contention. ***(2 marks)***

3.13 Is the application filed by Mayur Co Ltd seeking advance ruling permissible in law ? Also, decide whether the foreign company PQR Inc. can seek advance ruling when the application of Mayur Co Ltd is pending ? ***(4 marks)***

3.14 With brief reasons for treatment of the items, you are requested to compute the tax liability of PQR Inc. for the assessment year 2020-21. ***(4 marks)***

3.15 The assessee wants to know the forms to be obtained from the Chartered Accountant and filing of the same before the income-tax authorities. In respect of tuition fee paid by Vijay Jain for his son. Advise him suitably. ***(4 marks)***

3.16 Advise whether XY Co Publishers Ltd should have a website and server owned by it or avail the same from an outsider in the context of Income-tax Act, 1961. ***(4 marks)***

3.17 Compute the arm's length price adjustment for Chetan Ltd ignoring any adjustment towards advertisement expenditure. ***(4 marks)***

3.18 Is the Assessing Officer justified in applying "Bright Line Test" for disallowing or adjusting the advertisement expenditure in computing arm's length price ? ***(2 marks)***

Solution to Case Study 3

Answer to Q.3.1 to 3.10

Q. No.	Answer
3.1	(C)
3.2	(B)
3.3	(C)
3.4	(C)
3.5	(A)

Q. No.	Answer
3.6	(A)
3.7	(A)
3.8	(B)
3.9	(D)
3.10	(B)

Answer to Q.3.11

Computation of total income of resident Ramji for the A.Y.2020-21		
Particulars	**₹**	**₹**
Income from house property		
Annual Value of house in USA = $ 10,000 x 70	7,00,000	
Less: Deduction@30%	2,10,000	
		4,90,000
Profits and gains of business or profession		
Income from business carried on in India	8,00,000	
Business income in Sri Lanka (4,00,000 LKR/2.54) [Taxable only in Sri Lanka – Hence, not included in computation of total income][5]	Nil	
Income chargeable under this head		8,00,000
Income from Other Sources		
Agricultural income in Sri Lanka (1,00,000 LKR/2.54)	39,370	
Dividend income from a company incorporated in the USA ($ 20,000 x 71) – Since dividend was declared on 10.1.2020, the rate as on 31.12.2019 has to be considered for conversion.	14,20,000	
Royalty income from a detective novel published in Sri Lanka (7,00,000 LKR/2.54)	2,75,591	
Income chargeable under this head		17,34,961
Gross Total Income		**30,24,961**
Less: **Deductions under Chapter VI-A**		
Section 80QQB [Royalty income from detective novel[6]]		2,75,591
Total Income		**27,49,370**

Answer to Q.3.12

Mr. Pramod has stayed in India for 87 days [27 days (January) +29 days (February) + 31 days (March)] in the P.Y.2019-20. During the four preceding previous years, i.e., from P.Y.2015-16 to P.Y.2018-19, he has been in India for 1015 days [i.e., 365 days in P.Y.2015-16, 365 days in P.Y.2016-17, 285 days in P.Y.2017-18 and 0 days in P.Y.2018-19]. Mr. Pramod is a resident in

[5] Alternatively, the income can first be included in total income to determine the rate of tax on remaining income as per Article 23(2) of the India-Sri Lanka DTAA.

[6] Assuming that the same is in the nature of literary work

India for A.Y.2020-21, since his stay in India is for more than 60 days in the P.Y.2019-20 and more than 365 days in the four preceding previous years.

Also, he is resident and ordinarily resident in India since his stay in India has exceeded 730 days in the seven immediately preceding previous years and he has been resident in 2 or more previous years out of 10 immediately preceding previous years.

In case of a resident and ordinarily resident, global income would be taxable in India. Hence income from salary earned in USA (including per diem allowance) would be taxable in India under the provisions of the Income-tax Act, 1961.

Note *– (1) The second condition of 60 days in the P.Y.2019-20 + 365 days in the 4 preceding previous years for determining his residential status will apply to him since he is an Indian citizen who, being outside India, has returned to India during the P.Y.2019-20. Only if he is visiting India, will the second condition not apply.*

(2) This answer is based on the provisions of the Income-tax Act, 1961. Since the relevant extract of the India-US DTAA is not given in the question, the same has not been considered for the purpose of answering this question.

Answer to Q.3.13

A resident applicant can make an application for advance ruling for determining the tax liability of a non-resident arising out of a transaction which has been undertaken or is proposed to be undertaken by the resident applicant with such non-resident.

Therefore, Mayur Co. Ltd., a resident, can file an application for advance ruling for determining the rate of withholding tax on royalties paid to a non-resident, PQR Inc. Germany.

Even though it has filed its return of income on 30.8.2019, since notice under section 143(2) has been issued on 10.1.2020 only after the application for advance ruling was made in September, 2019, it would not be treated as a case where an application is pending before the income-tax authority. This is because the application was not pending before the income-tax authority on the date of making the application for advance ruling. It was so held in *Sin Oceanic Shipping ASA vs. AAR (2013) 357 ITR 102 (Delhi).*

Therefore, the application filed by Mayur Co. Ltd. seeking advance ruling is permissible in law.

Permissibility of PQR Inc., a foreign company, seeking advance ruling when application filed by Mayur Co. Ltd. is pending before the AAR

The application filed by Mayur Co. Ltd. is pending before the AAR for ruling. The issue in respect of which PQR Inc. wants to file an application is the same issue for which Mayur Co. Ltd. has already made an application.

The Income-tax Act, 1961 does not contain any specific provision debarring the non-resident from making an application to the AAR where the application by the resident is pending before the AAR. However, there is no requirement for filing the same, since the said issue has already been raised by the resident applicant for the same transaction.

Therefore, it is advisable that PQR Inc. does not file an application in respect of the same transaction to the AAR.

Answer to Q.3.14

Computation of tax liability of PQR Inc., a German Company, in India for A.Y.2020-21

	Particulars of Income	Tax treatment	Tax liability (₹)
(i)	Dividend income of ₹12,50,000 from Indian listed companies	Exempt u/s 10(34), since the same is subject to dividend distribution tax u/s 115-O. Section 115BBDA is not attracted in case of a foreign company which is non-resident in India.	Nil
(ii)	Royalty of ₹ 8,40,000 from Roger Moore (P) Ltd., Cochin	Subject to tax@10% as per India-Germany DTAA (DTAA rate is inclusive of cess)	84,000
(iii)	Interest of ₹ 5,50,000 on GDRs purchased in foreign currency from ABC Ltd.	Subject to tax@10.4% [i.e., 10% as per section 115AC plus cess@4%]	57,200
(iv)	Interest of ₹ 3,20,000 received from infrastructure debt fund referred to in section 10(47)	Subject to tax@5.2% [i.e., 5% as per section 115A plus cess@4%]	16,640
		Total tax liability	**1,57,840**

Answer to Q. 3.15

Section 195(6) requires the person responsible for paying to a non-corporate non-resident or a foreign company, any sum, whether or not chargeable under the provisions of the Income-tax Act, 1961, to furnish the information relating to payment of such sum in Form 15CA and 15CB.

As per Rule 37BB(2), the person responsible for paying to a non-corporate non-resident, or to a foreign company, any sum which is not chargeable under the provisions of the Income-tax Act, 1961, shall furnish the information in Part D of Form No.15CA.

Rule 37BB(3), however, provides that no information is required to be furnished for any sum which is not chargeable under the provisions of the Act, if, *inter alia*, the remittance is of the nature specified in the specified list given thereunder.

Payment of tuition fees by Vijay Jain for his son studying abroad is not income chargeable to tax in the hands of his son. Further, since the remittance is in the nature finding place in the specified list given in Rule 37BB(3)(ii), no information is required to be furnished in respect thereof in Part D of Form No.15CA or Form 15CB.

Hence, there is no form is required to be obtained from Chartered Accountant and filed before income-tax authorities.

Answer to Q.3.16

The concept of "business connection" assumes significant importance in the context of the Income-tax Act, 1961. The scope of business connection has now been expanded to include "significant economic presence" in India.

"Significant economic presence" means systematic and continuous soliciting of business activities or engaging in interaction with such number of users in India through digital means, *inter alia*, through websites with the help of servers owned by the assessee or a third person. The Rules in this regard are yet to be notified.

It is possible that transacting business in India by availing the services of website and server, irrespective of its location, would fall within the meaning of "significant economic presence" and hence, constitute business connection, in which case, the income would be taxable in India. However, since the number of users in India are yet to be prescribed, business connection would be established only if users are of the prescribed number.

Note [Alternate Answer] *: As per section 92F(iiia), "permanent establishment" includes a fixed place of business through which the business of the enterprise is wholly or partly carried on.*

Existence of website by itself would not constitute a PE. Where the website is being used as a virtual office for transacting orders of purchases or sales, then, it could be regarded as a permanent establishment, if the server supporting the website is located in India.

In this case, since XY Co. Publishers Ltd., UK, wants to procure online orders from Indian customers, for which payment has to be made online by them, the website and server owned by them in India would constitute a permanent establishment. A warehouse set up in India may not constitute a PE in this case, since only delivery of goods is being effected through the warehouse and there is no direct sale of goods by the warehouse.

Therefore, XY Co. Publishers Ltd. should avail the services of website and server from an outsider.

Answer to Q.3.17

Arms' length adjustment for Chetan Ltd.	
Particulars	**₹**
Price charged by Beijing Ltd. to unrelated parties	13,000

Add: Excess billing to Chetan Ltd. attributable to 3 months credit provided [₹ 15,000 x 3/12 x12/100]	450
	13,450
Less: Difference in warranty charges [₹ 2,000 – ₹ 1,500] to be deducted, since the warranty charges were lower for Chetan Ltd.	500
Arm's length adjustment to be made in the price of each handset	12,950
Price charged from Chetan Ltd.	15,000
Arm's length adjustment for each handset	2,050

Arm's length adjustment for 40,000 handsets[7] = 40,000 x ₹ 2,050 = ₹ 8,20,00,000

Answer to Q.3.18

The issue under consideration is whether bright line test can be used by the Assessing Officer to determine the excess/non-routine advertising, marketing and promotion (AMP) expenditure incurred by the taxpayer for building brand of its associated enterprises in India.

The Delhi High Court, in *Bausch & Lomb Eyecare (India) (P.) Ltd. v. Addl. CIT [2016] 381 ITR 227, held that a*dvertisement expense is not an international transaction and there is no machinery provision for computation of AMP expense adjustment.

In *Sony Ericsson Mobile Communications India (P) Ltd v. CIT (2015) 374 ITR 118,* the Delhi High Court held that bright line test has no statutory mandate and a broad-brush approach is not mandated or prescribed. It further opined that the exercise to separate "routine" and "non-routine" advertising, marketing and promotion or brand building exercise by applying the bright line test of non-comparables should not be sanctioned

Hence, applying the rationale of the above rulings of the High Court, the Assessing Officer is not justified in adopting the "Bright Line Test" for disallowing or adjusting the advertisement expenditure in computing arm's length price.

Note – *There are other court rulings on this issue, and the question can be answered on the basis of any such ruling(s).*

[7] In the absence of information in the question, it is assumed that the handsets supplied by Beijing Ltd. is 40,000, being the number of handsets sold by Chetan Ltd. in the P.Y.2019-20

MOCK TEST PAPER

FINAL (NEW) COURSE : GROUP II ELECTIVE PAPER 6C: INTERNATIONAL TAXATION

Attempt any four out of five case study based questions.

Each case study carries 25 Marks.

Time Allowed – 4 Hours **Maximum Marks – 100**

CASE STUDY - 1

M/s. Shiva Vishnu LLP is a leading tax consultant based at New Delhi. The firm has four resident partners, Mr. Shiva, Mr. Vishnu, Mr. Ganesh and Mr. Karthik. As per the partnership deed, the profits and losses are shared equally amongst partners. All partners are working partners and salary is paid to all partners as per the terms of the partnership deed.

One of the partners, Mr. Vishnu sold listed equity shares of B Ltd (STT was paid both at the time of purchase and sale) on 23rd January, 2020 for Rs.2,70,000. The said shares were purchased by him on 15th January, 2018 for Rs.2,75,000. The fair market value of such shares on 31st January, 2018 was Rs.2,50,000. He sold residential house owned by him in Pune for Rs.22 lakhs on 24th February, 2020. The said land was purchased by him for Rs.11 lakhs on 22nd February, 2018.

The LLP provides direct taxes consultancy services. Over the last couple of years, they have taken up few assignments in the area of international taxation. These assignments relate to double taxation avoidance agreements, non-resident taxation, transfer pricing and other international taxation matters.

The details of some of the assignments are as follows -

Assignment 1 [Client – Ganges Ltd.]

Ganges Ltd. is an Indian Company in which Nile Inc., a Country E company holds 40% shareholding and voting power. During the previous year 2017-18, the Indian company supplied computers to the Country E based company @CED 1100 per piece. The price of computer supplied to other unrelated parties in Country E is @CED 1400 per piece. During the course of assessment proceedings relating to A.Y.2018-19, the Assessing Officer carried out primary adjustments and added a sum of Rs. 168 lakhs, being the difference between actual price of computer and arm's length price for 700 pieces and it was duly accepted by the assessee. The Assessing Officer passed the order, in which the primary adjustments were made, on 1.6.2019. On account of this adjustment, the excess money of Rs. 168 lakhs is available with Nile Inc, Country E. In this context, Ganges Ltd. wants to know the effect of this transaction for the assessment year 2020-21 on the basis that it declared an income of Rs. 300 lakhs and the excess money is still lying with Nile Inc. till today. Assume the rate of exchange as 1 CED = Rs. 80. [CED stands for Country E Dollars, which is the currency of Country E]

Assignment 2 [Client – Godavari Ltd.]

Godavari Ltd., a resident Indian Company, on 01-04-2019 has borrowed Rs. 80 crores from M/s. Missisippi Inc, a Company incorporated in Country F, at an interest rate of 8% p.a. The said loan is repayable over a period of 12 years. Further, loan is guaranteed by M/s Amazon Inc incorporated in Country F. M/s. Colorado Inc, a nonresident, holds shares carrying 40% of voting power both in M/s Godavari Ltd. and M/s Amazon Inc. M/s Colorado Inc has also deposited Rs. 80 crores with M/s Missisippi Inc.

The net profit of M/s. Godavari Ltd. was Rs. 7 crores after debiting the above interest, depreciation of Rs. 4 crores and income-tax of Rs. 2.70 crores. Godavari Ltd. wants to know if interest is allowable as deduction under the head "Profits and gains of business or profession" and if so, to what extent.

Assignment 3 [Client – Ms. Sheetal]

Ms. Sheetal is a resident Individual. She has income from the following sources:

(i) Taxable income from a sole-proprietary concern in Baroda Rs. 80 lakhs.

(ii) Share of profit from a partnership firm in Bhopal Rs. 40 lakhs.

(iii) Agricultural Income (Gross) from coffee estate in Country G which has no DTAA with India, CGD 40000. Withholding Tax on the above income CGD 8000

(iv) Brought forward business loss of F.Y.2015-16 in Country G was CGD 12000 which is not permitted to be set off against other income as per the laws of that country.

Ms. Sheetal desires to know her total income and tax liability for the A.Y. 2020-21 (Assume 1 CGD = Rs.50).
[CGD stands for Country G Dollars which is the currency of Country G]

Based on the above facts, answer the following questions –

Multiple Choice Questions

Write the most appropriate answer to each of the following questions by choosing one of the four options given. Each question carries two marks.

1. Would the total income of A.Y.2020-21 of Ganges Ltd. undergo a change if –

   (i) the primary adjustment made was Rs.90 lakhs;

   (ii) the said adjustment pertained to P.Y.2015-16 ?

   The correct answer is -

   (a) No, the total income of A.Y.2020-21 would not undergo any change due to the reasons stated in either (i) or (ii) above.

   (b) Yes, the total income of A.Y.2020-21 would undergo a change due to the reason stated in (i) but not due to the reason stated in (ii) above.

   (c) Yes, the total income of A.Y.2020-21 would undergo a change due to the reason stated in (ii) but not due to the reason stated in (i) above .

   (d) Yes, the total income would undergo a change due to the reasons stated in both (i) and (ii) above.

2. Interest payable by Godavari Ltd. to Mississippi Inc. would be subject to limitation of interest deduction because –

   (i) M/s. Colorado Inc. holds shares carrying 40% voting power in Godavari Ltd.

(ii) M/s. Colorado Inc. holds shares carrying 40% voting power both in Godavari Ltd. and M/s. Amazon Inc

(iii) M/s. Amazon Inc. guarantees the loan taken by Godavari Ltd. from M/s. Mississippi Inc.

(iv) M/s. Colorado Inc. has deposited Rs.80 crores with M/s. Mississippi Inc.

The most appropriate answer is -

(a) (i) and (iv) above

(b) (ii) and (iii) above

(c) (i) and (iii) above

(d) Either (a) or (b)

3. While computing total income of Ms. Sheetal under the Income-tax Act, 1961, brought forward business loss in Country G –

(i) can be set-off against her business income from sole-proprietorship in Baroda

(ii) cannot be set-off against her business income from sole-proprietorship in Baroda since such set-off is not permitted as per the tax laws of Country G

(iii) should not be deducted while computing doubly taxed income for the purpose of deduction under section 91

(iv) has to be deducted while computing doubly taxed income for the purpose of deduction under section 91

Which of the above statements are correct?

(a) (i) and (iii)

(b) (ii) and (iii)

(c) (i) and (iv)

(d) (ii) and (iv)

4. If Ms. Sheetal derived share income from a partnership firm in Country G which is taxable under the laws of Country G, then, assuming that the shares of the partners are not specified in the instrument evidencing partnership since the same is not a requirement as per the laws of Country G, which of the following statements would be correct?

(i) Share income of Ms. Sheetal from the partnership firm would be taxable under the Income-tax Act, 1961

(ii) Share income of Ms. Sheetal from the partnership firm would be exempt under section 10(2A) of the Income-tax Act, 1961

(iii) Share income of Ms. Sheetal from the partnership firm would be included in “doubly taxed income” for the purpose of deduction under section 91

(iv) Share income of Ms. Sheetal from the partnership firm would not be included in “doubly taxed income” for the purpose of deduction under section 91

The correct answer is –

(a) (i) and (iii)

(b) (i) and (iv)

(c) (ii) and (iii)

(d) (ii) and (iv)

5. In relation to the transaction of sale of shares and land by Mr. Vishnu, which of the following statements are correct, in the context of the facts given in the case study and the provisions contained in the Incometax Act, 1961 –

   (a) Long-term capital loss (computed) on sale of listed equity shares by Mr. Vishnu cannot be set-off against long-term capital gains on sale of land by him, since loss from an exempt source cannot be set-off against gains from a taxable source.

   (b) Long-term capital loss (computed) on sale of listed equity shares by Mr. Vishnu can be set-off against long-term capital gains on sale of land by him.

   (c) Long-term capital gains (computed) on sale of listed equity shares by Mr. Vishnu is includible in computation of total income but not taxable.

   (d) Long-term capital gains (computed) on sale of listed equity shares by Mr. Vishnu is exempt, and hence not includible while computing total income.

DESCRIPTIVE QUESTIONS

1. (a) Ganges Ltd. wants to know the effect of the transaction of supply of computers to Nile Inc., in respect of which the Assessing Officer carried out primary adjustments in computing the total income for A.Y.2020-21, considering that the excess money is still lying with Nile Inc. ***(3 Marks)***

   (b) Is the interest payable by Godavari Ltd. to M/s. Mississippi Inc. allowable as deduction while computing the total income of Godavari Ltd.? If so, to what extent? ***(5 Marks)***

2. Compute the total income and tax liability of Ms. Sheetal for A.Y.2020-21. ***(7 Marks)***

CASE STUDY - 2

Mr. Eashwar, an Indian citizen aged 55 years, carries on the business of trading in garments in India. He has also set up a branch office in Country X and Country Y for trading in garments in those countries. He visits Country X and Y frequently for furtherance of his business. During the P.Y.2019-20, he made three visits to
Country X from 13th May, 2019 to 13th June, 2019, from 18th August, 2019 to 5th October, 2019 and from 17th January, 2020 to 4th February, 2020. He visited Country Y thrice from 3rd April, 2019 to 24th April, 2019, from 4th July, 2019 to 14th August, 2019 and 5th March, 2020 to 20th March, 2020. The number of days of his stay in Country X and Y during the past ten years is as follows –

Previous Year (P.Y.)	No. of days in Country X	No. of days in Country Y
P.Y.2018-19	97	78
P.Y.2017-18	95	85
P.Y.2016-17	98	82
P.Y.2015-16	100	80
P.Y.2014-15	103	75
P.Y.2013-14	110	70
P.Y.2012-13	120	60
P.Y.2011-12	118	60
P.Y.2010-11	115	62
P.Y.2009-10	108	72

He has not visited any other country in the last 10 years. He has a passion for writing and has written two literary books, from which he earns royalty income in Country X. He has purchased agricultural land in Country X. In Country Y, he has purchased a house, which he has let out. He has invested in shares of a company incorporated in Country Y. The following are the particulars of income earned by him in India, Country "X" and Country "Y" for the previous year 2019-20.

Particulars	Rs.
Income from the business of trading in garments	
In India	34,30,000
In Country X	10,45,000
In Country Y	(1,30,000)
Agricultural income in Country "X" (gross) (taxable in Country X)	1,25,000
Dividend received from a company incorporated in Country "Y" (gross) (taxable in Country Y)	40,000
Royalty income from a literary book from Country "X" (gross) (taxable in Country X)	4,00,000
Expenses incurred for earning royalty	40,000
Rent from a house situated in Country "Y" (gross) (taxable in Country Y)	1,80,000
Municipal tax in respect of the above house (not allowed as deduction in country "Y")	10,000

Note: Business loss in Country "Y" not eligible for set off against other incomes as per law of that country.

The rates of tax in Country "X" and Country "Y" are 20% and 30%, respectively.

Mr. Eashwar's younger brother, Mr. Karan, aged 48 years, earns income from a business in Country Z.

Mr. Eashwar's elder sister, Mrs. Radha Srinivas, aged 61 years, is married and settled in Calcutta. She is a Hindustani classical singer and composer who gives concerts in India and Country W. She visits Country W every year during the music season in October to participate in the Mega music concert held there. For the rest of the year, she gives concerts in India. She earns Rs.10 lakhs from concerts held in India and CWD 10145 from concerts held in Country W. Tax deducted in Country W in October, 2019 in respect of income earned by her in that country was 2500 CWD. She earns income of CUD 10000 by way of royalty in respect of copyright of her musical compositions in Country U. The royalty is paid to her every year on 25th March after deduction of tax@10%. In India, she has interest income of Rs.4 lakhs from fixed deposits in her name and Rs.25,000 from savings bank account. She pays medical insurance premium of Rs.27,000 to insure her health and Rs.30,000 to insure the health of her husband, a resident aged 64 years. She deposits Rs.1.50 lakhs in public provident fund and Rs.3 lakhs in five-year fixed deposit in the name of her son, Mr. Ramesh. The conversion rates are as follows -

TT buying rate	**30.9.2019**	**31.10.2019**	**28.2.2020**	**31.3.2020**
Country U dollar (CUD)	Rs.70	Rs.74	Rs.78	Rs.80
Country W dollar (CWD)	Rs.70	Rs.72	Rs.68	Rs.69

Based on the above facts, answer the following questions, assuming that India has –

(i) no double taxation avoidance agreement with Countries W, X and Y;

(ii) a double taxation avoidance agreement with Country Z in line with OECD Model Convention, 2017

(iii) a double taxation avoidance agreement with Country U in line with UN Model Convention, 2017

(iv) India follows credit method for providing double taxation relief with respect to taxes paid in Countries Z and U.

Multiple Choice Questions

Write the most appropriate answer to each of the following questions by choosing one of the four options given. Each question carries two marks.

1. The total income of Mr. Eashwar for the A.Y.2020-21 is -

   (a) Rs.46,89,000

   (b) Rs.48,19,000

   (c) Rs.49,89,000

   (d) Rs.51,19,000

2. For the purpose of computing deduction under section 91 for A.Y.2020-21, the "doubly taxed income" of
   Mr. Eashwar in respect of income earned in Country X and Country Y would be –

   (a) Rs.15,30,000 and Rs.1,59,000, respectively

(b) Rs.12,30,000 and Rs.1,59,000, respectively

(c) Rs.15,30,000 and Rs.29,000, respectively

(d) Rs.12,30,000 and Rs.29,000, respectively

3. The rebate under section 91 available to Mr. Eashwar for A.Y.2020-21 is –

(a) Rs.2,53,842

(b) Rs.3,48,995

(c) Rs.3,13,842

(d) Rs.2,88,995

4. As per the India-Country Z DTAA and India-Country U DTAA, royalty, if any, arising to Mr. Karan and Ms. Radha Srinivas in Country Z and Country U, respectively, would be taxable –

(a) Only in India

(b) Royalty arising to Mr. Karan may be taxed either in India or in Country Z and royalty arising to Ms. Radha Srinivas may be taxed either in India or in Country U

(c) Royalty arising to Mr. Karan would be taxable only in India; Royalty arising to Ms. Radha Srinivas may be taxed either in India or in Country U

(d) Royalty arising to Ms. Radha Srinivas would be taxable only in India; Royalty arising to Mr. Karan may be taxed either in India or in Country Z

5. Let us suppose that, as per the DTAA between India and Country U, a particular income earned by Mrs.
Radha Srinivas in Country U may be taxed in Country U. While computing her total income under the Income-tax Act, 1961, the said income – (a) should not be taken into account at all

(b) should be taken into account; thereafter, deduction is to be allowed from the tax payable in India on her total income.

(c) may be taken into account in order to compute the amount of tax on the remaining income.

(d) may be taken into account; thereafter, deduction may be allowed from the tax payable in India on her total income.

DESCRIPTIVE QUESTIONS

1. Determine the residential status of Mr. Eashwar for A.Y.2020-21. ***(5 Marks)***

2. Compute the total income and tax liability of Ms. Radha Srinivas for A.Y.2020-21, and determine the foreign tax credit available to her. ***(10 Marks)***

CASE STUDY - 3

Mr. Arjun, aged 52 years, carries on in Mumbai, business of trading of spices grown in his own spice gardens in Munnar. He also has spice gardens in Country Z, and he derives income from Country Z from sale of spices grown therein. He stays in India during the entire month of May, July, September, November, January and March. He stays in Country Z during the months of April, June, August, October, December and February. As per the domestic laws of Country Z, he would be resident of that country if his stay in that country is for 180 days or more. Mr. Arjun owns a flat in Juhu, Bombay, where he lives with his wife, two children, and his parents. He also owns a flat in Thane which he has let out. He owns a residential house in Country Z where he stays when he visits Country Z. Mr. Arjun is passionate artist and has showcased his paintings in art exhibitions in Mumbai. He has saving deposits in SBI from which he earned interest of Rs.42,300 in the P.Y.2019-20. He deposited Rs.1,50,000 in public provident fund and paid Rs.28,000 as mediclaim premium to insure his health and that of his spouse. He also paid Rs.32,000 to insure the health of his parents.

Mr. Arjun holds 100 equity shares in each of the four Indian companies, namely, ABC Ltd., PQR Ltd., EFG Ltd and HIJ Ltd. The particulars of businesses carried on/services provided by these companies are detailed hereunder –

Company	Particulars
ABC Ltd.	It is engaged in manufacturing spices in India and has a branch in Country Z and Country L. It effects sale of spices to customers, P and Q through its branch in Country Z; and customers, J and K through its branch in Country L. In addition, it also effects sale of spices to bulk customers M and N in Country Z and bulk customers O and Q in Country L, directly.
PQR Ltd.	It is engaged in lending business and it also has a branch in Country L and Country Z. It has given a loan to L & Co., a firm located in Country L at interest taxable @ 20% as per the domestic tax laws of Country L. It has also given a loan to Z & Co., a firm located in Country Z, at interest taxable @ 8% as per the domestic tax laws of Country Z.
EFG Ltd.	It is engaged in assembly projects in India. It has also set up assembly projects in Country Z and Country L. In Country Z, the project was set up on 28th March, 2018 and lasted upto 30th March, 2020. In Country L, the project was set up on 5th May, 2019 and lasted upto 31st October, 2019.
HIJ Ltd.	It is engaged in providing technical consultancy services to clients in India and abroad. It provides technical consultancy to clients in Country Z and Country L, respectively, through personnel engaged by it for such purposes. The personnel so engaged for Country Z project stayed in Country Z from 3rd June, 2019 to 25th January 2020 in the P.Y.2019-20. The personnel so engaged for Country L project stayed in Country L from 10th July, 2019 to 24th December 2019 in the P.Y.2019-20.

Mr. Arjun sold part of the equity shares held by him in each of the above companies. The details of the shares are given below -

Name of Co.	No. of shares	Date of acquisition	Cost of acquisition (per share)	Date of transfer	Sale price (per share)	FMV as on 31.1.2018
ABC Ltd.	40	28.12.2017	Rs.1,000	2.1.2020	Rs.7,500	Rs.2,000
PQR Ltd.	25	30.11.2017	Rs.3,000	28.12.2019	Rs.5,000	Rs.6,500
EFG Ltd.	45	1.1.2018	Rs.2,000	15.1.2020	Rs.3,000	Rs.1,500
HIJ Ltd.	10	15.1.2018	Rs.4,000	2.3.2020	Rs.2,500	Rs.6,000

Based on the above facts, answer the following questions, assuming that India has –

(i) a double taxation avoidance agreement with Country Z in line with OECD Model Convention, 2017

(ii) a double taxation avoidance agreement with Country L in line with UN Model Convention, 2017

(iii) India follows credit method for providing double taxation relief with respect to taxes paid in Countries Z and L.

Multiple Choice Questions

Write the most appropriate answer to each of the following questions by choosing one of the four options given. Each question carries two marks.

1. For ABC Ltd., which of the following is a criterion for residency in India's DTAA with Country L but not in India's DTAA with Country Z –

   (a) Place of management (b) Place of incorporation

   (c) Neither (a) nor (b)

   (d) Both (a) and (b)

2. As per the DTAA entered into by India with Country Z and Country L, the assembly projects set up by EFG Ltd. in those countries would –

   (a) constitute a PE in both countries

   (b) not constitute a PE in either country Z or Country L

   (c) constitute a PE in Country Z but not constitute a PE in Country L

   (d) constitute a PE in Country L but not constitute a PE in Country Z.

3. As regards provision of technical consultancy services by HIJ Ltd. to its clients in Country Z and Country L through personnel engaged by them for such purposes, which of the following statements is correct, as per the DTAAs entered into by India with those countries?

   (a) Provision of such services would constitute a PE in both cases

   (b) Provision of such services would not constitute a PE in either case

   (c) Provision of such services would constitute a PE in Country Z but not in Country L

   (d) Provision of such services would constitute a PE in Country L but not in Country Z

4. As regards taxability of profits earned by ABC Ltd. from sale of spices to customers through its branches in Country Z and L and profit from sale of spices to customers in Country Z and L directly, which of the following statements is correct, considering the DTAA entered into by India with such countries?

   (a) ABC Ltd. will be subject to tax in Country Z and Country L, to the extent of profits earned from sales effected to customers through its branches located therein.

   (b) ABC Ltd. will be subject to tax in Country Z and Country L on entire profits earned from sales effected to customers located therein, whether through its branches or directly.

(c) ABC Ltd. will be subject to tax in Country Z in respect of profits earned from sales effected to customers through its branch located therein and in Country L on entire profits earned from sales effected to customers located therein, whether through its branch or directly.

(d) ABC Ltd. will be subject to tax in Country L in respect of profits earned from sales effected to customers through its branch located therein and in Country Z on entire profits earned from sales effected to customers located therein, whether through its branch or directly.

5. As regards taxability of interest received/receivable by PQR Ltd. on loan given to L & Co. and Z & Co., which of the following statements is correct, considering the DTAA entered into by India with such countries?

(a) Country L and Z can tax such interest in the hands of PQR Ltd. at its domestic tax rates, namely, 20% and 8%, respectively.

(b) Country L and Z cannot tax such interest in the hands of PQR Ltd. since interest is taxable only in India, being the country of residence of PQR Ltd.

(c) Country L and Z can tax such interest in the hands of PQR Ltd. at a rate, not exceeding the maximum rate to be established through bilateral negotiations

(d) Country Z can tax such interest in the hands of PQR Ltd. at a rate of 8%. However, Country L can tax such interest in the hands of PQR Ltd. at a rate, not exceeding the maximum rate to be established through bilateral negotiations.

DESCRIPTIVE QUESTIONS

1. Examine whether Arjun would be treated as a resident of India or Country Z, as per the relevant article of the DTAA between India and Country Z ***(6 Marks)***

2. Compute the capital gains of Arjun, assuming that the equity shares of all four companies are listed, and securities transaction tax has been paid both at the time of purchase and sale of such shares.

   Also, compute the tax liability of Mr. Arjun, assuming that income computed under the head "Profits and gains of business and profession" is Rs.18,50,000 and income from house property (computed) is Rs.5,25,000. ***(9 Marks)***

CASE STUDY - 4

Holding Ltd. is the Indian parent company of a group of various multinational companies having diversified business portfolio. Its group companies are spread across Country A, County B, Country C and Country D:

Holding Ltd undertakes various transactions with its subsidiaries situated in the countries mentioned above at a predetermined profit margin. One of its subsidiaries Beyond Ltd. (Country A) is engaged in the business of manufacturing and trading of wagons. Holding Ltd purchased a wagon from Beyond Ltd for $15,000 which included warranty for 3 months. The identical wagon was purchased by Holding Ltd by paying $14,000 from completely unrelated party with 1 year of warranty. Fair value of warranty is $700 for one year. However, Beyond Ltd provided credit of 4 months to Holding Ltd. Arm's length interest rate is 9% p.a. Net profit before tax of Holding Ltd. is Rs.25,00,000. Assume 1 $ = Rs.50.

Mr. Yatish is the employee of the War Ltd. (Country B). War Ltd is the associate enterprise of Holding Ltd.

Mr. Yatish, Citizen of Country B, came on deputation to Holding company. He came to India for the first time on

25th April, 2019 and left India on 21th October, 2019. For the F.Y. 2019-20, Yatish has earned salary of Rs.15,00,000 in India and Rs.23,00,000 in Country B. Out of that Rs.23,00,000 earned in Country B, Rs. 9,00,000 was received in India and Rs.14,00,000 was received in Country B.

Elizabeth Ltd (Country C) is one of the subsidiary companies of the Holding Ltd. Elizabeth Ltd. has filed a case in a High Court in India regarding interpretation of one of the clauses of the India-Country C DTAA and it has made reference to the decision given by Supreme Court of Justice Country E regarding the interpretation of a similar matter in Country E – Country F DTAA. However, the Income-tax department has contended that such reference of Foreign Court decision cannot be made in an Indian Court for interpretation of treaties.

Statue Ltd (Country D) has office in Pune which undertakes storage, display as well as delivery of the goods to the Indian customers. All sales orders and contracts are executed by the head office in Singapore.

Assume that India has a DTAA with Country A, County B, Country C and Country D in line with the OECD Model Tax Convention 2017.

Another Indian company, Signature Ltd., has earned following income in Country Y:

Income	**Date of Accrual of Income**
Dividend	25th May,2019
Profit of Shipping Business	12th December, 2019
Capital Gain	31st March, 2020

Based on the above facts, answer the following questions –

Multiple Choice Questions

Write the most appropriate answer to each of the following questions by choosing one of the four options given. Each question carries two marks.

1. India-Country B DTAA was signed on 1st July, 2017. However, TDS provisions of Goods and Service Tax Act came in force on 1st October, 2019. Whether such provisions will be covered in the India-Country B DTAA?

   (a) Yes, it will be covered

   (b) No, it won't be covered

   (c) Will be covered if India-Country B enters into fresh agreement to that effect

   (d) Will be covered if fresh DTAA is made.

2. Mr. Diana, resident and ordinarily resident, did not disclose foreign asset worth Rs.25 Lakh in income tax return. Calculate the amount of penalty leviable under the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015-

(a) Rs. 25 Lakh

(b) Rs.50 Lakh

(c) Rs.10 Lakh (d) Rs.1 Crore

3. In the interpretation of the treaty, the provisions shall be interpreted in such a way that it enables provisions of the treaty to work and to have their appropriate effects. Which of the following basic principle suggest the above:

   (a) Purposive Interpretation

   (b) The principle of effectiveness

   (c) Liberal Construction

   (d) Reasonableness and Consistency

4. Following details are given for Signature Ltd. in respect of Dividend received by it from Country Y:

   TTBR on 30th April,2019 – Rs.65/ CYD

   TTSR on 30th Aprl,2019– Rs.66/ CYD

   TTBR on 25th May,2019 – Rs.65/ CYD

   TTSR on 25th May,2019 – Rs.66/ CYD

   State the specified date and rate of exchange respectively for conversion of dividend.

   (a) 30th April, 65/CYD

   (b) 30th April, 65.5/CYD

   (c) 25th May, 65/CYD

   (d) 30th April, 66/CYD

5. Holding Ltd has advanced loan to Non-Resident company of Rs. 60 Crores. Is the company required to furnish information in Form 15CA in respect of this transaction and if so, in which part?

   (a) Part B of Form 15CA

   (b) Part C of Form 15CA

   (c) Part D of Form 15CA

   (d) Not required to furnish Form 15CA

Descriptive Questions

1. Calculate Holding Ltd'.s profit chargeable to tax after transfer pricing adjustments. ***(5 Marks)***

2. Determine residential status of Mr. Yatish for A.Y. 2020-21 and calculate Mr. Yatish's income which will be chargeable to tax in India. (Double taxation relief may be ignored) ***(6 Marks)***

3. Analyse the correctness of contention made by the Income-tax department in the case filed by Elizabeth Ltd. ***(2 Marks)***

4. State whether, Statue Ltd.'s office in India will constitute Permanent Establishment in India. ***(2 Marks)***

CASE STUDY - 5

Rio Grande Inc, a notified Foreign Institutional Investor (FII), derived the following incomes for the financial year 2019-20:-

(1) Interest received on investment in Rupee Denominated Bonds of Cauvery Ltd., an Indian company issued in March, 2018 - Rs.4,70,000

(2) Dividend from listed equity shares of Indian companies – Rs.2,80,000

(3) Interest on securities – Rs.15,48,000 (Expenses of Rs.13,000 has been incurred to earn such income)

(4) **<u>Income from sale of securities and shares</u>**:

(i) Bonds of Vaigai Ltd.

[Date of purchase 7th July 2016; Date of sale 5th February, 2020]

Sale proceeds	Rs. 58,00,000
Cost of purchase	Rs. 29,00,000

Cost Inflation Index: F.Y.2016-17:264; F.Y.2019-20:289

(ii) Listed equity shares of Mahanadi Ltd.

[Date of purchase – 5th June, 2019; Date of sale – 4th January, 2020]

Sale Consideration	Rs. 14,50,000
Purchase cost	Rs. 6,00,000

[STT paid both at the time of purchase and sale]

(iii) Unlisted equity shares of Godavari Ltd.

[Date of purchase – 2nd August, 2019; Date of sale – 29th March, 2020]

Sale Consideration	Rs. 7,80,000
Purchase cost	Rs. 2,65,000

Rio Grande Inc. wants to know its total income and tax liability for the A.Y. 2020-21. It has no other income during the F.Y.2019-20.

Zara Ltd. is a company resident in Country A. It had set-up a liaison office at Calcutta to receive trade inquiries from customers in India. The work of the liaison office is not only restricted to forwarding of the trade inquiries to Zara Ltd. but the liaison office also negotiates and enters into contracts on behalf of Zara Ltd. with the customers in India. Zara Ltd. wants to know whether setting up of a liaison office would constitute business connection in India.

Based on the above facts, answer the following questions –

Multiple Choice Questions

Write the most appropriate answer to each of the following questions by choosing one of the four options given. Each question carries two marks.

1. In respect of interest payable to Rio Grande Inc. on Rupee Denominated Bonds issued outside India by
   Cauvery Ltd., –
   (a) tax is deductible at source at the rates in force under section 195
   (b) tax is deductible at source@5.2%.
   (c) tax is deductible at source@20.8%
   (d) no tax is deductible at source.
2. If we assume that Rupee Denominated Bonds were issued outside India by Cauvery Ltd. in October, 2018 and Zara Ltd. has also subscribed to such bonds, then, in respect of interest payable to Zara Ltd. on such rupee denominated bonds,
   (a) tax is deductible at source at the rates in force under section 195
   (b) tax is deductible at source@5.2%.
   (c) tax is deductible at source@10.4%
   (d) no tax is deductible at source.
3. If we assume that Rio Grande Inc. had purchased listed shares of Vaigai Ltd. (STT paid) and not bonds, the date of purchase and sale remaining the same as given in respect of bonds, the entire capital gains arising on sale of such shares would be -
   (a) Exempt from tax
   (b) taxable@20% with indexation benefit.
   (c) taxable@10% without indexation benefit.
   (d) None of the above.
4. If the liaison office set up in India by Zara Ltd. does not conclude contracts in India but habitually plays the principal role leading to conclusion of service contracts, then, the activities of the liaison office -
   (a) would not constitute business connection for attracting deemed accrual provisions under section 9(1)(i), since it does not actually conclude contracts.
   (b) would not constitute business connection for attracting deemed accrual provisions under section 9(1)(i), since contract is for provision of services by Zara Ltd. and not purchase and sale of goods
   (c) would not constitute business connection due to reasons states in (a) and (b) above

(d) constitutes business connection for attracting deemed accrual provisions under section 9(1)(i).

5. What are the provisions which have been incorporated in Indian tax laws in line with BEPS Action 1?

   (i) Expansion of scope of business connection to include activities of an agent who habitually plays a principal role leading to conclusion of contracts

   (ii) Expansion of scope of business connection to include activities which constitute significant economic presence

   iii) Introduction of equalization levy

   (a) Only (iii) above

   (b) (i) and (iii) above

   (c) (ii) and (iii) above

   (d) (i), (ii) and (iii) above.

DESCRIPTIVE QUESTIONS

1. Compute the total income and tax liability of Rio Grande Inc. for A.Y.2020-21. ***(12 Marks)***

2. Would the activities carried out by the liaison office set up in India by Zara Ltd. constitute business connection to attract deemed accrual provisions under section 9(1)? ***(3 Marks)***

MOCK TEST PAPER 1

FINAL (NEW) COURSE : GROUP II

ELECTIVE PAPER 6C: INTERNATIONAL TAXATION

SOLUTION TO CASE STUDY 1

I. ANSWERS TO MCQs (Most appropriate answers)

Q. No.	Answer
1	(a)
2	(d)
3	(c)
4	(a)
5	(b)

II. Answers to Descriptive Questions

Answer to Q.1

(a) In this case, Ganges Ltd., the Indian company, and Nile Inc., a Country E company, are deemed to be associated enterprises as per section 92A(2) since Nile Inc. holds more than 26% voting power in Ganges Ltd.

On account of the primary adjustment of Rs.168 lakhs made by the Assessing Officer, the total income of Ganges Ltd. for A.Y.2018-19 would increase by Rs.168 lakhs. In this case, secondary adjustment has to be made under section 92CE, since –

(1) The company has accepted the primary adjustment made by the Assessing Officer;

(2) The primary adjustment is in respect of A.Y.2017-18; and

(3) The primary adjustment exceeds Rs.100 lakhs.

Accordingly, the excess money (i.e., Rs.168 lakhs) available with the associated enterprise (i.e., Nile Inc., Country E) not repatriated to India within 90 days of the date of the order of the Assessing Officer would be deemed as an advance made by the Ganges Ltd. to its associated enterprise, Nile Inc. Interest would be calculated on such advance at the rate of six month LIBOR as on 30th September + 3%, since the international transaction is denominated in foreign currency. Such interest computed upto 31.3.2020 would be added to his total income for A.Y.2020-21.

(b) If an Indian company, being the borrower, incurs any expenditure by way of interest in respect of any debt issued by its non-resident associated enterprise (AE) and such interest exceeds Rs. 1 crore, then, the interest paid or payable by such Indian company in excess of 30% of its earnings before interest, taxes, depreciation and amortization (EBITDA) or interest paid or payable to associated enterprise, whichever is lower, shall not be allowed as deduction as per section 94B.

Further, where the debt is issued by a lender which is not associated but an associated enterprise either provides an implicit or explicit guarantee to such lender or deposits a corresponding and matching amount of funds with the lender, such debt shall be deemed to have been issued by an associated enterprise and limitation of interest deduction would be applicable.

In the present case, since M/s Colorado Inc holds 40% of voting power i.e., more than 26% of voting power in both Godavari Ltd and M/s Amazon Inc, Godavari Ltd. and M/s Amazon Inc are deemed to be associated enterprises.

Since loan of Rs. 80 crores taken by Godavari Ltd., an Indian company from M/s Mississippi Inc, is guaranteed by M/s Amazon Inc, an associated enterprise of Godavari Ltd., such debt shall be deemed to have been issued by an associated enterprise and interest payable to M/s Mississippi Inc shall be considered for the purpose of limitation of interest deduction under section 94B.

Computation of interest to be allowed in the computation of income under the head profits and gains of business or profession of M/s.Godavari Ltd.

Particulars	Rs.
Net profit	7,00,00,000
Add: Interest already debited (Rs. 80 crores x 8%)	6,40,00,000
Depreciation	4,00,00,000
Income tax	2,70,00,000
EBITDA	**20,10,00,000**
Interest paid or payable by Godavari Ltd.	6,40,00,000
Less: Excess interest – Lower of	
Interest paid or payable in excess of 30% of EBITDA	
- Rs. 6,40,00,000 (-) Rs. 6,03,00,000 Rs. 37,00,000	
Interest paid or payable to non-resident AE Rs. 6,40,00,000	
	37,00,000
Interest allowable as deduction	**6,03,00,000**

Note – *Since Colorado Inc., an associated enterprise of Godavari Ltd., has deposited a matching amount of Rs. 80 crores with Mississippi Inc., the interest payable by Godavari Ltd. to Mississippi Inc. on loan of Rs. 80 crores borrowed from Mississippi Inc. would be subject to limitation of interest deduction on the basis of this line of reasoning also.*

Answer to Q.2

Computation of taxable income and tax payable by Ms. Sheetal for A.Y. 2020-21

Particulars	Rs.	Rs.
Profits and gains from business and profession		
Income from sole proprietary concern in Baroda	80,00,000	
Share of profit, Rs. 40 lakhs, from a partnership firm in Bhopal is exempt	Nil	
Business profit	80,00,000	

Less: Business Loss[1] in Country G (CGD 12,000 x Rs. 50/CGD)	6,00,000	
		74,00,000
Income from Other Sources		
Agricultural income from coffee estate in Country G, is taxable in India (CGD 40,000 x Rs. 50/CGD)		20,00,000
Gross Total Income/ Total Income		**94,00,000**
Tax on total income		
Tax on Rs. 94,00,000 [30% x Rs. 84,00,000 plus Rs. 1,12,500]		26,32,500
Add: Surcharge@10%, since total income exceeds Rs. 50 lakhs		2,63,250
		28,95,750
Add: HEC@4%		1,15,830
		30,11,580
Average rate of tax in India [i.e., Rs. 30,11,580/Rs. 94,00,000 x 100]	32.04%	
Average rate of tax in Country G [i.e., CGD 8,000/CGD 40,000]	20%	
Doubly taxed income [Rs. 20,00,000 – Rs. 6,00,000]	14,00,000	
Rebate under section 91 on Rs. 14,00,000 @20% (lower of average Indian tax rate and rate of tax in Country G]		2,80,000
Tax payable in India [Rs. 30,11,580 – Rs. 2,80,000]		**27,31,580**

Note: *Since Ms.Sheetal is resident in India for the P.Y.2019-20, her global income would be subject to tax in India. She would be allowed deduction under section 91 since all the following conditions are fulfilled:-*

(a) She is a resident in India during the relevant previous year.

(b) Agricultural income from coffee estate accrues or arises to her outside India in Country G during that previous year.

(c) Such agricultural income is not deemed to accrue or arise in India during the previous year.

(d) Such agricultural income has been subjected to income-tax in Country G in her hands and she has paid tax on such income in Country G.

(e) There is no agreement under section 90 for the relief or avoidance of double taxation between India and Country G, where the income has accrued or arisen.

SOLUTION TO CASE STUDY 2

I. ANSWERS TO MCQs

MCQ No.	Answer
1.	a
2.	d

[1] Since the eight year period from A.Y.2016-17, being the assessment year in which such business loss was incurred, has not expired, the business loss can be set-off against current year business income

3.	a
4.	c
5.	b

II. ANSWERS TO DESCRIPTIVE QUESTIONS

Answer to Q.1

Determination of residential status of Mr. Eashwar for A.Y.2020-21

No. of days of stay in Country X = 32 days + 49 days +19 days = 100 days

No. of days of stay in Country Y = 22 days + 42 days +16 days = 80 days

No. of days of stay in India = 365 days – 100 days – 80 days = 185 days

Since Mr. Eashwar's stay in India is for 185 days (i.e., 182 days or more) in the P.Y.2019-20, he is resident in India for A.Y.2020-21.

For determining whether he is resident and ordinarily resident in the A.Y.2020-21, the number of days of his stay in India in the last seven previous years is relevant -

Previous Year (P.Y.)	No. of days in Country X	No. of days in Country Y	No. of days in India
P.Y.2018-19	97	78	365-97-78 = 190
P.Y.2017-18	95	85	365-95-85 = 185
P.Y.2016-17	98	82	366-98-82 = 186
P.Y.2015-16	100	80	365-100-80 = 185
P.Y.2014-15	103	75	365-103-75 = 187
P.Y.2013-14	110	70	365-110-70 = 185
P.Y.2012-13	120	60	366-120-60 = 186
Total number of days in the last seven years			**1304**

Since his stay in India exceeds 730 days in the last seven previous years and his number of days of stay in India is 182 days or more in all the earlier previous years, he satisfies the condition of being resident in atleast 2 out of the 10 preceding previous years. Therefore, he is resident and ordinarily resident in India for A.Y. 2020-21.

Answer to Q.2

Computation of tax liability of Ms. Radha Srinivas for the A.Y. 2020-21

Particulars	Rs.	Rs.
Profits and gains of business or profession		
From concerts held in India	10,00,000	
From royalty received from Country U [CLD 10000 x 80 (being conversion rate as on 31.3.2020 -Rule 115)]	8,00,000	
From concerts held in Country W [CWD 10145 x 69 (being conversion rate as on 31.3.2020 – Rule 115)	7,00,005	
		25,00,005

Income from Other Sources		
Income from fixed deposits in her name	4,00,000	
Income from savings bank account	25,000	4,25,000
Gross Total Income		**29,25,005**
Less: **Deduction under section 80C**		
Deposit in PPF	1,50,000	
Five year fixed deposit in the name of her son (does not qualify for deduction under section 80C)		
Under section 80D	50,000	
Medical insurance premium to insure her health and health of spouse (Rs.57,000, restricted to Rs.50,000, being the maximum allowable for senior citizens) (See Note 1)		
Under section 80TTB	50,000	
Interest on bank FD and savings bank account restricted to		2,50,000
Total Income		**26,75,005**
Total Income (rounded off)		**26,75,010**
Tax on Total Income		
Income-tax (See Note 2)		6,12,503
Add: Health and Education Cess @4%		24,500
		6,37,003
Average rate of tax in India (i.e., Rs. 6,37,003/ Rs. 26,75,010 × 100)	23.813%	
Foreign Tax Credit		
Lower of tax payable under the Income-tax Act, 1961 on income from profession and foreign tax payable on such income		
Tax covered under India-Country U DTAA under section 90 [Lower of Rs.1,90,504 (i.e., 23.813% x Rs.8,00,000) and Rs.78,000 (Rs. 78, being the conversion rate as on 28.2.2019 as per Rule 128 x CUD 1000)]	78,000	
Income-tax referred to in section 91: Country W [Lower of Rs.1,66,692 (i.e., 23.813% x Rs.7,00,005) and Rs.1,75,000 (Rs. 70, being the conversion rate as on 30.9.2018 as per Rule 128 x CWD 2500)]	1,66,692	
		2,44,692
Tax payable in India (Rs. 6,37,003 – Rs. 2,44,692)		**3,92,311**
Tax payable (rounded off)		**3,92,310**

Notes:

1. Section 80D allows a higher deduction of up to Rs. 50,000 in respect of the medical premium paid to insure the heath of a senior citizen. Therefore, in respect of medical insurance premium of Rs.57,000 paid by Mrs. Radha Srinivas to insure the health of herself and her spouse, she will be allowed deduction of

Rs. 50,000 under section 80D, since she and her husband are resident Indians of the age of 60 years or more during the P.Y.2019-20.

2. The basic exemption limit for senior citizens is Rs. 3,00,000 and the age criterion for qualifying as a "senior citizen" for availing the higher basic exemption limit is 60 years. Accordingly, Mrs. Radha Srinivas is eligible for the higher basic exemption limit of Rs. 3,00,000, since she is 60 years old.

3. As per Rule 115, for computing income from profession of Mrs. Radha Srinivas, the TT buying rate as on 31.3.2020 has to be considered. Royalty income from Country U and income from concerts in Country W constitute her income from profession, since she is a singer and a composer. However, as per Rule 128, for computing foreign tax credit, TT buying rate as on the last day of the month immediately preceding the month in which tax was deducted or paid in that country has to be considered. Foreign Tax Credit has been computed accordingly.

4. Since the DTAA with Country U is in line with UN Model Convention, as per article 12(1), royalty income arising in a Contracting State (Country U, in this case) and paid to a resident of another Contracting State (Mrs. Radha Srinivas, a resident of India, in this case) ***may*** be taxed in that other State (India, in this case). However, such royalties may also be taxed in the Source State according to its laws, but if the beneficial owner is a resident of another State, then the tax so charged shall not exceed a prescribed percentage to be established though bilateral negotiations (assumed to be 10%, as given in the question, in this case). It is presumed that the rate of 10% is as per domestic tax laws and the negotiated rate as per Article 12(2) of the DTAA of India with Country U. Credit for such tax paid by Mrs. Radha Srinivas in Source State, i.e., Country U, in this case, would be available as per Article 23B(1).

SOLUTION TO CASE STUDY 3

I. ANSWERS TO MCQs

MCQ No.	Answer
1.	b
2.	b
3.	b
4.	c
5.	d

II. ANSWERS TO DESCRIPTIVE QUESTIONS

Answer to Q.1

The India-Country Z DTAA is in line with OECD Model Convention. Hence, the relevant article i.e., Article 4 of the OECD Convention needs to be looked into for determining the residential status of Mr.Arjun.

As per Article 4(1), the term "resident of a Contracting State" means, *inter alia*, any person who is a resident of a Contracting State in accordance with the taxation laws of that State.

Therefore, for determining whether Mr. Arjun is a resident of India or Country Z, first, the residential status as per the taxation laws of respective countries has to be ascertained.

As per section 6(1) of the Income-tax Act,1961, an individual is said to be resident in India in any previous year if he has been in India during the previous year for a total period of 182 days or more. Mr. Arjun stays in India for 184 days during the P.Y.2019-20 (31 days in May + 31 days in July + 30 days in September + 30 days in November + 31 days in January + 31 days in March). Therefore, he is resident in India for P.Y.2019-20.

For being resident and ordinarily resident, he should fulfil both the following conditions:

(i) He is a resident in atleast 2 out of 10 years preceding the relevant previous year, and

(ii) His total stay in India in last seven years preceding P.Y. 2019-20 is 730 days or more.

In this case, since Arjun stays in India for 184 days every year, he is resident in India in every previous year as per the provisions of the Income-tax Act, 1961. Therefore, he satisfies the condition of being resident in India for atleast 2 years out of 10 preceding previous years. Also, he has stayed in India for 1288 days (184 days x 7) during the last seven previous years, which is more than 730 days. Hence, he is resident and ordinarily resident in India for A.Y.2020-21 as per the provisions of the Income-tax Act, 1961.

As per Country "Z" tax residency rules, Arjun qualifies to be resident for the year 2019-20 in Country "Z", since he stays for 181 days (more than 180 days) in Country "Z" in the Financial Year 2019-20.

Thus, as per the domestic tax laws of India and Country Z, Arjun qualifies to be a resident both in India and Country Z during the year P.Y. 2019-20. Hence, the tie-breaker rule provided in Article 4(2) will come into play.

This Rule provides that where an individual is a resident of both the countries, he shall be deemed to be resident of that country in which he has a permanent home and if he has a permanent home in both the countries, he shall be deemed to be resident of that country, which is the centre of his vital interests i.e. the country with which he has closer personal and economic relations.

From the facts, it is evident that Arjun has been living in his own flat in Juhu, Bombay, with his family. Hence, it can be considered as permanent home for him in India. In Country "Z" also, he owns a residential house which would be considered as permanent home for him. Since he has a permanent home both in India and Country "Z", the next test needs to be analysed.

Arjun owns spice gardens in Munnar in India and in Country Z, from which he earns income. However, he also owns a house property in Thane in India from which he derives rental income. His family also resides in Mumbai, India. He has showcased his paintings in Art exhibitions in Mumbai. Therefore, his personal and economic relations with India are closer, since India is the place where -

(a) his residential property is located and

(b) social and cultural activities are closer

Thus, by applying Article 4 of the India-Country "Z" DTAA, Arjun shall be deemed to be resident in India in the P.Y.2019-20.

Answer to Q.2

Computation of total income of Mr. Arjun for A.Y.2020-21

Particulars	**Rs.**	**Rs.**
Income from house property		5,25,000
Profits and gains of business and profession		18,50,000
Capital Gains [**See Working Note below]**		2,50,000
Income from other sources		42,300
Gross Total Income		**26,67,300**

***Less:* Deduction under Chapter VI-A**		
Under section 80C [Deposit in PPF] Under section 80D [Rs.28,000, restricted to Rs.25,000 + Rs.32,000 (since parents are senior citizens, and Rs.32,000 is within the enhanced limit of Rs.50,000)]	1,50,000 57,000	
Under section 80TTA	10,000	2,17,000
Total Income		**24,50,300**

Computation of tax liability		
Particulars	**Rs.**	**Rs.**
Tax@10% u/s 112A on LTCG of Rs.1,50,000 [LTCG in excess of Rs.1 lakh]		15,000
Tax on other income of Rs.22,00,300		
Upto Rs.2,50,000	Nil	
Rs.2,50,001 – Rs.5,00,000@5%	12,500	
Rs.5,00,001 – Rs.10,00,000@20%	1,00,000	
Rs.10,00,001 – Rs.22,00,300@30%	3,60,090	
		4,72,590
		4,87,590
Add: Health and education cess@4%		19,504
Total tax liability		**5,07,094**
Total tax liability (rounded off)		5,07,090

Working Note-

The capital gains arising from sale of shares in all the four companies is long-term since the period of holding in each case is 12 months or more.

Company	Particulars	LTCG
ABC Ltd.	In this case, the lower of sale price (Rs.7,500) and FMV as on 31.1.2018 (Rs.2,000) is Rs.2,000.As the actual cost of acquisition of equity shares of ABC Ltd. (Rs.1,000) is less than Rs.2,000, the cost of acquisition of such share would be taken as Rs.2,000. The long-term capital gain would be Rs.2,20,000 (Rs.7,500 – Rs.2,000) x 40 shares.	2,20,000
PQR Ltd.	In this case, the lower of sale price (Rs.5,000) and FMV as on 31.1.2018 (Rs.6,500) is Rs.5,000. As the actual cost of acquisition of equity shares of PQR Ltd. (i.e., Rs.3,000) is less than Rs.5,000, the cost of acquisition would be taken as Rs.5,000. The long-term capital gains would be Nil (Rs.5,000 – Rs.5,000) x 25 shares.	Nil
EFG Ltd.	In this case, the lower of sale price (Rs.3,000) and FMV as on 31.1.2018 (Rs.1,500) is Rs.1,500. As the actual cost of Rs.2,000 is higher than Rs.1,500, the cost of acquisition would be taken as Rs.2,000. Accordingly, the long-term capital gains would be Rs.45,000 (Rs.3,000 – Rs.2,000) x 45	Rs.45,000

HIJ Ltd.	In this case, the lower of sale price (Rs.2,500) and the FMV as on 31.1.2018 (Rs.6,000) is Rs.2,500. Since the actual cost of acquisition (i.e., Rs.4,000) is less than Rs.2,500, accordingly, the actual cost of Rs.4,000 will be taken as the cost of acquisition. The long-term capital loss would be Rs.15,000 (Rs.2,500 – Rs.4,000) x 10 shares.	(Rs.15,000)
Long-term capital gains		**2,50,000**

SOLUTION TO CASE STUDY 4

I. Answer to MCQs

Q. No.	Answer
1	(b)
2	(c)
3	(b)
4	(a)
5	(d)

II. Answers to Descriptive Questions

Answer to Q.1

Holding Ltd, the Indian company and Beyond Ltd., Country A, are deemed to be associated enterprises as per section 92A, since Beyond Ltd. is the subsidiary of Holding Ltd.

As per *Explanation* to section 92B, the transactions entered into between these two companies for purchase of wagon is included within the meaning of "international transaction".

As Holding Ltd. purchased similar product from an unrelated entity at $14,000, the transactions between Holding Ltd. and such unrelated party can be considered as comparable uncontrolled transactions for the purpose of determining the arm's length price of the transactions between Holding Ltd. and Beyond Ltd. Comparable Uncontrolled Price (CUP) method of determination of arm's length price (ALP) would be applicable in this case.

However, such figure needs to be adjusted by the functional adjustments:

	Amount (in $)
Purchase of Wagon from unrelated party	$14,000
Less: Difference in Warranty (Note-1)	($525)
Add: Adjustment for credit extended (Note-2)	$450
Arm's length price	**$13,925**

Therefore, transfer pricing adjustment would be of Rs. 53,750 [($ 15,000 - $ 13,925) x Rs.50]. The profits of Holding Ltd chargeable to tax would be Rs.25,00,000+Rs.53,750 = Rs.25,53,750.

Note:

(1) Beyond Ltd offered warranty only for 3 months while unrelated party provided it for 1 year. Therefore, 9 months' cost of warranty has to be adjusted. ($700*9/12)

(2) Beyond Ltd has provided credit for 4 months whereas unrelated party has not provided such credit. Therefore, adjustment for the cost of such credit is needed to be carried out to arrive at arm's length price. ($15000*9%*4/12)

Answer to Q.2

As per section 6(1), an individual is said to be resident in India in any previous year if he satisfies the conditions:-

(i) He has been in India during the previous year for a total period of 182 days or more, or

(ii) He has been in India during the 4 years immediately preceding the previous year for a total period of 365 days or more and has been in India for at least 60 days in the previous year.

In this case, Mr. Yatish stay in India during the P.Y. 2019-20 is 180 days (i.e., 6+31+30+31+31+30+21 days). Since his stay in India is for less than 182 days, he does not satisfy condition (i). As regards, condition (ii), since Mr. Yatish came India for the first time in the P.Y. 2019-20, he cannot satisfy the second basic condition of stay of atleast 365 days in the four immediately preceding previous years. Hence, his residential status for A.Y.2020-21 is Non-Resident.

Taxability of income

As per section 5(2), in case of a non-resident, only income which accrues or arises in India or which is deemed to accrue or arise to him in India or which is received or deemed to be received in India in the relevant previous year is taxable in India.

Calculation of income chargeable to tax in the hand of Mr. Yatish

Particulars	Amount (Rs.)
Salary earned in India	15,00,000
Salary earned outside India but received in India	9,00,000
Salary earned outside India and received outside India (not taxable)	Nil
Amount Taxable in India	**24,00,000**

Answer to Q.3

In *CIT v. Vishakhapatnam Port Trust's case [1983] 144 ITR 146*, the Andhra Pradesh High Court observed that, "in view of the standard OECD Models which are being used in various countries, a new area of genuine 'international tax law' is now in the process of developing. Any person interpreting a tax treaty must now consider decisions and rulings worldwide relating to similar treaties. The maintenance of uniformity in the interpretation of a rule after its international adoption is just as important as the initial removal of divergences. Therefore, the judgments rendered by courts in other countries or rulings given by other tax authorities would be relevant." Therefore, stand taken by the Income Tax Department may not be accepted by the court.

Answer to Q.4

As per the Article-5 of DTAA between India – Country D, the term "permanent establishment" shall be deemed not to include the use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise. Therefore, Statue Ltd (Country D)'s office in India will not constitute Permanent Establishment, since its activities are confined only to storage, display and delivery of goods.

SOLUTION TO CASE STUDY 5

I. Answer to MCQs

Q. No.	Answer
1	(b)
2	(d)
3	(d)
4	(d)
5	(c)

II. Answers to Descriptive Questions

Answer to Q.1

Computation of total income of Rio Grande Inc., a notified FII, for A.Y.2020-21

Particulars	Rs.	Rs.
Interest on Rupee Denominated Bonds	4,70,000	
Dividend income of Rs. 2,80,000 [Exempt under section 10(34)]	Nil	
Interest on securities	15,48,000	20,18,000
[No deduction is allowable in respect of expenses incurred in respect thereof as per section 115AD(2)]		
Long-term capital gains on sale of bonds of Vaigai Ltd.		
Sale consideration	58,00,000	
Less: Cost of acquisition	29,00,000	
[Benefit of indexation is not allowable as per section 115AD(3)]		29,00,000
Short-term capital gains on sale of STT paid equity shares of Mahanadi Ltd.		
Sale consideration	14,50,000	
Less: Cost of acquisition	6,00,000	8,50,000
Short-term capital gains on sale on unlisted equity shares of Godavari Ltd.		
Sale consideration	7,80,000	
Less: Cost of acquisition	2,65,000	5,15,000
Total Income		**62,83,000**

Computation of tax liability of Rio Grande Inc. for A.Y.2020-21

Particulars	Rs.
Tax@5% on interest of Rs. 4,70,000 received from an Indian company on investment in rupee denominated bonds = 5% x Rs. 4,70,000	23,500
Tax@20% on interest on securities of Rs. 15,48,000 =20% x Rs. 15,48,000	3,09,600
Tax@10% on long-term capital gains on sale of bonds of Vaigai Ltd. = 10% x Rs. 29,00,000	2,90,000

Tax@15% on short-term capital gains on sale of listed equity shares of Mahanadi Ltd., in respect of which STT has been paid = 15% of Rs. 8,50,000	1,27,500
Tax@30% on short-term capital gains on sale of unlisted equity shares of Godavari Ltd. = 30% of Rs. 5,15,000	1,54,500
	9,05,100
Add: HEC@4%	36,204
Tax Liability	**9,41,304**
Tax Liability (rounded off)	9,41,300

Answer to Q.2

If a Liaison Office is maintained solely for the purpose of carrying out activities which are preparatory or auxiliary in character, and such activities are approved by the Reserve Bank of India, then, no business connection is established.

In this case, had the liaison office's activities been restricted to forwarding of trade inquiries to Zara Ltd., a Country A based company, its activities would not have constituted business connection. However, the activities of the liaison office in Calcutta extends to also negotiating and entering into contracts on behalf of Zara Ltd. with the customers in India, on account of which business connection is established. Hence, the deemed accrual provisions under section 9(1)(i) would be attracted.