DIRECT TAX

MODULE IV

Relevant for May 2018 / Nov 2018 Exam

CA MEHUL THAKKER

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ASSESSMENT YEAR 2018-19

Special Thanks to CA Chetan V Chaudhary

Law stated in this book is as amended by the Finance Act, 2017

All disputes are subject to Ahmedabad Jurisdiction only.

MASTER INDEX

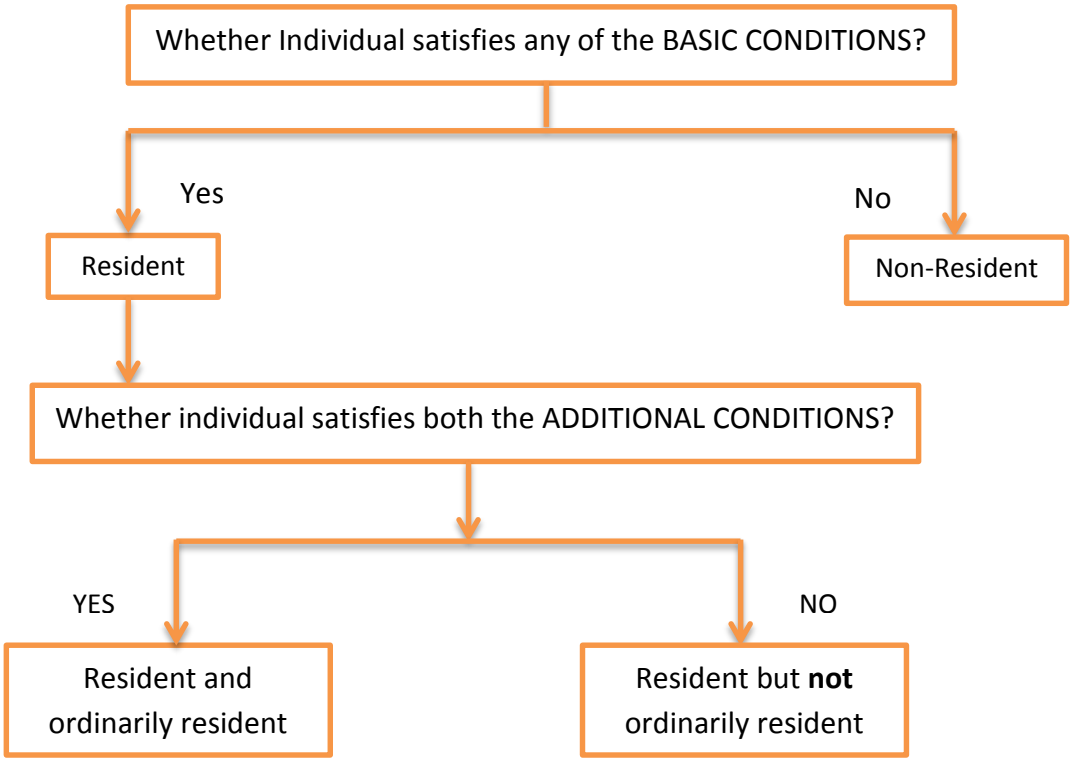
54 – TAXATION OF NON-RESIDENT

UNIT A - BASIC CONCEPTS

54.1 HOW TO DETERMINE RESIDENTIAL STATUS OF A PERSON?

Section:- 6(1)

(1) In case of Individual [Section 6(1)]



- **Let's understand Basic Conditions**

  (a) He is in India at least for 182 days during the previous year.

  Or

  (b) He is in India for at least 60 days during the previous year and 365 days during 4 years immediately preceding the concerned previous year.

- **Explanations to Basic Conditions (Popularly known as exceptions to the Basic Conditions)**

  (a) In case of an individual, being a citizen of India, who leaves India in any previous year as a member of the crew of an Indian ship or for the purposes of employment outside India, **then only basic condition to be checked is :- Condition mentioned at point no. (a)**.

  (b) In case of an individual, being a citizen of India, or a person of Indian origin, who, being outside India, comes on a visit to India in any previous year, then **only basic condition to be checked is :- Condition mentioned at point no. (a)**.

  (c) Person of Indian Origin: -A person shall be deemed to be of Indian origin if he, or either of his parents or any of his grand-parents, was born in undivided India.

- **How to count presence in India (days)?**
  - **(a)** If timings of arrival in India as well as departure from India are available, then presence in India shall be computed on hourly basis and thereafter total of 24 hours of stay in India shall be taken as one day.
  - **(b)** If such timings are not available, then day on which he enters India as well as day on which he leaves India, both days shall be taken into account.
  - **(c)** In the case of an individual, being a citizen of India and a member of the crew of a foreign bound ship leaving India, the period or periods of stay in India shall, in respect of such voyage, be determined in the manner and subject to such conditions as may be prescribed. (see notification below).

Notification No. 70/2015/ F.No.142 /12/2015-TPL Dated 17.08.2015

Computation of period of stay in India in certain cases. -

(1) For the purposes of clause (1) of section 6, in case of an individual, being a citizen of India and a member of the crew of a ship, the period or periods of stay in India shall, in respect of an eligible voyage, **not include the period computed in accordance with sub-rule (2).**

(2) The period referred to in sub-rule (1) shall be the **period beginning on the date entered into the Continuous Discharge Certificate in respect of joining the ship by the said individual for the eligible Voyage and ending on the date entered into the Continuous Discharge Certificate in respect of signing off** by that individual from the ship in respect of such voyage.

Explanation: For the purposes of this rule,-

(a) "Continuous Discharge Certificate" shall have the meaning assigned to it in the Merchant Shipping (Continuous Discharge Certificate - cum - Seafarer's Identity Document) Rules, 2001 made under the Merchant Shipping Act, 1958 ;

(b) "eligible voyage" shall mean a voyage undertaken by a ship engaged in the carriage of passengers or freight in international traffic where-

(i) for the voyage having originated from any port in India, has as its destination any port outside India; and

(ii) for the voyage having originated from any port outside India, has as its destination any port in India.'.

Practical 1

Mr. Navin , a citizen of India and a member of crew of a Foreign Bound Ship "ARJUN" provides following information for the previous year **2017-18**:-

The number of days as per continuous discharge certificate for an "eligible voyage" :-195 days

Whether Navin is said to be resident for the previous year **2017-18**?

Solution

Considering the notification, total period of stay in India for Mr. Navin is computed as under:

Particulars	No. of Days
Total No. of days in previous year **2017-18**	365
Less: No. of days as per continuous discharge certificate	(195)
Presence in India	**170**

Since presence of Mr. Navin in India is less than 182 days, he is said to be non-resident for the previous year **2017-18**.

Readers Note:

- **Now let's move to Additional Conditions**

  (a) He has been resident at least for 2 years out of 10 years immediately preceding the concerned previous year

  AND

  (b) He has been in India for at least 730 days during 7 years immediately preceeding the concerned previous year.

- **As per the provisions of section 6(5) of the Act,** if a person is resident in India in a previous year in respect of any source of income, he shall be deemed to be resident in India in the previous year in respect of each of his other sources of income.

Practical 2

Mr. Olama came to India for the first time on **14-08-2017.** He joined TCS Ltd. on **15-09-2017.** He also started trading in computer parts on **15-11-2017** on part-time basis after obtaining permission of employer. Determine his residential status for the previous year **2017-18.**

Solution

- Consider the definition of "Previous Year" under section 3 of Act.
  "Previous year" means the financial year immediately preceding the assessment year.
  However, in the case of a business or profession newly set up, or a source of income newly coming into existence, in the said financial year, the previous year shall be the period beginning with the date of setting up of the business or profession or, as the case may be, the date on which the source of income newly comes into existence and ending with the said financial year.
- Therefore, previous year for Mr. Olama for different sources of income is as under:

Source of Income	Previous Year
Salary Income from TCS Ltd.	15-09-2017 to 31-03-2018
Trading in Computer Parts	15-11-2017 to 31-03-2018

- For determining residential status, section 6(1) requires presence in India for at least **182 days or more during previous year.**

- Considering the definition of previous year for various sources of income, Residential Status of Mr. Olama is worked out as under:

Source of Income	Previous Year	Presence in India during P.Y.2017-18	Whether Resident for the P.Y. 2017-18?
Salary Income from TCS Ltd.	15-09-2017 to 31-03-2018	> 182 days	Yes
Trading in Computer Parts	15-11-2017 to 31-03-2018	< 182 days	No

Now, interesting outcome is that Mr. Olama is resident for the "Salary" source of income and non-resident for the "PGBP" income. Then what shall be his residential status for the previous year 2017-18?

To resolve this conflict, section 6(5) is at our help which provides that if a person is resident in India in a previous year in respect of any source of income, he shall be deemed to be resident in India in the previous year in respect of each of his other sources of income.

- Considering the above provision, Mr. Olama is said to be resident for the previous year 2017-18 for all the sources of income.

Readers Note:

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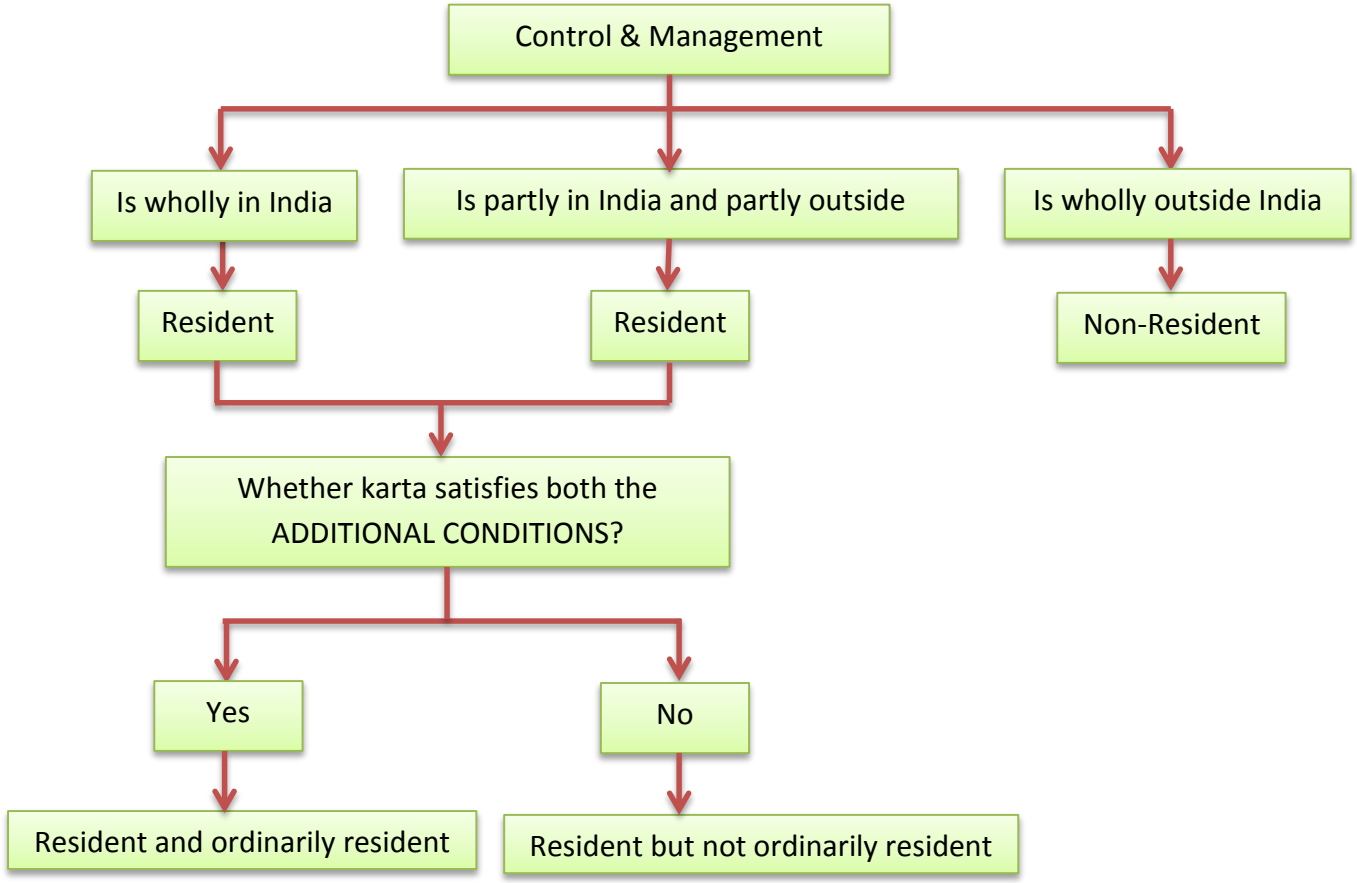
(2) In case of Hindu Undivided Family [Section 6(2)]

- **When a Hindu undivided family is resident or non-resident?**
  The residential status of a Hindu undivided family depends upon the fact that where the control and management of its affairs is situated? Following chart highlights the rules for determining the residential status of a Hindu undivided Family: -
- **What is "Control and Management"?**
  Control and management is situated at a place where the head, the seat and the directing power are situated.



(3) In case of Firm and Association of Persons (AOP) [Section 6(2)]

- A partnership firm and an association of persons are said to be resident in India if control and management of their affairs are wholly or partly situated within India during the relevant previous year. They are, however, treated as non-resident in India if control and management of their affairs are situated wholly outside India.
- The following Chart summarizes the rules for determining residential status of the firm and association of persons—

Place of control	**Resident or Non-resident?**
Control and management of the affairs of a firm/association of persons is-	
1. Wholly in India	Resident
2. Partly in India and partly outside India	Resident
3. Wholly outside India	Non-resident

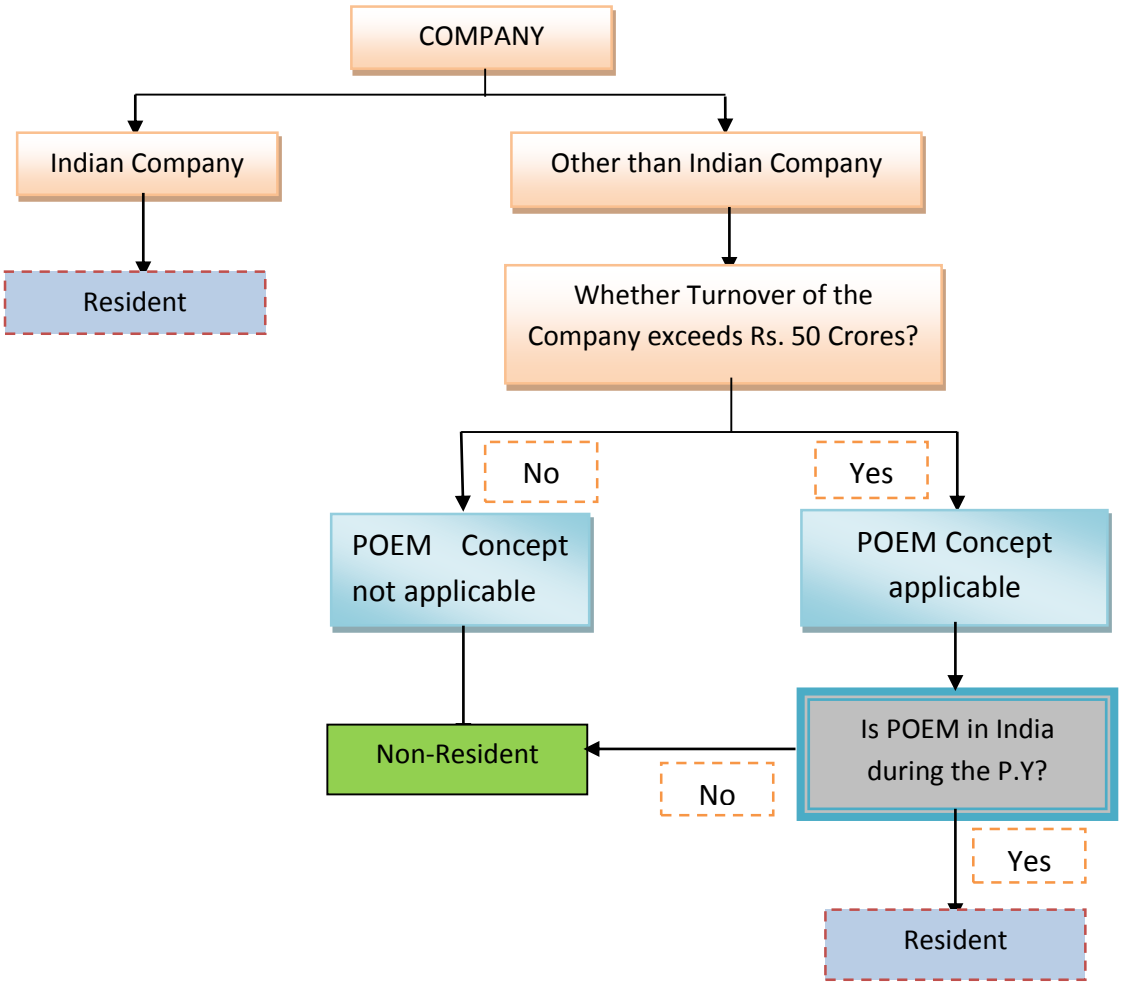
(4) In case of a Company [Section 6(3)]

- A company is said to be resident in India in any previous year, if—

  (i) it is an Indian company; or

  (ii) its place of effective management, in that year, is in India.

  Explanation:- *For the purposes of this clause "place of effective management" means a place where key management and commercial decisions that are necessary for the conduct of the business of an entity as a whole, are in substance made.*



GUIDING PRINCIPLES ON POEM

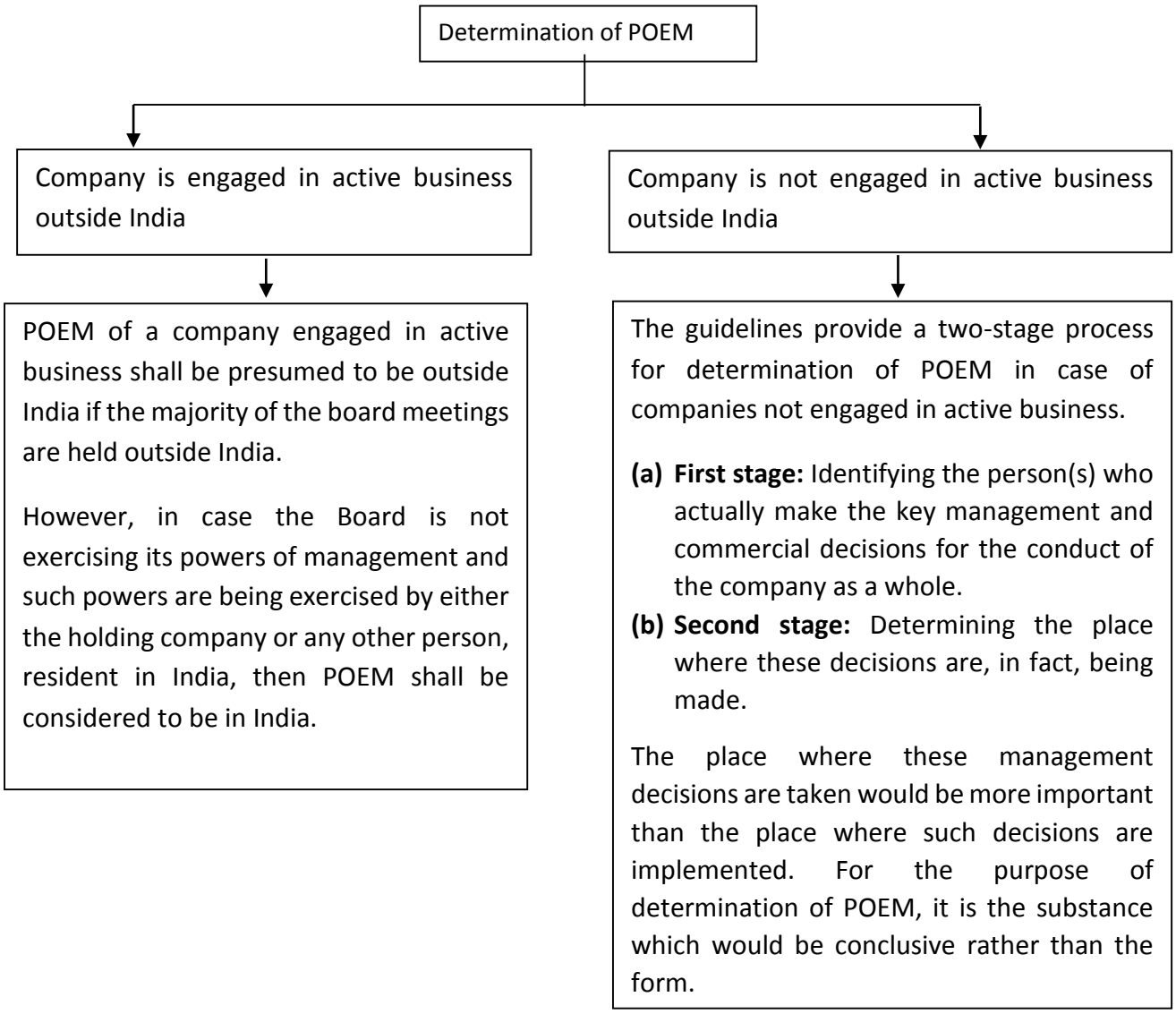
Circular No. 6/2017, dated 24.01.2017 & Circular No. 8/2017, dated 23-02-2017

Fundamental Points to be noted.

- Any determination of the POEM will depend upon the facts and circumstances of a given case.
- The POEM concept is one of substance over form.
- An entity may have more than one place of management, but it can have only one place of effective management at any point of time.
- Since "residential status" is to be determined for each year, POEM will also be required to be determined on year to year basis.

Process of determination of POEM

The process of determination of POEM would be primarily based on the fact as to **whether or not the company is engaged in active business outside India**.



When company shall be said to be engaged in "active business outside India"?

A company shall be said to be engaged in "active business outside India"

- 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.

For the purpose of determining whether the company is engaged in active business outside India, the average of the data of the previous year and two years prior to that shall be taken into account. In case the company has been in existence for a shorter period, then, data of such period shall be considered. Where the accounting year for tax purposes, in accordance with laws of country of incorporation of the company, is different from the previous year, then, data of the accounting year that ends during the relevant previous year and two accounting years preceding it shall be considered.

Meaning of certain terms:

<table>
<tr><th>Term</th><th>Meaning</th></tr>
<tr><td>Income</td><td>(a) As computed for tax purpose in accordance with the laws of the country of incorporation; or
(b) As per books of account, where the laws of the country of incorporation does not require such a computation</td></tr>
<tr><td>Value of assets</td><td>
<table>
<tr><td>(a)</td><td>In case of an individually depreciable asset</td><td>The average of its value for tax purposes in the country of incorporation of the company at the beginning and at end of the previous year;</td></tr>
<tr><td>(b)</td><td>In case of pool of fixed asset, being treated as a block for depreciation</td><td>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;</td></tr>
<tr><td>(c)</td><td>In case of any other asset</td><td>Value as per books of account</td></tr>
</table>
</td></tr>
<tr><td>Number of employees</td><td>The average of the number of employees as at the beginning and at the end of the year. It shall include persons, who though not employed directly by the company, perform tasks similar to those performed by the employees.</td></tr>
<tr><td>Pay roll</td><td>This term includes the cost of salaries, wages, bonus and all other employee compensation including related pension and social costs borne by the employer</td></tr>
</table>

Passive income	It 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; However, any income by way of interest shall not be considered to be passive income in case of a company which is engaged in the business of banking or is a public financial institution, and its activities are regulated as such under the applicable laws of the country of incorporation.

Examples on determination of POEM

Example 1: Company A Co. is a sourcing entity, for an Indian multinational group, incorporated in country X and is 100% subsidiary of Indian company (B Co.). The warehouses and stock in them are the only assets of company and are located in country X. All the employees of the company are also in country X. The average income wise breakup of the company's total income for three years is, -

(i) 30% of income is from transaction where purchases are made from parties which are non-associated enterprises and sold to associated enterprises;

(ii) 30% of income is from transaction where purchases are made from associated enterprises and sold to associated enterprises;

(iii) 30% of income is from transaction where purchases are made from associated enterprises and sold to non-associated enterprises; and

(iv) 10% of the income is by way of interest.

Interpretation: In this case passive income is 40% of the total income of the company. The passive income consists of, -

(i) 30% income from the transaction where both purchase and sale is from/to associated enterprises; and

(ii) 10% income from interest.

The A Co. satisfies the first requirement of the test of active business outside India. Since no assets or employees of A Co. are in India the other requirements of the test is also satisfied.

Therefore, company is engaged in active business outside India.

Example 2: *The basic facts are same as in Example 1. Further facts are that all the directors of the A Co. are Indian residents. During the relevant previous year 5 meetings of the Board of Directors is held of which two were held in India and 3 outside India with two in country X and one in country Y.*

Interpretation: The A Co. is engaged in active business outside India as the facts indicated in Example 1 establish. The majority of board meetings have been held outside India. Therefore, the POEM of A Co. shall be presumed to be outside India.

Example 3: *The facts are same as in Example 2 but it is established by the Assessing Officer that although A Co.'s senior management team signs all the contracts, for all the contracts above* Rs. *10 lakh the A Co. must submit its recommendation to B Co. and B Co. makes the decision whether or not the contract may be accepted. It is also seen that during the previous year more than 99% of the*

contracts are above Rs. *10 lakh and over past years also the same trend in respect of value contribution of contracts above* Rs. *10 lakh is seen.*

Interpretation: These facts suggest that the effective management of the A Co. may have been usurped by the parent company B Co. Therefore, POEM of A Co. may in such cases be not presumed to be outside India even though A Co. is engaged in active business outside India and majority of board meeting are held outside India.

Example 4: *The other facts remain same as that in Example 1 with the variation that A Co. has a total of 50 employees. 47 employees, managing the warehouse, storekeeping and accounts of the company, are located in country X. The Managing Director (MD), Chief Executive Officer (CEO) and sales head are resident in India. The total annual payroll expenditure on these 50 employees is of* Rs. *5 crore. The annual payroll expenditure in respect of MD, CEO and sales head is of* Rs. *3 crore.*

Interpretation: Although the first limb of active business test is satisfied by A Co. as only 40% of its total income is passive in nature. Further, more than 50% of the employees are also situated outside India. All the assets are situated outside India. However, the payroll expenditure in respect of the MD, the CEO and the sales head being employees resident in India exceeds 50% of the total payroll expenditure.

Therefore, A Co. is not engaged in active business outside India.

Example 5: *An Indian multinational group has a local holding company A Co. in country X. The A Co. also has 100% downstream subsidiaries B Co. and C Co. in country X and D Co. in country Y. The A Co. has income only by way of dividend and interest from investments made in its subsidiaries. The Place of Effective Management of A Co. is in India and is exercised by ultimate parent company of the group. The subsidiaries B, C and D are engaged in active business outside India. The meetings of Board of Director of B Co., C Co. and D Co. are held in country X and Y respectively.*

Interpretation: Merely because the POEM of an intermediate holding company is in India, the POEM of its subsidiaries shall not be taken to be in India. Each subsidiary has to be examined separately. As indicated in the facts since companies B Co., C Co., and D Co. are independently engaged in active business outside India and majority of Board meetings of these companies are also held outside India. The POEM of B Co., C Co., and D Co. shall be presumed to be outside India.

List of some of the guiding principles which may be taken into account for determining the POEM for the companies not engaged in active business outside India

(a) The location where a company's Board regularly meets and makes decisions

(b) Location of Executive Committee, in case powers are delegated by the board may be the company's place of effective management

(c) Location of head office

(d) Use of modern technology

(e) Decisions via circular resolution or round robin voting

(f) Decisions made by Shareholders are not relevant factor in determination of POEM

(g) Day to day routine operational decisions are not relevant for determination of POEM

List of secondary factors which may be taken into account for determining the POEM for the companies not engaged in active business outside India

If the above factors do not lead to clear identification of POEM then the final guidelines provide that following secondary factors may be considered:

- Place where main and substantial activity of the company is carried out; or
- Place where the accounting records of the company are kept.

Determination of POEM is to be based on all the relevant facts and not on the basis of isolated facts

It needs to be emphasized that the determination of POEM is to be based on all relevant facts related to the management and control of the company, and is not to be determined on the basis of isolated facts that by itself do not establish effective management, as illustrated by the following examples:

(i) The fact that a foreign company is completely owned by an Indian company will not be conclusive evidence that the conditions for establishing POEM in India have been satisfied.

(ii) The fact that there exists a Permanent Establishment of a foreign entity in India would itself not be conclusive evidence that the conditions for establishing POEM in India have been satisfied.

(iii) The fact that one or some of the Directors of a foreign company reside in India will not be conclusive evidence that the conditions for establishing POEM in India have been satisfied.

(iv) The fact of, local management being situated in India in respect of activities carried out by a foreign company in India will not, by itself, be conclusive evidence that the conditions for establishing POEM have been satisfied.

(v) The existence in India of support functions that are preparatory and auxiliary in character will not be conclusive evidence that the conditions for establishing POEM in India have been satisfied.

While determining POEM, "Snapshot" approach should not be adopted

It is reiterated that the above principles for determining the POEM are for guidance only. No single principle will be decisive in itself. The above principles are not to be seen with reference to any particular moment in time rather activities performed over a period of time, during the previous year, need to be considered.

In other words a "snapshot" approach is not to be adopted. Further, based on the facts and circumstances if it is determined that during the previous year the POEM is in India and also outside India then POEM shall be presumed to be in India if it has been mainly /predominantly in India.

Duty of the assessing officer to obtain prior approval of the Principal Commissioner or Commissioner before concluding that POEM of a particular company in India

The Assessing Officer (AO) shall, before initiating any proceedings for holding a company incorporated outside India, on the basis of its POEM, as being resident in India, seek prior approval of the Principal Commissioner or the Commissioner, as the case may be.

Further, in case the AO 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 AO 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, in this regard. The collegium so constituted shall provide an opportunity of being heard to the company before issuing any directions in the matter.

Practical 3

ABC Inc., a Swedish company headquartered at Stockholm, not having a permanent establishment in India, has set up a liaison office in Mumbai in **April, 2017** in compliance with RBI guidelines. It just spread awareness about the company's products and explore further opportunities. The liaison office takes decisions relating to day to day routine operations and performs support functions that are preparatory and auxiliary in nature. The significant management and commercial decisions are, however, in substance made by the Board of Directors at Sweden. Determine the residential status of ABC Inc. for **A.Y.2018-19.**

Whether ABC Inc. is required to file any statement under Income Tax Act, 1961?

Solution

- ABC Inc. has only a liaison office in India through which it looks after its routine day to day business operations in India. The place where decisions relating to day to day routine operations are taken and support functions that are preparatory or auxiliary in nature are performed are not relevant in determining the place of effective management.
- Considering the amendment in section 6(3) of the Act, ABC Inc., being a foreign company is a non-resident for **A.Y.2018-19**, since its place of effective management is outside India in the **P.Y.2017-18**
- ***As per section 285 of the Act,*** Every person, being a **non-resident having a liaison office in India** set up in accordance with the guidelines issued by the Reserve Bank of India under the Foreign Exchange Management Act, 1999, **shall**, in respect of its activities in a financial year, **prepare and deliver or cause to be delivered to the Assessing Officer** having jurisdiction, **within sixty days from the end of such financial year, a statement in such form and** containing **such particulars as** may be **prescribed**. [As per notification no. 5/2012 dated 6-2-2012, form no. 49C shall be submitted in electronic form]

Readers Note:

(5) In case of a Every Other Person [Section 6(3)]

Place of control	Resident or non-resident?
Control and management of the affairs of every other person is -	
1. Wholly in India	Resident
2. Partly in India and partly outside India	Resident
3. Wholly outside India	Non Resident

54.2 SCOPE OF TOTAL INCOME

Section:- 5

Section 5 of the Income Tax Act, 1961 governs the scope of total income. It depends on residential status of person. Consider the following chart depicting incidence of tax.

Rule No.	Particulars	Whether tax incidence arises in the case of		
		Resident and ordinarily resident	Resident but not ordinarily resident	Non-resident
(A)	Income *received* in India whether accrued in India or outside India	Yes	Yes	Yes
(B)	Income *deemed to be received* in India whether accrued in India or outside India	Yes	Yes	Yes
(C)	Income *accruing or arising* in India whether received in India or outside India	Yes	Yes	Yes
(D)	Income *deemed to accrue or arise* in India whether received in India or outside India **(Section 9 : Detailed discussion is given in para 3)**	Yes	Yes	Yes
(E)	Income received and accrued outside India from a business controlled in or a profession set-up in India	Yes	Yes	No
(F)	Income received and accrued outside India from a business controlled from outside India or a profession set-up outside India	Yes	No	No
(G)	Income (other than business or profession income) received and accrued outside India	Yes	No	No

54.3 INCOME DEEMED TO ACCRUE OR ARISE IN INDIA

Section:- 9

The following incomes shall be deemed to accrue or arise in India:

(1) Business connection

Income accruing or arising through or from any business connection in India is taxable irrespective of residential status of a person. Examples of business connection are:-

- **a.** Opening subsidiary company in India.
- **b.** Opening branch in India
- **c.** Appointing agent in India

Business connection includes Professional Connection also.

(2) House property or other source

Income through or from any property, any asset or source of income in India shall be deemed to accrue or arise in India.

Practical 4

Mr. Mohan, non-resident owns house property in Mumbai. The same was given on rent for the period of 5 months to Mr. Kishore, another non-resident. Since both are neighbors at Australia, it was agreed that rent shall be paid in Australia. Discuss taxability of rent income in the hands of Mr. Mohan.

Solution

Since house property is situated in India, income through such property shall be deemed to accrue or arise in India. Therefore, rental income earned by Mr. Mohan shall be taxed in India though rent was received in Australia.

Readers Note:

(3) Capital Gain

Income through the transfer of a capital asset situated in India shall be deemed to accrue or arise in India.

Practical 5

Continuing above problem, Mr. Kishore would like to buy the property and it was agreed that the consideration was paid to Mr. Mohan in Australia. Discuss taxability of capital gain in the hands of Mr. Mohan, if any.

Solution

Since capital asset (house property) is situated in India, income through transfer of such asset (capital gain) shall be deemed to accrue or arise in India. Therefore, capital gain, if any, on transfer of said property shall be taxed in the hands of Mr. Mohan though consideration was received in Australia.

Readers Note:

(4) Salary [Section 9(1)(ii)]

Income which falls under the head 'Salaries' shall be deemed to accrue or arise in India if services are rendered in India. Further, salary for the rest period or leave period which is preceded and succeeded by services rendered in India and forms part of the service contract of employment shall also be deemed to accrue or arise in India.

Practical 6

Mr. K. Bush, an employee of Microsoft (US) has been transferred to Bangalore to look after the operations of Microsoft (India) on **01-01-2018.** His monthly salary is US $ 2000. His salary was continued to be deposited with State Bank of America, Old jersey branch. Find out taxable income of Mr. K. Bush, if any in India on the assumption that this is the first visit of Mr. K. Bush to India. Adopt 1$ = Rs. 65 for sake of simplicity.

Solution

First of all, let's determine the residential status of Mr. K. Bush. His presence in India is as under:

Month	**No. of Days**
January, **2018**	31
February,**2018**	28
March,**2018**	31
Total	**90**

Since presence of Mr. K. Bush in India during previous year **2017-18** is less than 182 days, he is non-resident.

Tax incidence in the hands of Mr. K. Bush for the previous year **2017-18** is as under:

Salary for the period	**Whether taxable or not?**	**Reasons**	**Amount (Rs.)**
1st April **2017** to 31st December, **2017**	Not Taxable	Income accrued and received outside India **(Rule G)**	Nil
1st January, **2018** to 31st March,**2018**	Taxable	**Services are rendered in India** therefore, such income is deemed to accrue or arise in India though received outside India **(Rule D)**	3,90,000
Taxable Salary Income			**3,90,000**

Readers Note:

Practical 7

Mr. Janak, an employee of State Bank of India, Ahmedabad brach, has been transferred to State Bank of India, Singapore branch with effect from **01-06-2017**. His monthly salary is Rs. 50,000. His salary, thereafter, deposited with Singapore branch. Determine tax consequences on the assumption that he left India for the first time.

Does your answer differ if his salary is continued to be deposited with SBI, Ahmedabad branch?

Solution

First of all, let's determine the residential status of Mr. Janak. His presence in India is as under:

Month	**No. of Days**
April, **2017**	30
May,**2017**	31
Total	**61**

Since Mr. Janak left India for the purpose of employment, only first basic condition (i.e. 182 days) needs to be checked. However, his presence in India is only for 61 days therefore, he is non-resident for the previous year **2017-18.**

Tax incidence in the hands of Mr. Janak for the previous year **2017-18** is as under:

Salary for the period	**Whether taxable in India or not?**	**Reasons**	**Amount (Rs.)**
1st April **2017** to 31st May, **2017**	Taxable	Salary income is received in India **(Rule A)**	1,00,000
1st June, **2017** to 31st March,**2018**	Not Taxable	Salary income accrued and received outside India **(Rule G)**	Nil
Taxable Amount			**1,00,000**

If salary is continued to be deposited with Ahmedabad branch then, tax incidence would be:

Salary for the period	**Whether taxable in India or not?**	**Reasons**	**Taxable Amount (Rs.)**
1st April **2017** to 31st May, **2017**	Taxable	Salary income is received in India **(Rule A)**	1,00,000
1st June, **2017** to 31st March, **2018**	Taxable	Salary income is received in India though accrued outside India **(Rule A)**	5,00,000
Taxable Amount			**6,00,000**

Readers Note:

(5) Salary paid by the Government to a citizen of India [Section 9(1)(iii)]

Salary paid by the Government to a citizen of India for service outside India shall be deemed to accrue or arise in India. It may be noted that allowances and perquisites paid outside India by the Government is exempt by virtue of section 10(7).

Practical 8

Mr. Nayankumar, a citizen of India, employed in the Indian Embassy at Tokyo, Japan. He provides following information for the relevant previous year:-

Particulars	Amount (Rs.)
Basic Pay	1,50,000 p.m.
Dearness Allowance	15,000 p.m.
Transport Allowance	12,000 p.m.
Servant allowance	3,000 p.m.
Sumptuary allowance	5,000 p.m.
Rent Free official residence	3,00,000 (Annual License fee)
Bonus	75,000

Examine the taxability of salary, allowances and perquisites in the hands of Mr. Nayankumar assuming that his salary was received in Japan and he is non-resident for the relevant previous year

Solution

Computation of taxable salary of Mr. Nayankumar

Particulars	Amount in (Rs.)	Amount in (Rs.)
Basic Pay	1,50,000 p.m. × 12 months	18,00,000
Dearness Allowance	15,000 p.m.	Exempt under section 10(7)
Transport Allowance	12,000 p.m.	Exempt under section 10(7)
Servant allowance	3,000 p.m.	Exempt under section 10(7)
Sumptuary allowance	5,000 p.m.	Exempt under section 10(7)
Rent Free official residence	3,00,000 (Annual License fee)	Exempt under section 10(7)
Bonus	75,000	75,000
Taxable Salary		**18,75,000**

Readers Note:

Practical 9

Mr. Joseph, an employee of American Government posted to India to assume charge of American Embassy in India. Since services are rendered in India, salary income of Mr. Joseph shall be deemed to accrue or arise in India. Mr. Joseph seeks your advice on taxability of remuneration in India.

Solution

As per the provisions of section 9, salary income earned by Mr. Joseph is deemed to accrue or arise in India and therefore, remuneration received by him shall be taxed in India.

However, **section 10(6)(ii)** shall be at his help. As per the provision of this section, the remuneration received by him as an official, by whatever name called, of an embassy, high commission, legation, commission, consulate or the trade representation of a foreign State, or as a member of the staff of any of these officials, for service in such capacity is exempt. This exemption is subject to following:

Provided that the remuneration received by him shall be exempt only if the remuneration of the corresponding officials or member of the staff of Government of India enjoys a similar exemption in that country.

Readers Note:

Circular No. 13/2017, dated 11-04-2017 and Circular No. 17/2017, dated 26-04-2017
Clarification regarding liability to income-tax in India for a non-resident seafarer receiving remuneration in NRE (Non-Resident External) account maintained with an Indian Bank

Representations were received by the CBDT that income by way of salary, received by non-resident seafarers, for services rendered outside India on-board foreign ships, are being subjected to tax in India for the reason that the salary has been received by the seafarer into the NRE bank account maintained in India by the seafarer.

The CBDT has examined the matter. It noted that section 5(2)(a) of the Income-tax Act, 1961 provides that only such income of a non-resident shall be subjected to tax in India that is either received or is deemed to be received in India.

Accordingly, the CBDT has, vide this circular, clarified that that salary accrued to a non-resident seafarer for services rendered outside India on a foreign going ship (with Indian flag or foreign flag) shall not be included in the total income merely because the said salary has been credited in the NRE account maintained with an Indian bank by the seafarer.

(6) Dividend paid by an Indian company [Section 9(1)(iv)]

Dividend paid by an Indian company is always deemed to accrue or arise in India

(7) Interest [Section 9(1)(v)]

Interest are deemed to accrue or arise in India if payable by:-

Nature of Income	Payable by Government	Payable by Resident	Payable by Non Resident
Interest on monies borrowed	Deemed to accrue or arise in India	Deemed to accrue or arise in India if borrowed funds are used for :- (a) business or profession carried on in India or (b) for any source of income in India	Deemed to accrue or arise in India **only** when borrowed funds are used for the purposes of business or profession carried on in India.

Practical 10

Mr. Rohan, a resident borrowed US $ 1,00,000 @ 6% p.a. from Jackson, a non-resident. Discuss tax consequences in the hands of Mr. Jackson in the following alternatives:

(i) Mr. Rohan used borrowed funds for the purpose of construction of factory at Madras.

(ii) Mr. Rohan used borrowed funds for the purpose of construction of factory at Uganda

(iii) Mr. Rohan used borrowed funds for the purpose of purchasing house property at Rajkot which he given on monthly rent of Rs. 50,000.

Solution

Alternative (a): Since Rohan deployed borrowed funds in India for the purpose of business, interest earned on such fund by Mr. Jackson is deemed to accrue or arise in India. Therefore, such interest earned by Mr. Jackson is taxable in India.

Alternative (b) : Since Rohan deployed borrowed funds outside India, interest earned on such fund by Mr. Jackson is not deemed to accrue or arise in India. Further, Mr. Jackson is non-resident therefore, such interest is not taxable in India assuming that it is received outside India.

Alternative (c): Since Rohan deployed borrowed funds in India for the purpose of any source in India (in this case, rent income from house property), interest earned on such fund by Mr. Jackson is deemed to accrue or arise in India. Therefore, such interest earned by Mr. Jackson is taxable in India.

Readers Note:

Practical 11

Mr. Robert, a non-resident borrowed US $ 1,00,000 @ 6% p.a. from Jackson, an another non-resident. Discuss tax treatment in the hands of Mr. Jackson in the following alternatives:

(a) Mr. Robert used borrowed funds for the purpose of business in Mumbai.

(b) Mr. Robert used borrowed funds for the purpose of business in UAE.

(c) Mr. Robert used borrowed funds for the purpose of purchasing house property at Bangalore which he given on monthly rent of Rs. 50,000.

Solution

Alternative (a) : Since Robert deployed borrowed funds in India for the purpose of business, interest earned on such fund by Mr. Jackson is deemed to accrue or arise in India. Therefore, such interest earned by Mr. Jackson is taxable in India.

Alternative (b) : Since Robert deployed borrowed funds outside India, interest earned on such fund by Mr. Jackson is not deemed to accrue or arise in India. Further, Mr. Jackson is non-resident therefore, such interest is not taxable in India assuming that it is received outside India.

Alternative (c) : Since Robert deployed borrowed funds in India for the purpose of any source in India (in this case, rent income from house property) and not for business purpose, interest earned on such fund by Mr. Jackson is not deemed to accrue or arise in India. Therefore, such interest earned by Mr. Jackson is not taxable in India.

Readers Note:

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(8) Royalty and fees for technical services

Royalty and fees for technical services are deemed to accrue or arise in India if payable by:-

Nature of Income	Payable by Government	Payable by Resident	Payable by Non Resident
Royalty / Fees for technical services	Deemed to accrue or arise in India	Deemed to accrue or arise in India if borrowed funds are used for :- (a) business or profession carried on in India or (b) for any source of income in India.	Deemed to accrue or arise in India only when used for (a) business or profession carried in India or (b) for any other source of income in India

Practical 12

For the **assessment year 2018-19**, X is a non-resident in India. From the information given below, find out his income chargeable to tax.

Sr. No.	Particulars	Rs.
1.	Royalty received by him outside India from the Government of India	8,17,000
2.	Technical fees received from A Ltd. (an Indian Company) in Germany for advise given by him in respect of a project situated in Iran.	1,,17,000
3.	Income from a business situated in Sri Lanka (goods are sold in Sri Lanka, sale consideration is received in Sri Lanka but business is controlled partly in Sri Lanka and partly in India)	2,17,000
4.	Income from a business connection in India (it is received outside India)	3,17,000

Solution

Calculation of Income Chargeable to Tax in the hand of Mr. X (Non-Resident)

Sr. No.	Particulars	Rs.
1.	Royalty received by him outside India from the Government of India	8,17,000
2.	Technical fees received from A Ltd. (an Indian Company) in Germany for advise given by him in respect of a project situated in Iran.	Not Taxable
3.	Income from a business situated in Sri Lanka (goods are sold in Sri Lanka, sale consideration is received in Sri Lanka but business is controlled partly in Sri Lanka and partly in India)	Not Taxable
4.	Income from a business connection in India (it is received outside India)	3,17,000
	Total income chargeable to Tax	**11,34,000**

Readers Note:

UNIT B – SPECIAL PROVISIONS UNDER CHAPTER 'CAPITAL GAIN'

54.4 CERTAIN TRANSACTIONS NOT TREATED AS TRANSFER

Section:- 47

(1) Section 47(viia)

Any transfer of a capital asset, being bonds or Global Depository Receipts referred to in section 115AC(1), made by a non-resident to another non-resident is not treated as transfer provided that transfer is made outside India.

(2) Section 47(viiaa)

Any transfer of a capital asset, being rupee denominated bond of an Indian company issued outside India, made by a non-resident to another non-resident is not treated as transfer provided that transfer is made outside India.

(3) Section 47(viib)

Any transfer of a capital asset, being a Government Security carrying a periodic payment of interest, made outside India by a non-resident to another non-resident is not treated as transfer if made through an intermediary dealing in settlement of securities.

54.5 CONVERSION RULE AND BENEFIT OF INDEXATION

Section:- First and second proviso to section 48

(1) First Proviso to Section 48

First proviso to section 48 is applicable only in the case of a non-resident. Under this provision, capital gain is first calculated in foreign currency and then converted in to Indian currency.

(2) Conditions

1. The taxpayer is a non-resident (except the cases covered by sections 115AC and 115AD) at the time of sale of capital asset.
2. He acquires shares or debentures of an Indian company by utilizing foreign currency.

(3) Conversion Rules

Particulars	***Conservation rate***
1. Sale consideration	Average exchange rate **on date of transfer**
2. Cost of acquisition	Average exchange rate **on date of acquisition**
3. **Expenditure on sale**	**Average exchange rate on date of transfer**
4. Capital gain	**Buying rate on date of transfer**

(4) Benefit of indexation not available (second proviso to section 48)

Second proviso to section 48 provides that benefit of indexation is not available in respect of capital gain covered under first proviso to section 48.

Remark: Conversion Rule is mandatory (not optional) once conditions of first proviso to section 48 are satisfied.

Practical 13

Mr. Rackson, a non-resident foreign citizen, remits US $ 85,000 to India on **November 28, 2002**. The amount is partly utilised on **December 02, 2002** for purchasing 82,000 shares in Tech-Ex Pvt. Ltd., an Indian company, at the rate of Rs.42 per share. These shares are sold for Rs.79 per share on **July 25, 2017.** Brokerage expenses Rs.0.90 per share which was paid on **July 30, 2017.**

Find out the capital gains chargeable to tax on the assumption that telegraphic transfer, buying and selling rates of US dollars adopted by the State Bank of India are as follows:

Particulars	Buying (1 US $) Rs.	Selling (1 US $) Rs.
November 28, 2002	47.15	47.25
December 02, 2002	46.95	47.05
July 25, **2017**	60.65	62.15
July 30, **2017**	61.05	61.95

Solution

Particulars	Indian Currency (Rs.)	Conversion Rule	Foreign Currency ($)
Sale Consideration	64,78,000	Average Rate on Date of Transfer 1$ = Rs. 61.40	1,05,504.89
Less: Expenses	(73,800)	Average Rate on Date of Transfer 1$ = Rs. 61.40	(1,201.95)
Less: Cost of Acquisition	(34,44,000)	Average Rate on Date of Acquisition 1$ = Rs. 47	(73,276.60)
Long Term Capital Gain	**NA**		**31,026.34**

Long Term Capital Gain in Indian Currency = $ 31,026.34 x Buying Rate on the date of transfer
= $ 31,026.34 x Rs.60.65
= Rs.18,81,747.52

Readers Note:

Practical 14

Find out tax liability of Mr. Rackson assuming that he does not have any other income during the previous year.

Solution

Option 1

Tax calculation

Tax under section 112 @ 20% (No shifting benefit)	Rs. 3,76,350
Add: 3% Education Cess	Rs. 11,290
Total Tax Liability	Rs. 3,87,640

Option 2

As per amendment of Finance Act, 2012, special tax rate (10%) on long term capital gain arising on transfer of unlisted securities available to non-residents only provided-

- Non-resident shall not avail
  (a) Benefit of conversion rule as well as
  (b) Benefit of Indexation.

That means for this section, gain shall be worked out directly in Indian currency.

Particulars	Indian Currency (Rs.)
Sale Consideration	64,78,000
Less: Expenses	(73,800)
Less: Cost of Acquisition	(34,44,000)
Long Term Capital Gain	**29,60,200**

Tax = 10.30% of Rs.29,60,200

= Rs.3,04,901

Considering above, Mr. Rackson shall opt for **option 2.**

Readers Note:

54.6 HOW TO FIND OUT CAPITAL GAINS WHEN SHARES ACQUIRED ON REDEMPTION OF GDR ARE SUBSEQUENTLY SOLD?

Section:- 49(2ABB) and 2(42A)

(a) As per section 49(2ABB), the cost of shares acquired on redemption of GDRs referred to in Section 115AC shall be the price of such share or shares prevailing on any recognised stock exchange on the date on which a request for such redemption was made.

(b) To find out whether shares of a company, which is acquired by the non-resident assessee on redemption of GDRs are long-term capital asset or not, the period of holding shall be determined from the date on which a request for such redemption was made.

(c) The benefit of indexation will start from the date on which a request of such redemption was made.

54.7 RUPEE APPRECIATION GAINS ON REDEMPTION OF RDBS NOT TO BE INCLUDED IN FULL VALUE OF CONSIDERATION

Section:- Fourth Proviso to section 48-

As per the fourth proviso to section 48, in case of assessee being non-resident, any gains arising on account of rupee appreciation against foreign currency at the time of redemption of rupee denominated bond of an Indian company subscribed by him shall not be included in computation of full value of consideration.

Practical 15

Mr. Raghav, non-resident has subscribed rupee denominated bonds (RDBs) of Indian company. Discuss tax treatment of following components on redemption of above bonds.

(a) Interest earned on such RDBs.

(b) Gain arising on account of appreciation of rupee against a foreign currency at the time of redemption of rupee denominated bond of an Indian company subscribed by him.

Solution

(a) Interest earned on such RDBs shall be taxed in the hands of Mr. Raghav @ 5% u/s 115A of the Act.

(b) As per the amendment made by Finance Act, 2016 under section 48, gain arising on account of appreciation of rupee against a foreign currency at the time of redemption of rupee denominated bond of an Indian company subscribed by him, shall be ignored while computing full value of consideration. That means, such gain is not taxable.

Readers Note:

UNIT C – SPECIAL PROVISIONS UNDER THE HEAD 'PGBP'

54.8 PROVISIONS FOR COMPUTING PROFITS AND GAINS OF SHIPPING BUSINESS IN THE CASE OF NON-RESIDENTS

Section:- 44B and 172

(1) Special provisions for computing profits and gains of shipping business in the case of non-residents [Section 44B]

- Notwithstanding anything to the contrary contained in section 28 to 43A in the case of an assessee, who is a **non-resident** and is engaged in the business of **operation of ships**, a **sum equal to 7.5%** of following shall be deemed to be the profits of such business—
  - **(a)** the amounts paid or payable whether in or out of India to the assesses or to any person on his behalf, on account of carriage of passengers, livestock, mail or goods shipped at any port in India, and
  - **(b)** any amount received or deemed to be received in India by or on behalf of the assesses, on account of carriage of passengers, livestock, mail or goods shipped at any port outside India,
- For the purpose of this section, the amount shall also include amount paid or payable or received or deemed to be received by way of demurrage charge or handling charge or any other amount of similar nature.

Practical 16

Miss. Jecika, non-resident reports income under section 44B. He would like to claim unabsorbed depreciation and brought forward business loss against such income. Can he claim?

Solution

- Section 44B overrides provisions of sections 28 to 43A only.
- However, section 44B does not override the provision of Chapter VI (relating to set off and carry forward of losses) and Chapter VIA (relating to deductions under sections 80C to 80U). [Circular No. 169, dated 23-6-1975]
- Thus current year and brought forward losses are eligible for set off against profits determined under section 44B.
- However, unabsorbed depreciation which is covered by section 32 (2) cannot be set off against such profits. [Universal Cargo Carriers Inc. vs. CIT (1987) 165 ITR 209 (Cal)].

Readers Note:

(2) Shipping business of Non-Residents [Section 172]

(1) The provisions of this section shall, **notwithstanding** anything contained in the other provisions of this Act, apply for the purpose of the levy and recovery of tax in the case of any ship, belonging to or chartered by a non-resident, which carries passengers, livestock, mail or goods shipped at a *port in India.*

(2) Where such a ship carries passengers, livestock, mail or goods shipped at a port in India, [seven and a half] per cent of the amount paid or payable on account of such carriage to the owner or the charterer or to any person on his behalf, whether that amount is *paid or payable*

in or out of India, shall be deemed to be income accruing in India to the owner or charterer on account of such carriage.

(3) Before the departure from any port in India of any such ship, the master of the ship shall prepare and furnish to the [Assessing] Officer a return of the full amount paid or payable to the owner or charterer or any person on his behalf, on account of the carriage of all passengers, livestock, mail or goods shipped at that port since the last arrival of the ship thereat:

Provided that where the [Assessing] Officer is satisfied that it is not possible for the master of the ship to furnish the return required by this sub-section before the departure of the ship from the port and provided the master of the ship has made satisfactory arrangements for the filing of the return and payment of the tax by any other person on his behalf, the [Assessing] Officer may, if the return is filed **within thirty days** of the departure of the ship, deem the filing of the return by the person so authorised by the master as sufficient compliance with this sub-section.

(4) On receipt of the return, the [Assessing] Officer shall assess the income referred to in sub-section (2) and determine the sum payable as tax thereon at the rate or rates [in force] applicable to the total income of a foreign company and such sum shall be payable by the master of the ship.

(4A) No order assessing the income and determining the sum of tax payable thereon shall be made under sub-section (4) after the expiry of nine months from the end of the financial year in which the return under sub-section (3) is furnished:

(5) For the purpose of determining the tax payable under sub-section (4), the Assessing Officer may call for such accounts or documents as he may require.

(6) A port clearance shall not be granted to the ship until the Collector of Customs, or other officer duly authorised to grant the same, is satisfied that the tax assessable under this section has been duly paid or that satisfactory arrangements have been made for the payment thereof.

(7) Nothing in this section shall be deemed to prevent the owner or charterer of a ship from claiming before the expiry of the assessment year relevant to the previous year in which the date of departure of the ship from the Indian port falls, that an assessment be made of his total income of the previous year and the tax payable on the basis thereof be determined in accordance with the other provisions of this Act, and if he so claims, any payment made under this section in respect of the passengers, livestock, mail or goods shipped at Indian ports during that previous year shall be treated as a payment in advance of the tax leviable for that assessment year, and the difference between the sum so paid and the amount of tax found payable by him on such assessment shall be paid by him or refunded to him, as the case may be.

(8) For the purposes of this section, the amount referred to in sub-section (2) shall include the amount paid or payable by way of demurrage charge or handling charge or any other amount of similar nature.

(3) Section 44B Versus Section 172 – a comparison

Sr. No.	Particulars	Provisions u/s 172	Provisions u/s 44 B
(1)	**Scope**	It covers amount on account of carriage of goods, passengers etc. shipped at port in India only.	It covers amount on account of carriage of goods, passengers etc. shipped at Port in India as well as Port outside India
(2)	Overriding Effect	It overrides all other provisions of the Act.	It overrides sections 28 to 43A
(3)	Set off and carry forward of losses	Not Available	Available
(4)	Deduction from gross total income under sections 80C to 80 U	Not Available	Available
(5)	Tax liability	At the rate applicable to a foreign company	At the rate applicable to a non-resident

Practical 17

Mr. Tom, a non-resident is engaged in the business of shipping. He provides following information regarding shipping operations during the concerned previous year:

Goods shipped from	Freight collection (Rs. In lakhs)	Demurrage and handling charges (Rs. In lakhs)
-Kandla Port	49.40	0.60
-Bombay Port	24.75	0.25
-Colmbo Port (amount received in India)	10.50	0.20

Mr. Tom has brought forward loss of Rs.1,95,000 from a trading operations in India which was discounted three years back. Compute tax liability of Mr. Tom.

Solution

Section 172 is applicable throughout the previous year which requires master of vessel to pay tax at 40% of income and for this section,

Income = 7.5% in respect of goods shipped at port of India.
= 7.5% of [Rs.50,00,000 +Rs.25,00,000]
= Rs.5,62,500

Tax Payable = 41.20% of Rs.5,62,500
= Rs.2,31,750

After previous year ends, as per section 172(7), if Mr. Tom wants to be governed by other provisions of the Act then tax paid under section 172 (i.e., Rs.2,31,750) shall be treated as advance tax.

It must be noted that other provisions are always beneficial.

Therefore computation of total income of Mr. Tom under **section 44B** is as under:

Particulars	Rs.
7.5% in respect of Goods shipped at ports in India (Rs.75,00,000 x 7.5%)	5,62,500
Add: 7.5% of goods shipped outside India (Rs.10,70,000 x 7.5%)	80,250
	6,42,750
Less: Brought forward loss	(1,95,000)
Total Income	**4,47,750**

Computation of Tax Liability

Particulars	Tax Rate	Rs.
Upto Rs.2,50,000	Nil	Nil
Rs. 2,50,000 – Rs. 4,47,750	5%	9,888
Total		**9,888**
Add: 3% Education Cess		297
		10,185
Less: Advance Tax as per section 172(7)		2,31,750
Refund Due		**2,21,565**
Refund Due (Rounded off)		**2,21,570**

Readers Note:

(4) Interest under section 234 B

The Board has clarified that in case of a regular assessment under section 172 (7), the non-resident assessee is liable to pay interest under section 234B and 234 C and also entitled to receive interest under section 244A (Refund) as the case may be – Circular No. 9/ 2001.

(5) TDS while making payment to non-resident

The provisions of section 172 are to apply, notwithstanding anything contained in other provisions of the Act. Therefore, in such cases, the provisions of section 194 C and 195 relating to tax deduction at source are not applicable. As a result, tax is not required to be deducted at source, irrespective of the fact that the payment has been made to non-resident or its agent in India. – Circular No. 723, 19th September, 1995.

54.9 SPECIAL PROVISIONS FOR COMPUTING PROFITS AND GAINS IN CONNECTION WITH THE BUSINESS OF EXPLORATION, ETC., OF MINERAL OILS

Section:- 44BB

- Notwithstanding anything to the contrary contained in section 28 to 41 and 43 and 43A, the income of a non-resident engaged in the business of providing services or facilities in connection with, or supplying plant and machinery on hire, used or to be used, in the prospecting for, or extraction or production of, mineral oils, a **sum equal to 10%** of the following shall be deemed to be the profits of such business:

(a) the amount paid or payable whether in or out of India to the assessee or someone on his behalf on account of the provision of such services and facilities and supply of plant and machinery on hire used or to be used in the prospecting for, or extraction or production of mineral oils in India, and

(b) The amount received or deemed to be received in India by or on behalf of the assessee on account of the provision of services and facilities in connection with or supply of plant and machinery on hire used, or to be used, in the prospecting for, or extraction or production of, mineral oils outside India.

- The provisions of this section shall not apply to any income to which the provisions of sections 42, 44D, 44 DA, 115A or 293 A apply for the purpose of computing profits or gains or any other income referred to in these sections.
- As per section 44 BB (3), such assessee may claim lower profits and gains than the aforesaid amount of 10% if the following two conditions are satisfied:—
  (a) The assessee's keeps and maintains such books of account as are required u/s 44AA(2), and
  (b) The assessee's gets the accounts audited and furnishes a report of such audit as required u/s 44AB.
- However, in this case, the Assessing Officer shall proceed to make assessment of the total income/loss of the assessee's only under scrutiny assessment as per section 143(3).
- **Explanation:-** For the purpose of this section:
  1. "Plant" includes ships, aircraft, vehicles, drilling units, scientific apparatus and equipment, used for the purposes of the said business.
  2. "Mineral oil" includes petroleum and natural gas.

54.10 SPECIAL PROVISIONS FOR COMPUTING PROFITS AND GAINS OF BUSINESS OF OPERATION OF AIRCRAFT IN THE CASE OF NON-RESIDENTS

Section:- 44BBA

Notwithstanding anything to the contrary contained in section 28 to 43A, the income of a non-resident engaged in the business of operation of an aircraft, a **sum equal to 5% percent** of following shall be deemed to be the profits of such business:

(a) the amount paid or payable whether in India or out of India to the assesse or to any person on his behalf on account of carriage of passenger, live-stock, mail or goods from any place in India, and

(b) the amount received or deemed to be received in India, on account of carriage of such items from a place outside India.

Practical 18

Mr. Chaka, a non-resident, operates an aircraft between London to Ahmedabad. For the relevant previous year, he received following:-

(a) For carrying passengers from Ahmedabad: Rs. 50 Lacs

(b) For carrying passengers from London : Rs. 75 Lacs received in India

(c) For carrying goods from Ahmedabad : Rs. 25 Lacs

The total expenditure incurred by Mr. Chaka for the purpose of above business was Rs. 1.40 crore. Compute income of Mr. Chaka under the head "PGBP".

Solution

Computation of Total Income

Particulars	Rs.
Total Gross Receipts [Rs.50,00,000 + Rs. 75,00,000 + Rs.25,00,000]	1,50,00,000
Taxable Income @5% of Gross Receipts	7,50,000

Note: In view of overriding effect of section 44BB, expenses are not deductible.

Readers Note:

54.11 SPECIAL PROVISIONS FOR COMPUTING PROFITS AND GAINS OF FOREIGN COMPANIES ENGAGED IN THE BUSINESS OF CIVIL CONSTRUCTION, ETC. IN CERTAIN TURNKEY POWER PROJECTS

Section:- 44BBB

- Notwithstanding anything to the contrary contained in section 28 to 44AA, in the case of an assessee, being a foreign company, engaged in the business of civil construction or the business of erection of plant or machinery or testing or commissioning thereof, in connection with a turnkey power project approved by the Central Government in this behalf, a sum equal to 10% of the amount paid or payable (whether in or out of India) to the said assessee or to any person on his behalf on account of such civil construction, erection, testing or commissioning shall be deemed to be the profits and gains of such business chargeable to tax under the head "Profits and gains of business or profession".
- As per section 44 BBB (2), such assessee may claim lower profits and gains than the aforesaid amount of 10% if the following two conditions are satisfied:—
  (a) The assessee keeps and maintains such books of account as are required u/s 44AA(2), and
  (b) The assessee gets the accounts audited and furnishes a report of such audit as required u/s 44AB.
- However, in this case, the Assessing Officer shall proceed to make assessment of the total income/loss of the assesse only under scrutiny assessment as per section 143(3).

54.12 DEDUCTION OF HEAD OFFICE EXPENDITURE IN THE CASE OF NON-RESIDENTS

Section:- 44C

- Notwithstanding anything to the contrary contained in section 28 to 43A, the deduction in respect of head office expenses of a non-resident assessee shall be lowest of the following:
  (a) an amount equal to 5 per cent of the adjusted total income ; or
  (b) the amount of so much of the head office expenditure which is attributable to the business or profession in India.
- In cases where the adjusted total income of the non-resident for the current year is a loss, the rate of 5 per cent, referred to at (a) above shall be computed with reference to the average of the adjusted total income of the non-resident.

- **Explanation:**

(A) Adjusted total income

"Adjusted total income" means the total income computed in accordance with the provisions of the Act without giving effect to the following:

(i) Allowance in this section i.e. section 44C.

(ii) Unabsorbed depreciation allowance under section 32(2).

(iii) $1/5^{th}$ of the capital expenditure incurred by a company for the purpose of promoting family planning amongst its employees which is allowable as deduction as per the first proviso to section 36(1)(x).

(iv) Business loss brought forward under section 72(1).

(v) Speculation loss brought forward under section 73(2).

(vi) Capital loss brought forward under the head "Capital gains" under section 74(1).

(vii) Brought forward loss for owning maintaining the race horses [Section 74A(3)].

(viii) Deductions under Chapter VIA [Sections 80C to 80U].

(B) Average adjusted total income

"Average adjusted total income" means,

(a) in a case where the total income of the assessee is assessable for each of the 3 assessment years immediately preceding the relevant assessment year, 1/3 of the aggregate amount of the adjusted total income in respect of the previous years relevant to the aforesaid 3 assessment years;

(b) in a case where the total income of the assessee is assessable only for 2 of the aforesaid 3 assessment years, 1/2 of the aggregate amount of the adjusted total income in respect of the previous years relevant to the aforesaid 2 assessment years;

(c) in a case where the total income of the assessee is assessable only for 1 of the aforesaid 3 assessment years, the amount of the adjusted total income in respect of the previous year relevant to that assessment year.

(C) Head office expenditure

"Head office expenditure" means executive and general administration expenditure incurred by the assessee outside India, including expenditure incurred in respect of:

(a) rent, rates, taxes, repairs or insurance of any premises outside India used for the purposes of the business or profession;

(b) salary, wages, annuity, pension, fees, bonus, commission, gratuity, perquisites or profits in lieu of or in addition to salary, whether paid or allowed to any employee or other person employed in, or managing the affairs of, any office outside India;

(c) travelling by any employee or other person employed in, or managing the affairs of, any office outside India; and

(d) such other matters connected with executive and general administration as may be prescribed.

Practical 19

The net result of the business carried on by a branch of foreign company in India for the relevant previous year was a loss of Rs. 100 lacs after charge of head office expenses of Rs. 200 lacs allocated to the branch. Explain with reasons the income to be declared by the branch in its return.

Solution

Section 44C restricts the allowability of the head office expenses to the extent of lower of an amount equal to 5% of the adjusted total income or the amount actually incurred as is attributable to the business of the assessee in India.

As discussed earlier, for the purpose of computing the adjusted total income, the head office expenses of Rs. 200 Lacs charged to the profit and loss account have to be added back.

The amount of income to be declared by the assessee will be as under:

Particulars	Rs.
Net loss for the previous year	(100)
Add: Amount of head office expenses to be considered separately as per section 44C	200
Adjusted total income	100
Less: Head Office expenses allowable under section 44C is the lower of	
(i) Rs. 5 lacs, being 5% of Rs. 100 lacs **and** (ii) Rs. 200 lacs.	(5)
Income to be declared in return	**95**

Readers Note:

54.13 SPECIAL PROVISIONS FOR COMPUTING INCOME BY WAY OF ROYALTIES AND FEES FOR TECHNICAL SERVICES

Section:- 44D, 44DA and 115A(1)(b)

(1) Section 44D

- This section has overriding effect over the provisions contained in section 28 to 44C.
- Section 44D lays down special provisions for computing income by way of royalties and fees for technical services received by foreign companies from the Government or an Indian concern under an agreement.
- **Agreement made before April 1, 1976**
  Where such income is received under an agreement made before April 1, 1976, the deduction in respect of expenses incurred for earning such income is subject to a ceiling limit of 20% of the gross amount of such income.
- **Agreement made on or after April I, 1976**
  Where the agreement is made after 31-3-1976 but before the 1st day of April, 2003, no deduction shall be allowed in computing the income by way of royalty or fees for technical services.

(2) Section 44DA

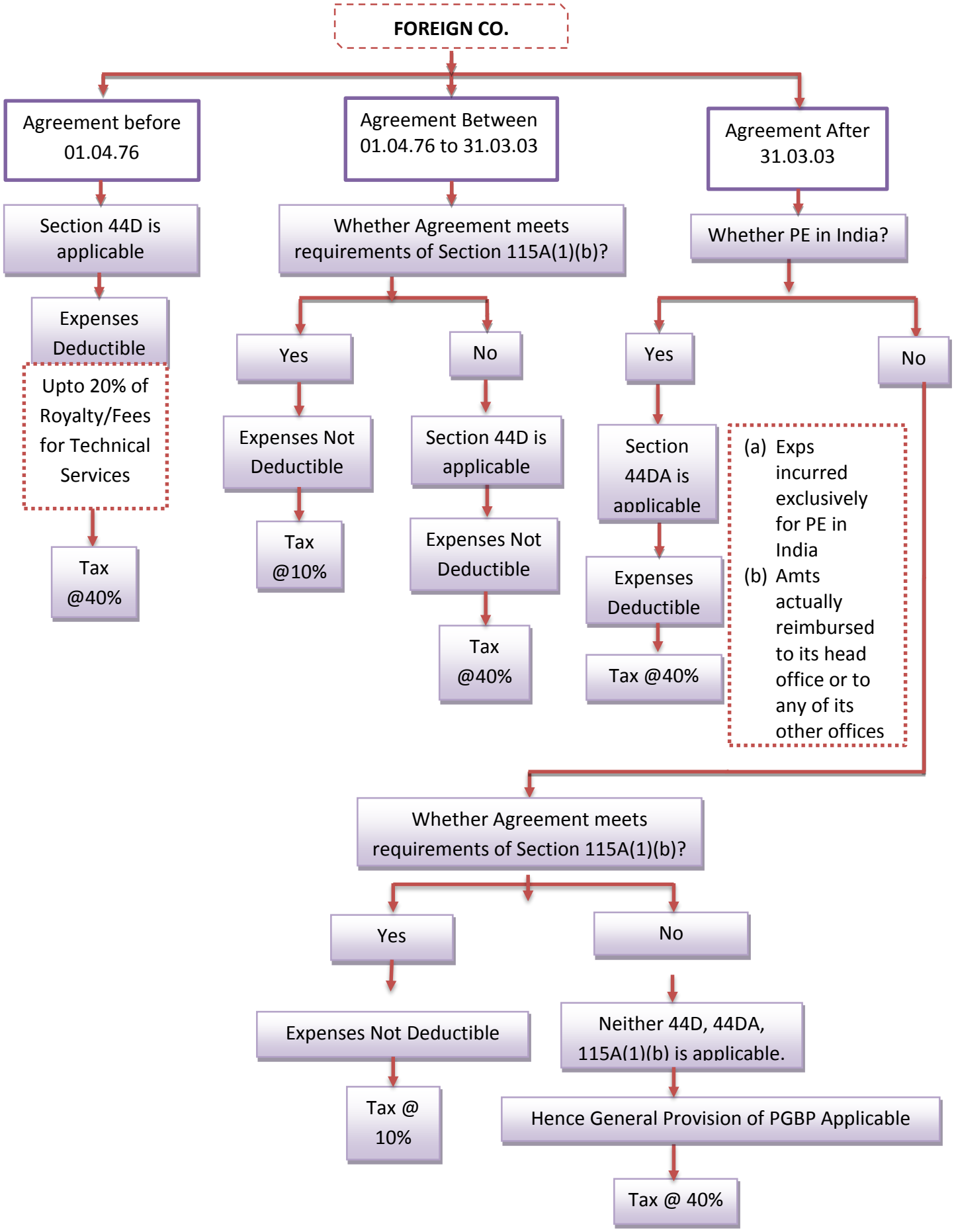
- **Section 44DA is applicable if the following conditions are satisfied—**
  - **(a)** The taxpayer is a foreign company or non-resident non-corporate-assessee who carries on a business through a permanent establishment / fixed place of profession situated in India.
  - **(b)** The taxpayer is in receipt of income by way of royalty or fees for technical services.
  - **(c)** The aforesaid royalty or technical fees is received from Government or an Indian concern in pursuance of an agreement made by the taxpayer with the Government or the Indian concern after March 31, 2003.
  - **(d)** The right, property or contract in respect of which the royalties or fees for technical services are earned shall be effectively connected with permanent establishment / fixed place of profession in India.
- **Following deductions shall not be allowed:**
  - **(a)** Deduction will not be allowed in respect of any expenditure or allowance, which is not wholly and exclusively incurred for the business of permanent establishment / fixed place of profession in India.
  - **(b)** Deduction will be not allowed in respect of amounts, if any, paid by the permanent establishment to its head office or to any of its other offices. However, reimbursement of actual expenses shall be allowed.
- **Further conditions to be observed by the assessee:-**
  - **(a)** The taxpayer shall keep and maintain books of account in accordance with the provisions contained in section 44AA.
  - **(b)** The books of account shall be audited by a chartered accountant and the audit report shall be submitted along with the return of income.

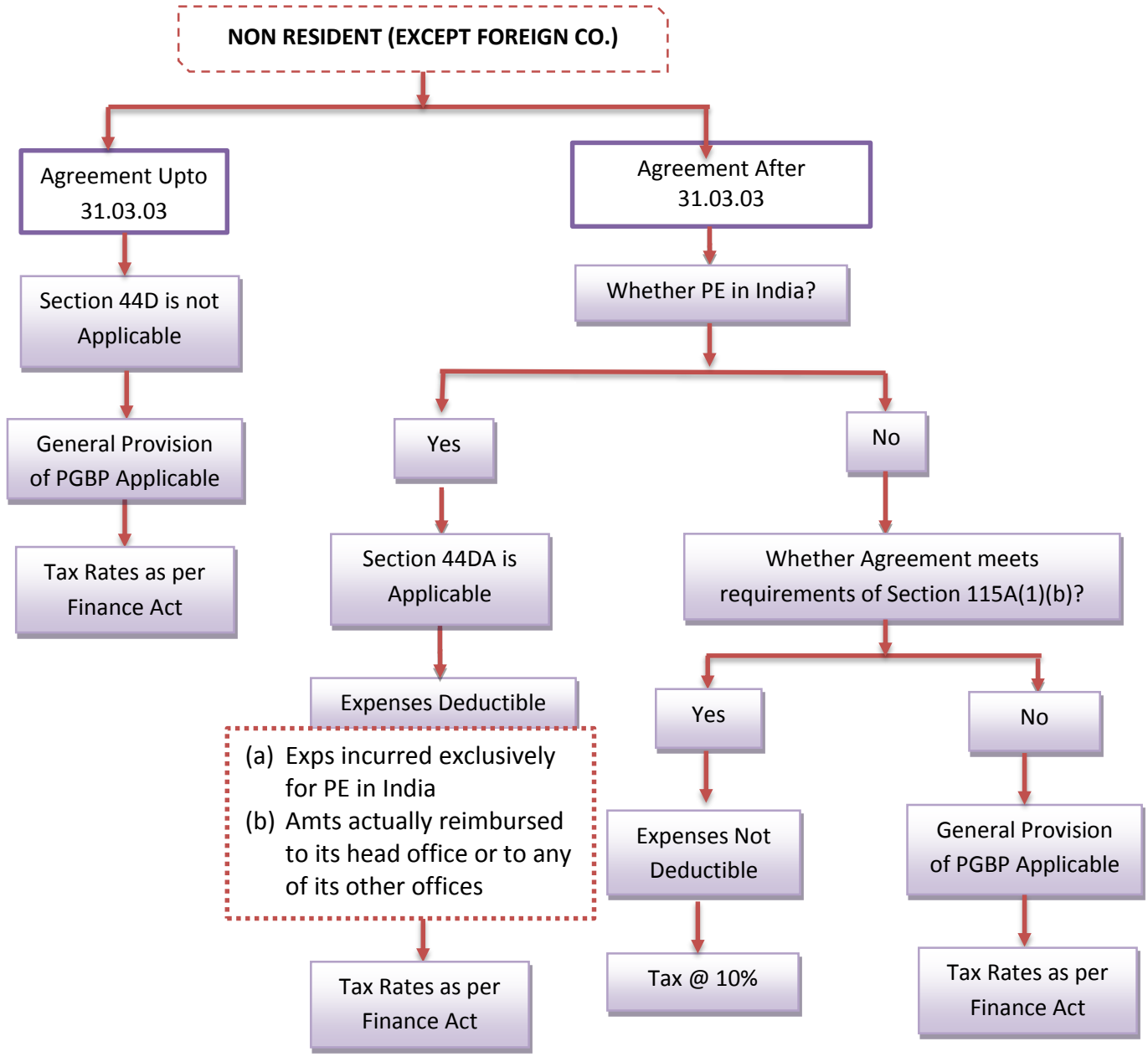
Remark: Provisions of sec. 44BB shall not apply in respect of the income referred to in this section

(3) Section 115A(1)(b)

- **(a)** Royalties and fees for technical services under an agreement made on or after 1st April, 1976 are governed by this section.
- **(b)** Up to 31-03-2003, this section was applicable to only foreign company.
- **(c)** W.e.f. 01-04-03, this section is applicable to every non-resident including foreign company provided assessee is not covered by section 44DA. (that means there is no permanent establishment in India)
- **(d)** This section is applicable if:-
  - (i) the agreement is with the Government of India; or
  - (ii) the agreement is with Indian concern and approved by the Central Government; or
  - (iii) the agreement relates to a matter included in the industrial policy; or
  - (iv) the agreement relates to consideration for transfer of all or any rights in respect of copyright in any book on a subject referred to in the proviso to section 115 A(1A) to the Indian concern or in respect of computer software referred to in second proviso to section 115 A(1A) to a person resident in India.
- **(e)** Once income is covered by this section, the assessee is not entitled to claim any deduction under the head “PGBP” or “IFOS”. However, assessee can claim deduction u/s 80 C to 80 U.
- **(f)** Rate of tax applicable :- 10 %

(4) DIAGRAMATICAL PRESENTATION SECTION 44D, 44DA & 115A(1)(b)




NON RESIDENT (EXCEPT FOREIGN CO.)
Agreement Upto 31.03.03
Agreement After 31.03.03
Section 44D is not Applicable
General Provision of PGBP Applicable
Tax Rates as per Finance Act
Whether PE in India?
Yes
No
Section 44DA is Applicable
Expenses Deductible
(a) Exps incurred exclusively for PE in India
(b) Amts actually reimbursed to its head office or to any of its other offices
Tax Rates as per Finance Act
Whether Agreement meets requirements of Section 115A(1)(b)?
Yes
No
Expenses Not Deductible
Tax @ 10%
General Provision of PGBP Applicable
Tax Rates as per Finance Act

Practical 20

Raj Inc., USA, entered into an agreement to provide technical services to Bhambani Ltd, Indian company. This agreement was approved by Central Government.

During concerned previous year, Raj Inc. estimates following:-

Receipts :- 50 Lakhs

Expenditure: - 20 Lakhs

Head Office Expenditure : -Rs. 5 Lakhs.

It seeks your advice, whether to open permanent establishment in India or not?

Solution

Computation if there is a Permanent Establishment in India	**Computation if there is no Permanent Establishment in India**
1) Section 44DA Applicable	1) Section 115A (1) (b) applicable
2) While determining total income, deduction for expenses incurred is available under the head PBGP	2) While determining total income, deduction for expenses incurred is not available under the head PBGP
3) Total Income = (Rs. 50 Lakhs – Rs.20 lakhs – Rs.5 Lakhs) = Rs. 25 Lakh	3) Total Income = Rs. 50 lakh
4) Tax Rate applicable -40% being foreign company	4) Tax Rate applicable-10% as per section 115A(1)(b)
5) Tax liability =40% of Rs.25 Lakhs+ 3% Education Cess =Rs.10 Lakhs + Rs. 0.30 lakhs =Rs.10.30 Lakhs	5) Tax Liability =10% of Rs. 50 Lakhs + 3% Education Cess =Rs. 5 Lakhs + Rs. 0.15 Lakhs = Rs. 5.15 Lakhs

In order to reduce tax burden in India, Raj. Inc. USA is advised not to open permanent establishment in India.

Readers Note:

UNIT D – CHAPTER XII

54.14 CHAPTER XII - SPECIAL PROVISIONS APPLICABLE TO NON-RESIDENTS

Section:- 115 A to 115BBA

(1) General points on Chapter XII

1. Incomes falling under Chapter XII shall be taxed at the special rates mentioned under this chapter.
2. No deduction shall be claimed under the head "PGBP" as well as "IFOS" while computing the incomes covered by Chapter XII.
3. No deduction shall be claimed under section 80 C to 80 U from the incomes covered by Chapter XII. However, there is one exception to this rule. Royalty income and fees for technical services covered by Chapter XII qualify for deduction under section 80 C to 80 U.
4. While computing capital gain covered by chapter XII, benefit of "Conversion rule" as well as "Benefit of indexation is not available.
5. Where the Central Government has entered into "double taxation avoidance agreement" (DTAA) with the Government of any country or specified territory, then, in relation to the assessee to whom such agreement applies, the provisions of this Act shall apply to the extent they are more beneficial to that assessee **[Section 90(2)]**. In short, DTAA and the provisions of Income Tax Act, whichever is most beneficial, shall apply.
6. Shifting benefit is not available for such incomes.

(2) Section 115A(1)

(a) Eligible Assessee: Non-resident or Foreign Company

(b) Nature of Income and Tax Rate:

Sr. No.	NATURE OF INCOME	TAX RATE
	Section 115A(1)(a)	
1.	Dividends (This does not include dividend covered u/s.115-0)	20%
2.	Interest income where monies lent in foreign currency	20%
3.	Income from units (purchased in foreign currency)	20%
4.	Interest received from an infrastructure debt fund referred to in section 10(47)- Section 194LB	5%
5.	Interest from an Indian company referred to in section 194LC	5%
6.	**Interest payable to FII or Qualified Foreign Investor referred to in section 194LD**	5%
7.	**Income from units of business trust referred to in section 115UA Section 194LBA**	5%
	Section 115A(1)(b)	
8.	***Royalty and fees for technical services.***	**10%**

(c) Other Points:

In the case of section 115A (1) (a), filing of return of income u/s. 139(1) shall not be necessary in case the following **conditions are satisfied:**

(a) The total income comprises only of the income referred in this section; and

(b) Tax deductible in respect of such income has been deducted.

Practical 21

Massy incorporated, a foreign company furnishes the following data for the relevant previous year.

Sr. No.	Particulars	Rs.
(1)	Royalty from Indian concern under in agreement made on 15-9-1995 (Rs.) approved by Central Government	3,00,000
(2)	Expenditures as per section 28 to 44C for earning such income	2,00,000
(3)	Interest from an Indian company on money lent in foreign currency	11,00,000
(4)	Expenditure on collection of above interest	50,000
(5)	Income from units of U.T.I. purchase in foreign currency	5,00,000
(6)	Collection charges for collection above income	40,000
(7)	Gross sale of trading business in India	30,00,000
(8)	Expenditure as per sections 28 to 44C for above business	28,00,000
(9)	Donations to P.M.N.R.F.	4,00,000

Determine the total income of the foreign company and the tax payable by it. Ignore MAT provisions

Solution

Calculation of Total Income

Sr. No.	Particulars	Whether covered by Chapter XII?	Rs.	Rs.
(1)	Royalty from Indian concern under in agreement made on 15-9-1995 (Rs.) approved by Central Government	Yes	3,00,000	
	Less: Expenditures as per section 28 to 44C for earning such income		Not Allowed	3,00,000
(2)	Interest from an Indian company on money lent in foreign currency	Yes	11,00,000	
	Less: Expenditure on collection of above interest		Not Allowed	11,00,000
(3)	Income from units of U.T.I. purchased in foreign currency	No	Exempt u/s 10	
	Less: Collection charges for collection above income		Not Allowed	Exempt
(4)	Gross sale of trading business in India	No	30,00,000	
	Less: Expenditure as per sections 28 to 44C for above business		(28,00,000)	2,00,000
	Gross Total Income			**16,00,000**
	Less: Deduction under 80G – Donation to P.M.N.R.F.			(4,00,000)
	Total Income			**12,00,000**

Computation of Tax Liability

Particulars	Section Applicable	Gross Income	80G	Net Income	Tax Rate	Tax Liability
Royalty	115A(1)(b)	3,00,000	2,00,000	1,00,000	10%	10,000
Interest	115A(1)(a)	11,00,000	Nil	11,00,000	20%	2,20,000
Trading Business	PGBP	2,00,000	2,00,000	Nil	40%	Nil
Total		**16,00,000**	**4,00,000**	**12,00,0000**		**2,30,000**
Add: Education Cess						6,900
Tax Liability						**2,36,900**

Readers Note:

(3) Section 115AB

(a) Eligible Assessee: Overseas Financial Organization (Offshore Fund)

(b) Nature of Income and Tax Rate:

Sr. No.	NATURE OF INCOME	TAX RATE
1.	Income from units purchased in foreign currency and	10%
2.	Long term capital gains arising from the transfer of such units.	10%

Practical 22

A foreign company which is also an Overseas Financial Organisation as per the requirement of chapter XII provides following information about its income during the previous year:

(a) Details of Capital assets in India (purchased in foreign currency)

Particulars	Nature of Asset	Cost of Acquisition (Rs.)	Sale Consideration (Rs.)
Units of Reliance Mutual Fund (Other than equity oriented MF)	Long Term	47,00,000	62,00000
Units of UTI Mutual fund (Equity oriented MF)	Long Term	12,50000	16,40,000
Units of PNB Mutual Fund (Other than equity oriented MF)	Short Term	34,25,000	37,75,000
Units of DSP Mutual Fund (Equity oriented MF)	Short Term	19,00,000	21,00,000

(b) It has also received Rs.7,15,000 for fees of technical services from an Indian concern under an agreement approved by the Central Government for which the foreign company incurred an expenditure of Rs.1,00,000.

(c) It has donated a sum of Rs.3,65,000 to Prime Minister Relief Fund.

Compute the income and tax payable.

Solution

Calculation of Total Income

Sr. No.	Particulars	Rs.	Rs.
(1)	Capital Gain (Working Note 1)		20,50,000
(2)	Fees for Technical services from Indian concern under in agreement approved by Central Government	7,15,000	
	Less: Expenditures as per section 28 to 44C for earning such income	Not Allowed	7,15,000
	Gross Total Income		**27,65,000**
	Less: Deduction under 80G-Donation to P.M.N.R.F.		**(3,65,000)**
	Total Income		**24,00,000**

Working Note 1:- Computation of Capital Gain

Units of Mutual Fund	Nature of Capital Gain	Sale Consideration	Cost of Acquisition	Capital Gain
Reliance-**Other than equity oriented MF**	Long Term	**62,00,000**	**(47,00,000)**	**15,00,000**
UTI-equity oriented MF	Long Term	Exempt under section 10(38)		
PNB-Other than equity oriented MF	Short Term	**37,75,000**	**(34,25,000)**	**3,50,000**
DSP-Equity oriented MF	Short Term	**21,00,000**	**(19,00,000)**	**2,00,000**
Total				20,50,000

Computation of Tax Liability

Particulars	Section Applicable	Gross Income	80G	Net Income	Tax Rate	Tax Liability
Reliance-Other than equity oriented MF	Section 115AB	15,00,000	-	15,00,000	10%	1,50,000
UTI-equity oriented MF	Section 10(38)	Exempt				
PNB-Other than equity oriented MF	Finance Act, 2017	3,50,000	3,50,000	Nil	40%	Nil
DSP-Equity oriented MF	111A	2,00,000	-	2,00,000	15%	30,000
Fees for Technical Services	115A(1)	7,15,000	15,000	7,00,000	10%	70,000
Total		**27,65,000**	**3,65,000**	**24,00,000**		**2,50,000**
Add: Education Cess						7,500
Tax Liability						**2,57,500**

Readers Note:

(4) Section 115AC

(a) Eligible Assessee: Non-Resident

(b) Nature of Income and Tax Rate:

Sr. No.	NATURE OF INCOME	TAX RATE
1.	Interest income from notified bonds of an Indian Company or bonds of any public sector company bought in foreign currency;	10%
2.	Dividend Income from notified GDRs, purchased in foreign currency. (This does not include dividend covered u/s.115-0); and	10%
3.	Long term capital gains arising from the transfer of such bonds or GDRs.	10%

(c) Other Points:

(i) Where the assessee acquired GDRs or bonds in an amalgamated or resulting company by virtue of his holding shares or bonds in the amalgamating or demerged company, the provisions of section 115AC shall apply to such GDRs or bonds.

(ii) In case of section 115AC, filing of return of income u/s. 139(1) shall not be necessary in case the following **conditions are satisfied:**

(a) The total income comprises only of the income referred in this section; and

(b) Tax deductible in respect of such income has been deducted.

Practical 23

Mr. Raghu, a non-resident provides the following information:

- Information in respect of GDRs held in Indian companies:

Name of company	Nature of Capital Asset	Sale Consideration (Rs.)	Purchase Consideration (Rs.)	Remark:
A Ltd.	Long Term	8,30,000	7,25,000	Sold to another non-resident outside India.
B Ltd.	Long Term	12,50,000	10,00,000	--

Compute tax payable by Mr. Raghu.

Solution

Computation of Total Income of Mr. Raghu

Particulars	A Ltd. (Rs.)	B Ltd. (Rs.)
Full value of consideration	Exempt under	12,50,000
Less: Cost of Acquistion	section 47(viia)	10,00,000
Long Term Capital Gain chargeable to tax u/s 115AC @ 10%	**[Refer Note]**	2,50,000

Note: As per section 47(viia), any transfer of a capital asset, being bonds or Global Depository Receipts referred to in section 115AC(1), made by a non-resident to another non-resident is not treated as transfer provided that transfer is made outside India.

Computation of Tax Liability of B Ltd.

Particulars	Rs.
Tax on Long Term Capital Gain @10%	25,000
Add: Education Cess	750
Tax Liability	25,750

Readers Note:

Practical 24

Suppose in the above problem, Mr. Raghu earned interest from ABC Ltd. Rs.3,00,000 where monies lent in Indian currency; find out tax liability.

Solution

Readers Note:

(5) Section 115ACA

(a) Eligible Assessee: Resident employee of an Indian company or its subsidiary company engaged in specified knowledge based industry or service

"Specified knowledge based industry or service" means -

(i) information technology software;

(ii) information technology service;

(iii) entertainment service;

(iv) pharmaceutical industry;

(v) bio-technology industry; and

(vi) any other industry or service, as may be notified by the Central Government.

(b) Nature of Income and Tax Rate:

Sr. No.	NATURE OF INCOME	TAX RATE
1.	Income by way of dividends from GDRs issued by the Indian Company in accordance with Employee's Stock Options Scheme notified by the Central Government purchased in foreign currency ;(This does not include dividend covered u/s. 115-0)	10%
2.	Income by way of long term capital gain arising from the transfer of such GDRs	10%

(6) Section 115AD

(a) Eligible Assessee: Foreign Institutional Investors (FIIs)

(b) Nature of Income and Tax Rate:

Sr. No.	NATURE OF INCOME	TAX RATE
1.	Long term capital gains on transfer of securities (other than units covered by section 115AB)	10%
2.	Income in respect of securities ***(except covered by 115A)***	20%
3.	Any short term capital gain on transfer of securities (except covered by section 111A)	30%

(7) Section 115BBA

(a) Eligible Assessee: Foreign national non-resident sportsman (including athlete)

Sr. No.	NATURE OF INCOME	TAX RATE
1.	Income from participation in any game or sport(other than those given in Sec.115 5BB);	20%
2.	Income from advertisement; or	20%
3.	Income from contribution of articles relating to any game or sport in India in journals, newspapers etc.	20%

(b) Eligible Assessee: Non- resident sports association or institution

Sr. No.	NATURE OF INCOME	TAX RATE
1.	Income by way of amount guaranteed to be paid or payable in relation to any game or sport played in Indi. (other than those given in Sec. 115BB)	20%

(c) Eligible Assessee: Non-resident foreign citizen entertainer

Sr. No.	NATURE OF INCOME	TAX RATE
1.	Income received or receivable from his performance in India.	20%

(d) Other Points:

In case of section 115BBA, filing of return of income u/s. *139(1)* shall not be necessary in case the following **conditions are satisfied:**

(a) **The total income comprises only of the income referred in this section; and**

(b) **Tax deductible in respect of such income has been deducted.**

Practical 25

Smith, a foreign national, non-resident and a cricketer came to India for the first time, as a member of Australian cricket team in the year ended **31st March, 2018**. He received Rs. 5 lakhs for participation in matches in India. He also received Rs. 1 lakh for an advertisement of a product on TV. He contributed articles in a newspaper for which he received Rs. 10,000. When he stayed in India, he also won a prize

of Rs. 12,000 from horse racing in Mumbai. He incurred Rs. 30,000 on travelling expense for visit to India. He has no other income in India during the year.

(i) Compute tax liability of Smith for previous year **2017-18**.

(ii) Are the income specified above subject to deduction of tax at source?

(iii) Is he liable to file his return of income for previous year **2017-18**?

(iv) What would have been his tax liability, had he been a match referee instead of a cricketer?

Solution

(i) Computation of Total Income and Tax Liability of Smith

Computation of Total Income

Particulars	Rs.
Income taxable under section 115BBA	
Income from participation in matches in India	5,00,000
Advertisement of product on TV	1,00,000
Contribution of articles in newspaper	10,000
Income taxable under section 115BB	
Income from horse races	12,000
Total income	**6,22,000**

Computation of Tax Liability

Particulars	Rs.
Tax@ 20% under section 115BBA on Rs. 6,10,000	122,000
Tax@ 30% under section 115BB on income of Rs. 12,000 from horse races	3,600
	1,25,600
Add: Education cess@2% and Secondary and higher education cess@1%	3,768
Total tax liability of Smith	**1,29,368**

Note:-

Since income of Smith falls under Chapter XII, travelling expenditure is not allowed as deduction.

(ii) Yes, the above income is subject to tax deduction at source.

- Income referred to in section 115BBA (i.e., Rs. 6,10,000, in this case) is subject to tax deduction at source@ 20% under section 194E.
- Income referred to in section 115BB (i.e., Rs. 12,000, in this case) is subject to tax deduction at source@30% under section 194BB.
- Since Smith is a non-resident, the amount of tax to be deducted calculated at the prescribed rates mentioned above, would be increased by education cess@2% and secondary and higher education cess@1%.

(iii) 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.

However, in this case, Mr. Smith has income from horse races as well. Therefore, he cannot avail the benefit of exemption from filing of return of income as contained in section 115BBA. Hence, he would be liable to file his return of income for **A.Y.2018-19**

(iv) The Calcutta High Court in Indcom v. CIT (TDS) (2011) 335 ITR 485 has held that 'match referee' would not fall within the meaning of "sportsman". Therefore, the provisions of section 115BBA would not apply to him. As a result, computation of total income of 'match referee' is governed by the general provisions of chapter "PGBP". As a result, he can claim deduction of travelling expense from his professional income. Computation of total income of 'Match referee' is as under:

Computation of Total Income

Particulars	Rs.	Rs.
Income under the head "PGBP"		
Income from participation in matches in India	5,00,000	
Advertisement of product on TV	1,00,000	
Contribution of articles in newspaper	10,000	
	6,10,000	
Less: Travelling Expenses	(30,000)	5,80,000
Income From Other Sources		
Income from horse races		12,000
Total income		**5,92,000**

Computation of Tax Liability

Particulars		Rs.
Tax@30% under section 115BB on winnings of Rs. 12,000 from horse races		3,600
Upto Rs. 2,50,000	Nil	
2,50,000 – 5,00,000 @ 5%	12,500	
5,00,000 – 5,80,000 @ 20%	16,000	**28,500**
		32,100
Add: Education cess@2% and secondary and higher education cess@1%		963
Total tax liability of Smith as a 'match referee'		**33,063**

Readers Note:

Practical 26

Mr. Fredrick Watson, a foreign national, non-resident and a singer came to India to perform in a music show organized during the premier of an IPL match to be played in **August, 2017**. He received Rs. 5 lakh for his performance. He does not have any other income in India.

(1) Compute tax liability of Mr. Fedrick Watson for previous year **2017-18**.

(2) Is this income specified above subject to deduction of tax at source?

(3) Is he liable to file his return of income for previous year **2017-18**?

Solution

(i) Computation of Total Income and Tax Liability of Mr. Fedrick

Computation of Total Income

Particulars	Rs.
Income taxable under section 115BBA	
Income from music performance in India	5,00,000
Total income	**5,00,000**

Computation of Tax Liability

Particulars	Rs.
Tax@ 20% under section 115BBA on Rs. 5,00,000	1,00,000
Add: Education cess@2% and Secondary and higher education cess@1%	3,000
Total tax liability of Mr. Fedrick	**1,03,000**

(ii) Yes, the above income is subject to tax deduction at source.

- Income referred to in section 115BBA (i.e., Rs. 5,00,000, in this case) is subject to tax deduction at source@ 20% under section 194E.
- Since Mr. Fedrick is a non-resident, the amount of tax to be deducted calculated at the prescribed rates mentioned above, would be increased by education cess@2% and secondary and higher education cess@1%.

(iii) 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.

Since Mr. Fedrick does not have any other income, he is not required to file return provided tax deductible at source has been fully deducted.

Readers Note:

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(8) Definitions relevant for Chapter XII

(i) "Qualified Foreign Investor" shall have the meaning assigned to it in the Circular No. Cir/IMD/DF/14/2011, dated the 9th August, 2011, as amended from time to time, issued by the Securities and Exchange Board of India, under section 11 of the Securities and Exchange Board of India Act, 1992.

(ii) "Overseas Financial Organisation" means any fund, institution, association or body, whether incorporated or not, established under the laws of country outside India which has entered into an arrangement for investment in India with any public sector bank or public financial institution or a mutual fund specified u/s.10 (23D) and such arrangement is approved by the *SEBI.*

(iii) "Global Depository Receipts" means any instrument in the form of a depository receipt or certificate (by whatever name called) created by the Overseas Depository Bank outside India and issued to investors against the issue of,—

(a) ordinary shares of issuing company, being a company listed on a recognised stock exchange in India; or

(b) foreign currency convertible bonds of issuing company".

(iv) "Foreign Institutional Investor" means such investor as the Central Government may, by notification in the Official Gazette, specify in this behalf.

Practical 27

X Ltd. Non-resident foreign Co., had entered into collaboration on **Feb. 21, 2017** with an Indian company and it is in receipt of following payments during previous year ending on **31-03-2018.** How do you deal with them for computation in case of X Ltd.

1. Interest on 8% debentures for Rs.50 Lacs issued by an Indian company on **01-07-2017** in consideration of providing technical know-how manufacturing process and design (date of payment of Interest every **31st March**)
2. Service charges @ 2.5% of face value of plant and machinery Rs.500 lakhs leased out to Indian company payable each year before **31st March.**

Solution

Readers Note:

UNIT E – CHAPTER XII A

54.15 CHAPTER XIIA - SPECIAL PROVISIONS APPLICABLE TO NON-RESIDENTS INDIANS

Section:- 115C to 115I

(1) Income covered by Chapter XII A and special tax rates [Section 115E]

1. Income arising from "Foreign Exchange Asset" (to be called income from investment) - Taxed @ 20 %

2. Long term capital gains arising on transfer of foreign exchange asset – Taxed @ 10%

(2) Definitions [Section 115C]

(a) "Foreign exchange asset" means the following assets acquired or purchased with or subscribed to in, convertible foreign exchange :

(i) Shares in an Indian company ;

(ii) Debentures issued by an Indian public company;

(iii) Deposits with an Indian public company;

(iv) Securities of the Central Government; and

(v) Such other assets as may be notified by the Central Government.

(b) *"Non-resident Indian" means an individual, being a citizen of India or a person of Indian origin who is not a resident.*

A person shall be deemed to be of Indian origin if he, or either of his parents or any of his grandparents, was born in undivided India.

(3) How to compute income covered by section 115 E? [Section 115D]

(a) In computing investment income,

- No deduction in respect of any expenditure or allowance under any provisions of the Income-tax Act shall be allowed.
- No deduction under chapter VIA shall be allowed.

(b) While computing capital gain,

- First proviso to section 48 (Conversion Rule) is applicable and therefore benefit of Indexation is not available.
- No deduction under chapter VIA shall be allowed.

(4) Exemption for long term capital gains [Section 115F]

The long term capital gains arising from the transfer of any foreign exchange asset will be exempt as per following formula provided net proceeds realised on such transfer are re-invested or re-deposited within 6 months from the date of such transfer in the "Foreign exchange assets" or savings certificates notified u/s.10 (4B).

$$\frac{\text{Amount invested}}{\text{Net consideration}} \times \textit{Long Term Capital Gain}$$

However, where the new asset is transferred or converted (otherwise than by transfer) into money within a period of three years from its acquisition, the capital gains arising from the transfer of the original asset which has been exempted from tax shall be deemed to be the long term capital gains of the previous year in which the new asset is transferred or converted into money.

(5) Return of income [Section 115G]

A non-resident Indian having only investment income or income by way of long-term capital gains arising from the transfer of any foreign exchange asset or both, need not file his return of income u/s. 139, if the tax deductible from such income has been correctly deducted at source.

(6) Benefit after the assessee becomes resident [Section 115H]

A non-resident Indian who becomes a resident in any subsequent year has the option to claim that the special provisions shall continue to apply to him in relation to investment income derived from foreign exchange asset for that assessment year and for every subsequent assessment year until the transfer or conversion of such assets into money.

Such option can be exercised by furnishing a declaration in writing to the Assessing Officer to that effect along with his return of income for that assessment year.

(7) Option to Assessee [Section 115 I]

A non-resident Indian has the option to claim that in respect of any particular assessment year the special provisions relating to chapter XII A should not apply to him by furnishing his return of income with such declaration for that assessment year u/s. 139. In such a case, the whole of the total income of that assessment year will be charged to tax under the general provisions of the Income-tax Act.

Practical 28

Mr. Rackson, a non-resident Indian, remits US $ 85,000 to India on **November 28, 2002**. The amount is partly utilised on **December 02, 2002** for purchasing 82,000 shares in Tech-Ex Pvt. Ltd., an Indian company, at the rate of Rs.42 per share. These shares are sold for Rs.79 per share on **July 25, 2017.** Brokerage expenses Rs.0.90 per share which was paid on **July 30, 2017.** He re-invested Rs. 32,02,100 in the shares of ABC Educare Private Ltd, an Indian company on **August 18, 2017.**

Find out the capital gains chargeable to tax on the assumption that telegraphic transfer, buying and selling rates of US dollars adopted by the State Bank of India are as follows:

	Buying (1 US $) Rs.	**Selling (1 US $) Rs.**
November 28, 2002	47.15	47.25
December 02, 2002	46.95	47.05
July 25, **2017**	60.65	62.15
July 30, **2017**	61.05	61.95

Solution

Computation of Capital Gains

Particulars	**Rs.**
Long term capital gain **(WN 1)**	18,81,748
Less: Exemption under section 115F (18,81,748 X 32,02,100 / 64,04,200)	9,40,874
Taxable capital gain	**9,40,874**

Working Note 1:

Particulars	Indian Currency (Rs.)	Conversion Rule	Foreign Currency ($)
Sale Consideration	64,78,000	Average Rate on Date of Transfer 1$ = Rs. 61.40	1,05,504.89
Less: Expenses	(73,800)	Average Rate on Date of Transfer 1$ = Rs. 61.40	(1,201.95)
Less: Cost of Acquisition	(33,44,000)	Average Rate on Date of Acquisition 1$ = Rs. 47	(73,276.60)
Long Term Capital Gain	**NA**		**31,026.34**

Long Term Capital Gain in Indian Currency = $ 31,026.34 x Buying Rate on the date of transfer
= $ 31,026.34 x Rs.60.65
= Rs.18,81,747.52

Working Note 2: Computation of Net Consideration

Particulars	Indian Currency (Rs.)
Sale Consideration	64,78,000
Less: Expenses	(73,800)
Net Consideration	64,04,200

Readers Note:

Practical 29

Biswas, an Indian citizen, who was not resident in India, returned to India on 10th April, **2017** for permanent residence. He had made investment in shares in Indian Companies and had also made deposits in public limited companies in India, out of money remitted in convertible foreign exchange. The details of his Indian income for the **F.Y. 2017-18** are as under:

Particulars	Income Rs.	TDS Rs.
Dividend Income	60 000	Nil
Interest on deposits in public companies	13,70 000	1,37,000
Property Income (Net)	4,50 000	Nil
Total Income	**18,80 000**	

The assesse seeks your advice on his tax liability. What will be your advice?

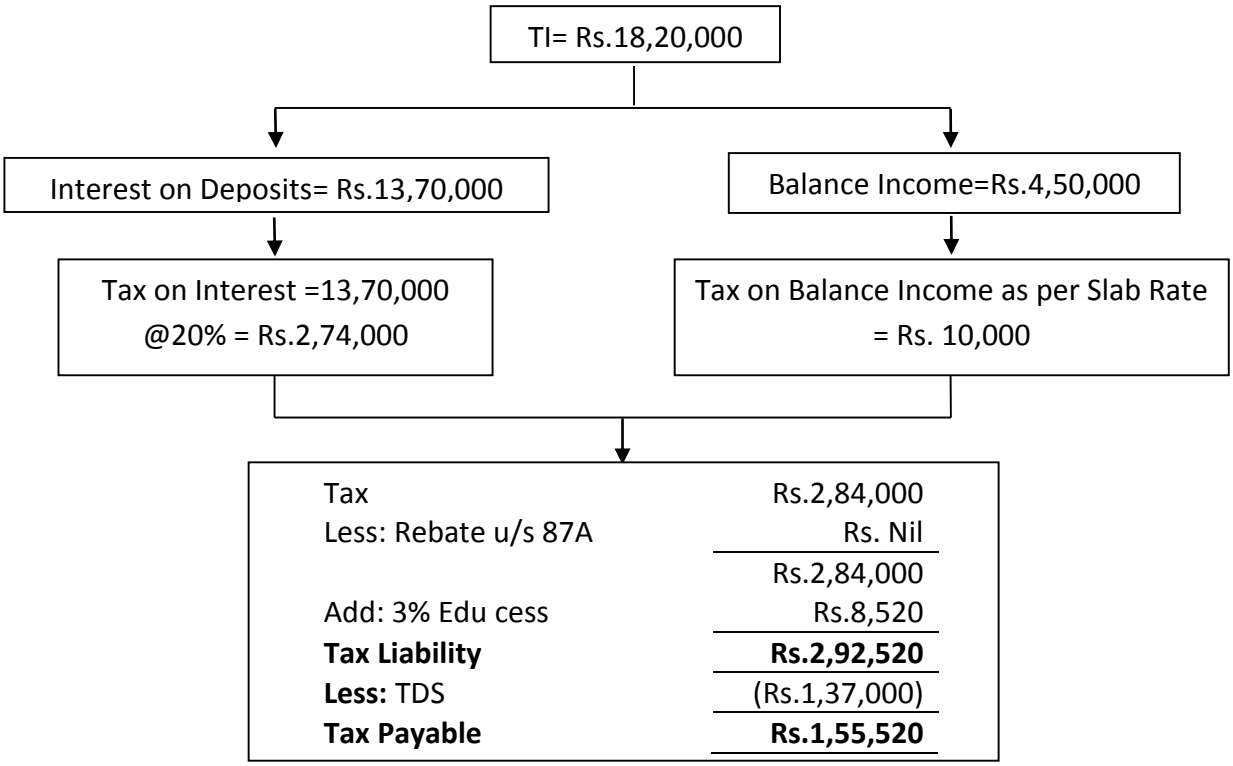
Solution

(A) He opts for Chapter XIIA

Computation of Total Income

Particulars	Rs.
Dividend Income	Exempt
Interest on deposits in public companies	13,70 000
Property Income (Net)	4,50 000
Total Income	**18,20 000**

Computation of Tax Liability



(B) He does not opt for Chapter XIIA

Computation of Total Income

Particulars	**Rs.**
Dividend Income	Exempt
Interest on deposits in public companies	13,70 000
Property Income (Net)	4,50 000
Total Income	**18,20 000**

Computation of Tax liability [As per Slab Rate]

Particulars	**Tax Rate**	**Tax Liability (Rs.)**
Upto Rs.2,50,000	Nil	Nil
Rs.2,50,000 to Rs.5,00,000	5%	12,500
Rs.5,00,000 to Rs. 10,00,000	20%	1,00,000
Above Rs.10,00,000 (Here Rs.8,20,000)	30%	2,46,000
Sub Total		**3,58,500**
Less: Rebate under section 87A (NA because TI>Rs.3,50,000)		Nil
Balance		**3,58,500**
Add: Education Cess	3%	10,755
Total Tax Liability		**3,69,255**
Less: TDS		**(1,37,000)**
Tax Payable		**2,32,255**

Advice: It is better to opt for Chapter XIIA

Readers Note:

Practical 30

Ajay, a non-resident Indian, has the following sources of income in India during the previous year **2017-18**:

Sr. No.	Particulars	Rs.	Rs.
(i)	Income from house property located in India (computed)		1,80,000
(ii)	Dividend from Indian Companies		75,000
(iii)	Interest on debentures of Indian company (Subscribed in convertible foreign exchange)	1,00,000	
	Less: Interest on loan taken for purchase of debentures	20,000	80,000
(iv)	Long-term capital gains on sale of debentures subscribed in US $:		
	Cost in 2004-05	4,00,000	
	Sale in 2017-18	6,00,000	
		2,00,000	
	Less: Commission to brokers	(6,000)	1,94,000
	Cost Inflation Index: F.Y. 2004-05 - 113; F.Y.2017-18 – 272.		

Compute the tax payable by Ajay for **A.Y 2018-19**, if he opts for the provisions of Chapter XII-A of the Income-tax Act, 1961.

Solution

Computation of tax liability of Mr. Ajay for the A.Y. 2017-18 as per Chapter XII-A

Particulars	Rs.	Rs.
Tax on long term capital gain (Rs. 1,94,000 × 10% as per chap. XIIA)	19,400	
Tax on interest on debentures being investment income (Rs.1,00,000 × 20% as per chap. XIIA)	20,000	
Tax on balance income of Rs. 1,80,000	Nil	39,400
Add: Education cess @ 2%		**788**
Add: Secondary and higher education cess @ 1%		394
Total tax liability		**40,582**
Total tax liability (rounded off)		**40,580**

Notes:

(1) Computation of total income of Mr. Ajay for the A.Y. 2018-19 as per provisions of Chapter XII-A

Particulars	Rs.	Rs.
Income from house property (computed)		1,80,000
Capital Gains on sale of debentures		
Sale consideration	6,00,000	
Less: Commission to brokers	(6,000)	
Net consideration	5,94,000	
Less: Cost of acquisition **(Refer Note 2)**	(4,00,000)	
Long term capital gain		1,94,000
Dividend income received from Indian companies [exempt u/s 10(34)]		Nil
Interest on debentures of Indian company **(Refer Note 3)**		1,00,000
Total Income		**4,74,000**

(2) It has been assumed that the debentures referred to in the question are issued by an Indian company which is not a private company and are hence, specified assets. Since the specified assets have been subscribed in convertible foreign exchange, they are foreign exchange assets.

If a non-resident purchases shares in, or debentures of, an Indian company by utilising foreign currency, capital gain shall be calculated under first proviso to section 48 in the same foreign currency which was initially utilised in purchase of shares and debentures. Capital gains so computed in foreign currency shall be reconverted into Indian currency. Since the telegraphic transfer buying rates and telegraphic transfer selling rates of US $ on the date of acquisition, date of sale and 31st March, 2018 are not given in the question, effect has not been given to the first proviso to section 48 in the above solution.

As per section 115D, the indexation benefit would not be available for calculating cost of acquisition for computing long term capital gains under Chapter XII-A.

(3) No expenditure is allowed to be deducted from the interest on debentures being the investment income as per the provisions of section 115D. Therefore, interest on loan taken for purchase of debentures is not deductible.

Readers Note:

UNIT F – EXEMPTION IN CASE OF NON-RESIDENTS

54.16 INTEREST TO NON-RESIDENTS

Section:- 10(4)

(i) in the case of a non-resident, any income by way of interest on such securities or bonds as the Central Government may, by notification in the Official Gazette, specify in this behalf, including income by way of premium on the redemption of such bonds shall be exempt.

Provided that the Central Government shall not specify, for the purposes of this sub-clause, such securities or bonds on or after the 1st day of June, 2002;

(ii) in the case of an individual, any income by way of interest on moneys standing to his credit in a Non-Resident (External) Account in any bank in India shall be exempt.

54.17 INTEREST TO NON-RESIDENTS

Section:- 10(4B)

In the case of an individual, being a citizen of India or a person of Indian origin, who is a non-resident, any income from interest on such savings certificates issued before the 1st day of June, 2002 by the Central Government as that Government may, by notification in the Official Gazette, specify in this behalf shall be exempt.

Provided that the individual has subscribed to such certificates in convertible foreign exchange remitted from a country outside India.

54.18 EXEMPTION FROM TAX PAID ON BEHALF OF FOREIGN COMPANIES IN RESPECT OF CERTAIN INCOME.

Section:- 10(6A)

If following conditions are satisfied then tax liability of foreign company borne by the payer shall be exempt in the hands of foreign company:

1. The taxpayer is a foreign company.
2. It has derived income by way of royalty or fees for technical services.
3. Such royalty is received from the Central Government or State Government or an Indian concern under an agreement made after May 31, 1976 but before June1, 2002.
4. The above agreement is in accordance with the industrial policy of the Indian Government or it is approved by the Central Government.
5. Tax liability of the foreign company in respect of the above Income has been borne by the payer.

Practical 31

A foreign company, ST (does not have PE in India), has entered into an agreement with an Indian Company KN for supply of know- how and the agreement is within the industrial policy conditions laid down by the Central Government. During the year, Rs. 50 lakh is paid, under the agreement, to ST by KN.

ST claims to have spent Rs. 14 lakh as expenses in India to be recognised as a deduction.

In the following situations, what will be your decision on the tax liability of the parties:

(i) The agreement having been entered into on June 1, 2001 and approved by the Government, KN pays to the Indian Income-tax Authorities the tax payable by ST;

(ii) The agreement having been entered into on June 1, 2003 and approved by the Government, KN PAYS to the Indian Income-tax Authorities the tax payable by ST.

Solution

Alternative (i)

Computation of total income of ST

Particulars	**Rs.**
Royalty income	50,00,000
Add: Tax borne by KN [Exempt under section 10(6A)]	Nil
Sub-Total	50,00,000
Less: expenses (not deductible since income fall under chapter XII)	Nil
Total Income	**50,00,000**

Tax calculation of ST

Particulars	**Rs.**
Tax on Royalty income under chapter XII @ 10.30%	5,15,000
Less: Tax borne by KN as per agreement	(5,15,000)
Net Tax payable by ST	**Nil**

Alternative (ii)

Computation of total income of ST

Particulars	**Rs.**
Royalty income	50,00,000
Add: Tax borne by KN [Taxable u/s 28(iv)-since condition of sec. 10(6A) are not satisfied]	Assume (X)
Sub-Total	50,00,000 plus (X)
Less: expenses (not deductible since income fall under chapter XII)	Nil
Total Income	**50,00,000 plus (X)**

Tax calculation of ST

Particulars	Rs.
Tax on Royalty income under chapter XII @ 10.30%	10.30% [50,00,000 plus (X)]
Therefore, Tax payable by ST	5,15,000 plus (0.1030X)
Therefore, (X)	5,15,000 plus (0.1030X)
Therefore, 0.897 (X)	5,15,000
Therefore, X	5,74,136
Less: above tax borne by KN	(5,74,136)
Net tax payable by ST	**Nil**

Readers Note:

54.19 TAX PAID ON BEHALF OF NON-RESIDENTS/FOREIGN COMPANIES IN RESPECT OF OTHER INCOME.

Section:- 10(6B)

If following conditions are satisfied then tax liability of non-resident or foreign company borne by the payer shall be exempt in the hands of such non-resident or foreign company as the case may be.

1. The taxpayer is a non-resident or a foreign company.
2. It has derived income (not being salary, royalty or fees for technical services).
3. Such other income is received from the Government or an Indian concern under an agreement entered into before June1, 2002.
4. The above agreement is approved by the Central Government.
5. Tax liability of the non-resident or foreign company in respect of the above income has been borne by the payer.

54.20 INCOME BY WAY OF ROYALTY OR FEES FOR TECHNICAL SERVICES RECEIVED BY A NOTIFIED FOREIGN COMPANY IS EXEMPT

Section:- 10(6C)

Any income arising to such foreign company, as the Central Government may, by notification in the Official Gazette, specify in this behalf, by way of royalty or fees for technical services received in pursuance of an agreement entered into with that Government for providing services in or outside India in projects connected with security of India is exempt from tax.

54.21 REMUNERATION RECEIVED BY AN OFFICIAL OF EMBASSY IS EEXEMPT

Section:- 10(6)(ii)

The remuneration received by him as an official, by whatever name called, of an embassy, high commission, legation, commission, consulate or the trade representation of a foreign State, or as a member of the staff of any of these officials, for service in such capacity is exempt.

Provided that the remuneration received by him as a member of the staff of any of those officials, shall be exempt only if the remuneration of the corresponding officials or, as the case may be, members of the staff, if any, of the Government of India enjoys a similar exemption in that country.

54.22 SALARY TO FOREIGN EMPLOYEES IS EXEMPT SUBJECT TO CERTAIN CONDITIONS

Section:- 10(6)(vi)

The remuneration received by him as an employee of a foreign enterprise for services rendered by him during his stay in India is exempt from tax, provided the following conditions are fulfilled—

(a) the foreign enterprise is not engaged in any trade or business in India ;

(b) his stay in India does not exceed in the aggregate a period of ninety days in such previous year ; and

(c) such remuneration is not liable to be deducted from the income of the employer chargeable under this Act.

54.23 SALARY RECEIVED BY A SHIP'S CREW IS EXEMPT SUBJECT TO CERTAIN CONDITIONS

Section:- 10(6)(viii)

Any income chargeable under the head "Salaries" received by or due to any such individual being a non-resident as remuneration for services rendered in connection with his employment on a foreign ship is exempt where his total stay in India does not exceed in the aggregate a period of ninety days in the previous year ;

54.24 REMUNERATION OF A FOREIGN TRAINEE IS EXEMPT SUBJECT TO CERTAIN CONDITIONS

Section:- 10(6)(xi)

The remuneration received by him as an employee of the Government of a foreign State during his stay in India in connection with his training in any establishment or office of, or in any undertaking owned by,—

(i) the Government ; or

(ii) any company in which the entire paid-up share capital is held by the Central Government, or any State Government or Governments, or partly by the Central Government and partly by one or more State Governments ; or

(iii) any company which is a subsidiary of a company referred to in item (ii) ; or

(iv) any corporation established by or under a Central, State or Provincial Act ; or

(v) any society registered under the Societies Registration Act, 1860 (14 of 1860), or under any other corresponding law for the time being in force and wholly financed by the Central Government, or any State Government or State Governments, or partly by the Central Government and partly by one or more State Governments ;

is exempt.

54.25 ALLOWANCES AND PERQUISITES EXEMPT FOR CERTAIN CENTRAL GOVERNMENT EMPLOYEE

Section:- 10(7)

Any allowances or perquisites paid or allowed as such outside India by the Government to a citizen of India for rendering service outside India is exempt.

54.26 INCOME OF A FOREIGN GOVERNMENT EMPLOYEE UNDER CO-OPERATIVE TECHNICAL ASSISTANCE PROGRAMMES:-

Section:- 10(8)

In the case of an individual who is assigned to duties in India in connection with any co-operative technical assistance programmes and projects in accordance with an agreement entered into by the Central Government and the Government of a foreign State (the terms whereof provide for the exemption given by this clause)—

(a) the remuneration received by him directly or indirectly from the Government of that foreign State for such duties, and

(b) any other income of such individual which accrues or arises outside India, and is not deemed to accrue or arise in India, in respect of which such individual is required to pay any income or social security tax to the Government of that foreign State ;

shall be exempt.

54.27 REMUNERATION OR FEES RECEIVED BY NON-RESIDENT CONSULTANTS AND THEIR FOREIGN EMPLOYEES

Section:- 10(8A) and 10(8B)

Under Section 10(8A) following incomes are exempt-

In the case of a consultant—

(a) any remuneration or fee received by him or it, directly or indirectly, out of the funds made available to an international organisation hereafter referred to in this clause and clause (8B) as the agency under a technical assistance grant agreement between the agency and the Government of a foreign State ; and

(b) any other income which accrues or arises to him or it outside India, and is not deemed to accrue or arise in India, in respect of which such consultant is required to pay any income or social security tax to the Government of the country of his or its origin.

Explanation.—In this clause, "consultant" means—

(i) any individual, who is either not a citizen of India or, being a citizen of India, is not ordinarily resident in India ; or

(ii) any other person, being a non-resident,

engaged by the agency for rendering technical services in India in connection with any technical assistance programme or project, provided the following conditions are fulfilled, namely :—

(1) the technical assistance is in accordance with an agreement entered into by the Central Government and the agency ; and

(2) the agreement relating to the engagement of the consultant is approved by the prescribed authority34 for the purposes of this clause.

Under Section 10 (8B) following incomes are exempt –

In the case of an individual who is assigned to duties in India in connection with any technical assistance programme and project in accordance with an agreement entered into by the Central Government and the agency—

(a) the remuneration received by him, directly or indirectly, for such duties from any consultant referred to in clause (8A) ; and

(b) any other income of such individual which accrues or arises outside India, and is not deemed to accrue or arise in India, in respect of which such individual is required to pay any income or social security tax to the country of his origin, provided the following conditions are fulfilled, namely :—

(i) the individual is an employee of the consultant referred to in clause (8A) and is either not a citizen of India or, being a citizen of India, is not ordinarily resident in India ; and

(ii) the contract of service of such individual is approved by the prescribed authority34 before the commencement of his service.

54.28 INCOME OF FAMILY MEMBERS OF AN EMPLOYEE SERVING UNDER A CO-OPERATIVE TECHNICAL ASSISTANCE PROGRAMME

Section:- 10(9)

The income of any member of the family of any such individual as is referred to in clause (8) or clause (8A) or, as the case may be, clause (8B) accompanying him to India, which accrues or arises outside India, and is not deemed to accrue or arise in India, in respect of which such member is required to pay any income or social security tax to the Government of that foreign State or, as the case may be, country of origin of such member, is exempt.

54.29 LEASE RENT OF AIRCRAFT AND TAX BORNE ON SUCH LEASE RENT ARE EXEMPT SUBJECT TO CERTAIN CONDITIONS

Section:- 10(15A) and 10(6BB)

Under Section 10(15A)

Any payment made, by an Indian company engaged in the business of operation of aircraft, to acquire an aircraft or an aircraft engine (other than a payment for providing spares, facilities or services in connection with the operation of leased aircraft) on lease from the Government of a foreign State or a foreign enterprise under an agreement, not being an agreement entered into between the 1st day of April, 1997 and the 31st day of March, 1999, and approved by the Central Government in this behalf is exempt.

Provided that nothing contained in this clause shall apply to any such agreement entered into on or after the 1st day of April, 2007.

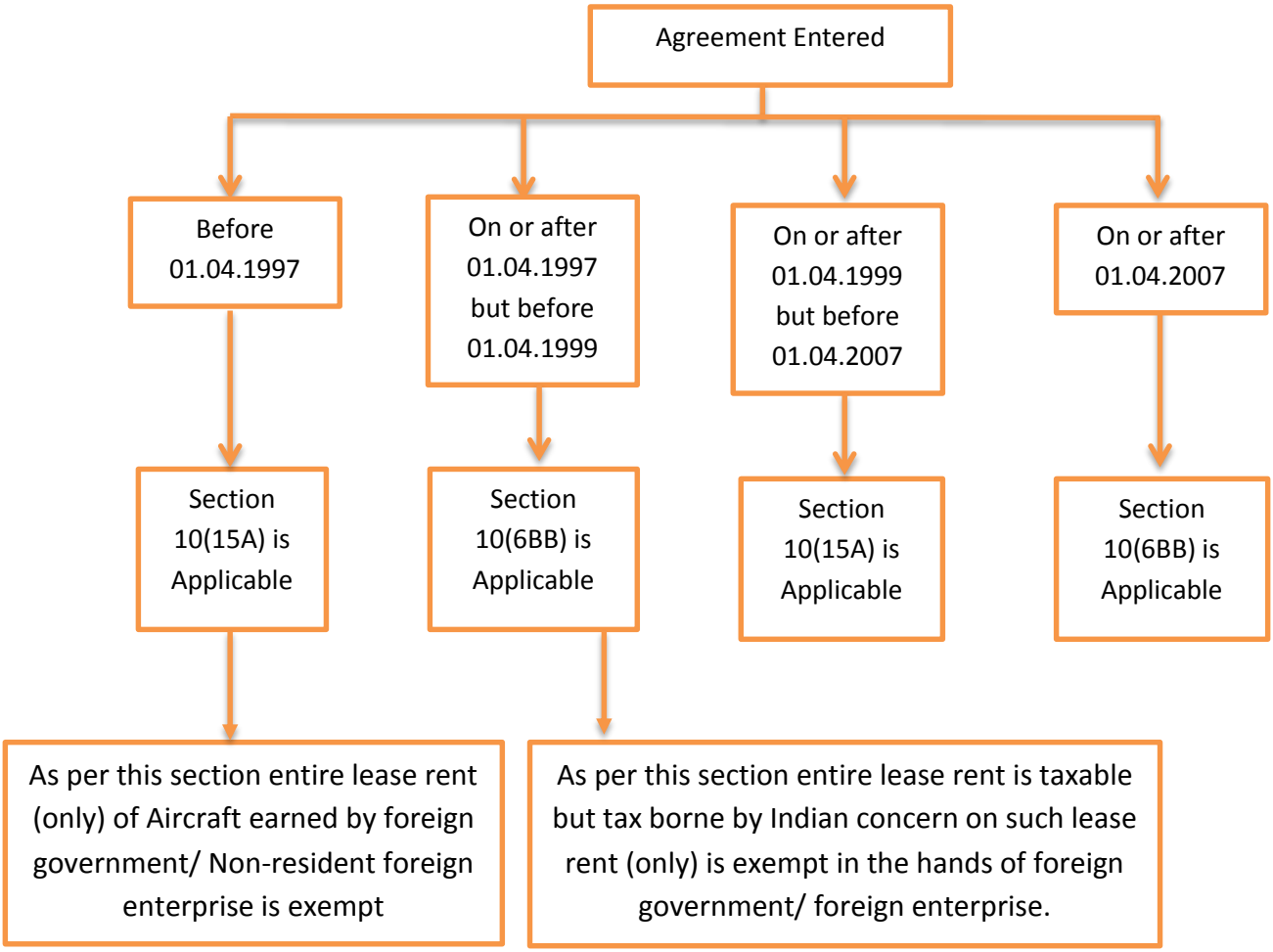
Explanation.—For the purposes of this clause, the expression "foreign enterprise" means a person who is a non-resident;

Under Section 10(6BB)

Where in the case of the Government of a foreign State or a foreign enterprise deriving income from an Indian company engaged in the business of operation of aircraft, as a consideration of acquiring an aircraft or an aircraft engine (other than payment for providing spares, facilities or services in connection with the operation of leased aircraft) on lease under an agreement entered into after the 31st day of March, 1997 but before the 1st day of April, 1999, or entered into after the 31st day of March, 2007 and approved by the Central Government in this behalf and the tax on such income is payable by such Indian company under the terms of that agreement to the Central Government, the tax so paid is exempt.

Explanation.—For the purposes of this clause, the expression "foreign enterprise" means a person who is a non-resident.

Section 10(15A) and Section 10(6BB):



UNIT G – SECTION 9

54.30 MEANING OF BUSINESS CONNECTION

Section:- Explanation 2 and 3 to section 9(1)(i)

Business connection as defined by Supreme Court in case of CIT vs. R.D. Aggarwal & Co. [1965] 56 ITR 20

The expression "business connection" undoubtedly means something more than "business". A business connection involves a relation between a business carried on by a non-resident which yields profits or gains and some activity in the taxable territories which contributes directly or indirectly to the earning of those profits or gains.

Business connection as defined in Explanation 2 to section 9(1)(i)

As per Explanation 2 to section 9(1) (i), "business connection" shall include any business activity carried out through a person who, acting on behalf of the non-resident,—

(a) who has and who habitually exercises in India, an authority to conclude contracts on behalf of the non-resident, unless his activities are limited to the purchase of goods or merchandise for the non-resident; or

(b) who has no such authority, but habitually maintains in India a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the non-resident; or

(c) who habitually secures orders in India, mainly or wholly for the non-resident or for that non-resident and other non-residents controlling, controlled by, or subject to the same common control, as that non-resident:

Provided that such business connection shall not include any business activity carried out through a broker, general commission agent or any other agent having an independent status, if such broker, general commission agent or any other agent having an independent status is acting in the ordinary course of his business:

Provided further that where such broker, general commission agent or any other agent works mainly or wholly on behalf of a non-resident (referred to as the principal non-resident) or on behalf of such non-resident and other non-residents which are controlled by the principal non-resident or have a controlling interest in the principal non-resident or are subject to the same common control as the principal non-resident, he shall not be deemed to be a broker, general commission agent or an agent of an independent status.

Explanation 3

Where a business is carried on in India through a person referred to in clause (*a*) or clause (*b*) or clause (*c*) of *Explanation 2*, only so much of income as is attributable to the operations carried out in India shall be deemed to accrue or arise in India;

Practical 32

Mr. Nayan habitually secures orders in India on behalf of Mr. Karlos, Non-resident. Discuss whether Mr. Karlos is said to have business connection in India under following alternatives:

Alternative 1: Mr. Nayan also secures orders for various non-residents across the globe.

Alternative 2: Mr. Nayan works mainly for Mr. Karlos and his group companies.

Solution

Alternative 1: Mr. Nayan under this alternative is nothing but an agent of independent status and therefore, it will not give rise to business connection in India for Mr. Karlos.

Alternative 2: Since Mr. Nayan works mainly for Mr. Karlos and his group companies, he cannot be said to be an agent of independent status. Therefore, dealing through Mr. Nayan in India give rise to business connection in India for Mr. Karlos.

Readers Note:

Practical 33

A firm of solicitors in Mumbai engaged a barrister in UK for arguing a case before Supreme Court of India. A payment of 5000 pounds was made as per terms of professional engagement. Whether this transaction attract income-tax in India in the hands of barrister in UK under section 9?

Solution

- As per section 9(1)(i), all income accruing or arising, whether directly or indirectly, through or from any business connection in India is deemed to accrue or arise in India. In this case, there was a professional connection between the firm of solicitors in Mumbai and the barrister in UK.
- The expression "business" includes not only trade and manufacture; it includes, within its scope, "profession" as well. Therefore, the existence of professional connection amounts to existence of "business connection" under section 9(1)(i). It was so held by the **Supreme Court in Barendra Prasad Roy v. ITO (1981) 129 ITR 295.**
- Hence, the amount of 5,000 pounds paid to the barrister in UK as per the terms of the professional engagement constitutes income which is deemed to accrue or arise in India under section 9(1)(i). Hence, it is taxable in India.

Readers Note:

However, followings shall not give rise to business connection in India.

(a) in the case of a non-resident, no income shall be deemed to accrue or arise in India to him through or from operations which are confined to the purchase of goods in India for the purpose of export ;

(b) in the case of a non-resident, being a person engaged in the business of running a news agency or of publishing newspapers, magazines or journals, no income shall be deemed to accrue or arise in India to him through or from activities which are confined to the collection of news and views in India for transmission out of India ;

(c) in the case of a non-resident, being—

(1) an individual who is not a citizen of India ; or

(2) a firm which does not have any partner who is a citizen of India or who is resident in India ; or

(3) a company which does not have any shareholder who is a citizen of India or who is resident in India,

no income shall be deemed to accrue or arise in India to such individual, firm or company through or from operations which are confined to the shooting of any cinematograph film in India

(d) in the case of a business of which all the operations are not carried out in India, the income of the business deemed under this clause to accrue or arise in India shall be only such part of the income as is reasonably attributable to the operations carried out in India

(e) ***in the case of a foreign company engaged in the business of mining of diamonds, no income shall be deemed to accrue or arise in India to it through or from the activities which are confined to the display of uncut and unassorted diamond in any special zone notified by the Central Government in the Official Gazette in this behalf. [Inserted by Finance Act, 2016 w.r.e.f. A.Y. 2016-17]***

Practical 34

XY Pvt. Ltd., a company having registered head office in Singapore, for the first time had carried out operations during the year **2016-17** of purchase of goods in India on four occasions. Immediately after purchase, the company exported the same to China. The total value of such exports was Rs.100 Lacs, on which it earned profits of Rs.20 Lacs, before the expenses of Rs.12 Lacs, which were directly paid by H.O. The company seeks your advice regarding its tax liability in India. How much of income for the A.Y.2017-18 shall be subjected to tax? Assume that the place of effective management of XY Pvt. Ltd is in Singapore.

Solution

- 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, the POEM is not in India and therefore, XY Pvt. Ltd. is not resident in India.
- 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.
- XY Pvt. Ltd. had purchased the goods in India and thereafter exported the same in total to China and accordingly no income of the non-resident company shall be subject to tax for A.Y **2017-18.**

Readers Note:

Practical 35

As per the various explanation to section 9, in the case of a business of which all the operations are not carried out in India, the income of the business deemed under this clause to accrue or arise in India shall be only such part of the income as is reasonably attributable to the operations carried out in India. In this context, explain the relevant rule for apportionment of income chargeable to tax in India.

Solution

The relevant rule for apportionment of income is Rule 10:- Determination of income in the case of non-residents.

It provides as under:-

In any case in which the Assessing Officer is of opinion that the actual amount of the income accruing or arising to any non-resident person whether directly or indirectly, through or from any business connection in India or through or from any property in India or through or from any asset or source of income in India or through or from any money lent at interest and brought into India in cash or in

kind cannot be definitely ascertained, the amount of such income for the purposes of assessment to income-tax may be calculated :—

(i) at such percentage of the turnover so accruing or arising as the Assessing Officer may consider to be reasonable, or

(ii) on any amount which bears the same proportion to the total profits and gains of the business of such person (such profits and gains being computed in accordance with the provisions of the Act), as the receipts so accruing or arising bear to the total receipts of the business, or

(iii) in such other manner as the Assessing Officer may deem suitable.

Readers Note:

54.31 INCOME THROUGH THE TRANSFER OF CAPITAL ASSET SITUATE IN INDIA

Section:- Explanation 4, 5 6 and 7 to section 9(1)(i)

Income through the transfer of a capital asset situated in India shall be deemed to accrue or arise in India.

Explanation 4:- For the removal of doubts, it is hereby clarified that the expression "through" shall mean and include and shall be deemed to have always meant and included "by means of", "in consequence of" or "by reason of".

The Finance Act, 2012 had inserted Explanation 5 in section 9(1)(i) w.r.e.f. 1.04.1962 to clarify that an asset or **capital asset, being any share** or interest **in a company** or entity **registered** or incorporated **outside India** shall be deemed to be and shall always be deemed to have been **situated in India**, if the share or interest derives, directly or indirectly, its value substantially from the assets located in India.

Finance Act, 2015 inserted following explanation to make explanation 5 operational.

Explanation 6.—For the purposes of this clause, it is hereby declared that—

(a) 'Substantial' -The share or interest of a foreign company entity 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,-

a) exceeds the amount of Rs.10 crore rupees; **and**

b) represents at least 50 per cent of the value of all the assets owned by the company or entity

(b) Value of asset - The value of an asset shall be the fair market value of such an asset without reduction of liabilities, if any, in respect of the asset.

(c) "Specified date" —The specified date of valuation shall be the date on which the accounting period of the company or entity ends preceding the date of transfer.

If, however, the book value of the assets of the company or entity on the date of transfer exceeds by at least 15 percent of the book value of the assets as on the last balance sheet date preceding the date of transfer, then instead of the date mentioned above, the date of transfer shall be the specified date of valuation.

(d) Mode of determination of fair market value- The manner of determination of fair market value of the assets shall be prescribed in the rules.

(e) Taxation on proportionate basis – Where all the assets owned by the company or entity registered or incorporated outside India, are not located in India, then the capital gain arising on transfer of a share or interest will be on proportional basis. The method for determination of proportionality will be specified in the rules.

(f) <u>Exemption to the transferor:</u>

A. Exemption covered by explanation 7

1. Exemption in case foreign company or entity (whose share or interest get transferred) directly owns Indian assets

Exemption shall be available to the transferor of a share of, or interest in, a foreign entity if the transferor (along with its associated enterprises), at any time in the twelve months preceding the date of transfer,

a. Neither holds the right of control or management of such foreign company or entity;

b. Nor holds voting power or share capital or interest exceeding 5 per cent of the total voting power or total share capital of such foreign company or entity;

2. Exemption in case foreign company or entity (whose share or interest get transferred) indirectly owns Indian assets

In case the transfer is of shares or interest in a foreign entity which does not hold the Indian assets directly then the exemption shall be available to the transferor if the transferor (along with its associated enterprises), at any time in the twelve months preceding the date of transfer,-

a. Neither holds the right of management or control in relation to such foreign company or the entity

b. Nor holds any rights in such company which would entitle it to either exercise control or management of the company or entity that directly owns the assets situated in India or

c. Nor entitle it to voting power exceeding 5 percent of total voting power of the company or entity that directly owns the assets situated in India.

B. Exemption covered by proviso to explanation 5

The explanation 5 has been amended by Finance Act, 2017 inserting following two provisos.

(a) The provisions of explanation 5 shall not apply to an asset or capital asset, which is held by a non-resident by way of investment, directly or indirectly, in Foreign Institutional Investors for the assessment years 2012-13 to 2014-15.

(b) The provisions of explanation 5 shall not apply to an asset or capital asset, which is held by a non-resident by way of investment, directly or indirectly, in Category I or Category II foreign portfolio investor under the SEBI (Foreign Portfolio Investors) Regulations, 2014 for the assessment years 2015-16 and onwards.

C. Exemption covered by section 47 (viab) and (vicc)

Exemption in the case of amalgamation/demerger – The transfer of shares in a foreign company (deriving value of assets substantially from assets situated in India) on account of amalgamation / demerger of foreign companies will be exempt from tax subject to the satisfaction of the following conditions of section 47(viab) and (vicc)-

In case of amalgamation [Section 47(viab)]	In case of demerger [Section 47(vicc)]
At least 25 per cent of the shareholders of the amalgamating foreign company continue to remain shareholders of the amalgamated foreign company	The shareholders, holding not less than 75 percent in value of shares of the demerged foreign company, continue to remain shareholders of the resulting foreign company.
Such transfer does not attract tax on capital gains in the country in which the amalgamating company is incorporated.	Such transfer does not attract to tax on capital gains in the country in which the demerged foreign company is incorporated

Other Points for amalgamation / demerger mentioned above:

- The provisions of section 391 to 394 of the Companies Act, 1956 shall not apply in case of demerger for this clause.
- As per section **49(1) (iii) (e)**, in future, if amalgamated / resulting foreign company transfers the capital asset [which has been received from demerged company meeting conditions of section 47(viab) and 47(vicc)], then **the cost of acquisition in the hands of amalgamated /resulting company shall be the cost incurred by the previous owner. (i.e. cost for which amalgamating/demerged foreign company acquired the capital asset)**
- Further, to find out whether such transferred assets are long-term capital assets or not, the period of holding shall be determined from date of acquisition of such assets by the previous owner (i.e. amalgamating/demerged foreign company) – Explanation 1 to section 2(42A) .

(g) <u>Section 285A: Furnishing of information or documents by an Indian concern</u>

For the purposes of determination of any income accruing or arising in India under section 9(1)(i), an Indian concern has to furnish, within the prescribed period to the prescribed income-tax authority, the information or documents, in prescribed manner, if -

a. any share of, or interest in, a company or an entity registered or incorporated outside India derives, directly or indirectly, its value substantially from the assets located in India, as referred to in Explanation 5 to section 9(1)(i), and
b. such company or, entity, holds, directly or indirectly, such assets in India through, or in, the Indian concern.

(h) <u>Section 271GA: Penalty for failure to furnish the information or document under section 285A</u>

In case of any failure on the part of Indian concern to furnish the information or document as required under section 285A, then following penal action under section 271GA may be invoked as -

a. a sum equal to 2% of the value of the transaction in respect of which such failure has taken place, in a case where such transaction had the effect of directly or indirectly transferring the right of management or control in relation to the Indian concern;

b. a sum of Rs. 5,00,000, in any other case.

However, no penalty is imposable if it is proved that there is a reasonable cause for such failure [Section 273B].

Practical 36

Softdrink India Private Limited, an Indian company, is a wholly owned subsidiary of Mepsi Inc, USA, a foreign comapny. Mepsi Inc. is also a wholly owned subsidiary of HP Inc., another foreign company. On 01-07-2015, HP Inc. transferred 80% shares of Mepsi Inc. to Cocomo Inc., a foreign company. The last accounting period of Mepsi Inc. comprises of twelve months and ended on 31-12-2014. Discuss tax consequences of this transaction in the hands of HP Inc and Cocomo Inc. under following different situations:-

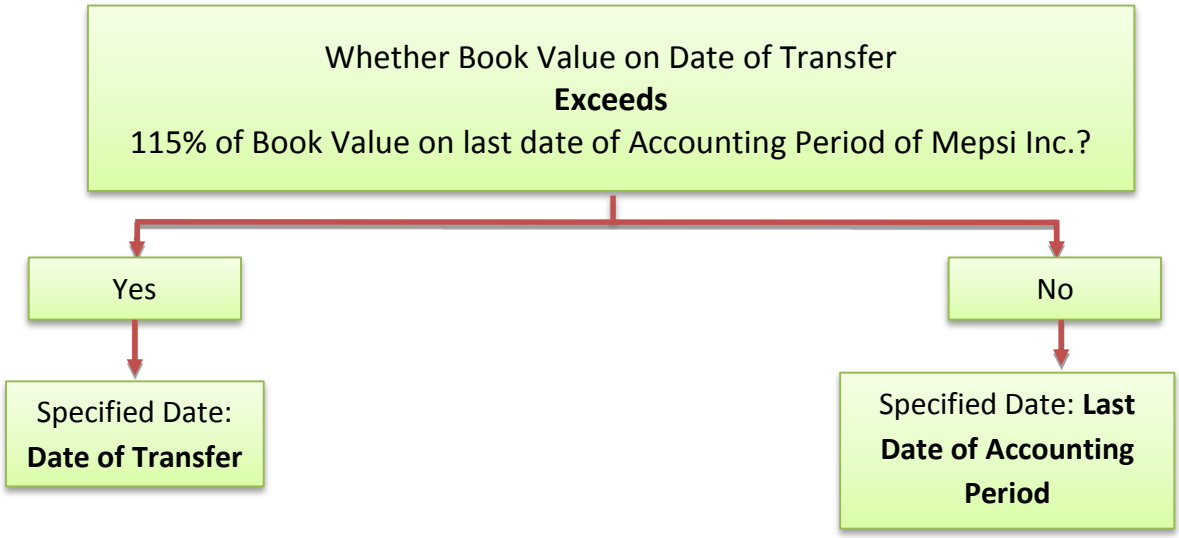
SITUATION 1	**Rs. in Crores**			
	As on 31-12-2014		**As on 01-07-2015**	
	Book Value	**Fair Market Value**	**Book Value**	**Fair Market Value**
Types of assets of Mepsi Inc.				
- Indian Assets	56	57	56	60
- Other Assets	44	45	54	65
Total Assets	100	102	110	125
Liabilities other than Share capital and Reserves	60		70	

SITUATION 2	**Rs. in Crores**			
	As on 31-12-2014		**As on 01-07-2015**	
	Book Value	**Fair Market Value**	**Book Value**	**Fair Market Value**
Types of assets of Mepsi Inc.				
- Indian Assets	56	57	60	60
- Other Assets	44	45	58	65
Total Assets	100	102	118	125
Liabilities other than Share capital and Reserves	60		70	

SITUATION 3	**Rs. in Crores**			
	As on 31-12-2014		**As on 01-07-2015**	
	Book Value	**Fair Market Value**	**Book Value**	**Fair Market Value**
Types of assets of Mepsi Inc.				
- Indian Assets	9	11	9	8
- Other Assets	11	12	16	6
Total Assets	20	23	25	14
Liabilities other than Share capital and Reserves	7		6	

Solution

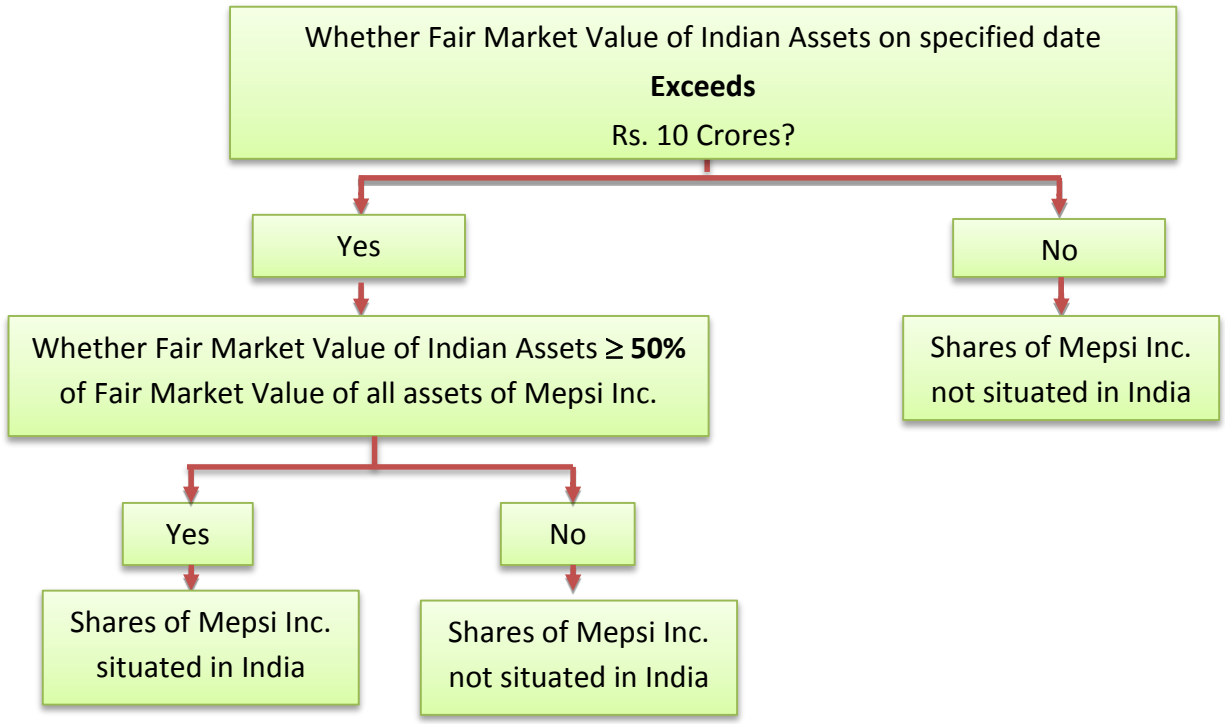
- As per explanation 5 to section 9(1) (i) read with definition of transfer under section 2(47), HP Inc. is liable for capital gain tax in India only when shares of Mepsi Inc. deemed to be situated in India.
- In order to decide whether shares of Mepsi Inc. shall be deemed to be situated in India or not, we need to check whether such shares derives directly or indirectly its value substantially from assets located in India.
- For that purpose, first we need to decide the specified date in view of Explanation 6 to section 9 (1) (i). Consider following chart :



Determination of Specified Date:

					(Rs. in crores)
(I)	**(II)**	**(III)**	**(IV)**	**(V)**	**(VI)**
Situations	**Book value of Assets on 31-12-2014**	**Book Value of Assets on 01-7-2015**	**% (III)/(II)**	**Whether % at (IV) exceeds 115%?**	**Specified Date**
1.	100	110	110%	No	31-12-2014
2.	100	118	118%	Yes	01-07-2015
3.	20	25	125%	Yes	01-07-2015

Now, follow next chart in view of word "substantial" under explanation 6 to section 9 (1) (i).



Determination of "Whether shares of Mepsi Inc. are deemed to be situated in India or not?"

(Rs. in crores)

(I)	(II)	(III)	(IV)	(V)	(VI)	(VII)	(VIII)
Situations	**Specified Date**	**FMV of Indian Assets on Specified Date**	**FMV of All Assets on Specified Date**	**Does FMV at (III) exceeds Rs. 10 Crores?**	**% of (III)/(IV)**	**Does % at (VI) ≥ 50%**	**Whether shares of Mepsi Inc. deemed to be situated in India?**
1.	31-12-2014	57	102	Yes	55.88%	Yes	Yes
2.	01-07-2015	60	125	Yes	48.00%	No	No
3.	01-07-2015	8	14	No	NA	NA	No

Tax Consequences in the hands of HP Inc. (Transferor) and Cocomo Inc. (Transferee)

Situations	Whether shares of Mepsi situated in India?	Tax consequences in the hands of HP Inc.	Tax consequences in the hands of Cocomo Inc.
1.	Yes	Liable for Capital gain tax on proportionate basis.	Liable to deduct TDS in view of Explanation 2 to section 195(1)
2.	No	No Capital gain tax liability in India.	Not required to deduct TDS since capital gain is not to be taxed in India.
3.	No	No Capital gain tax liability in India.	Not required to deduct TDS since capital gain is not to be taxed in India.

Readers Note:

Practical 37

Whether dividend declared and paid by Mepsi Inc. outside India is deemed to be income accruing or arising in India in view of explanation 5 to section 9(1) (i)?

Solution

Clarification regarding applicability of Explanation 5 to section 9(1)(i) to dividend declared and paid by a foreign company outside India in respect of shares which derive its value substantially from the assets located in India [Circular No. 4/2015 dated 26-03-2015]

- **Explanation 5 would be applicable** in relation to deeming any income arising outside India from any **transaction in respect of any share** or interest in a foreign company or entity, **which has the effect of transferring, directly or indirectly, the underlying assets located in India**, as income accruing or arising in India.
- **Declaration of dividend by a foreign company outside India does not have the effect of transfer of any underlying assets located in India. This circular, therefore, clarifies that the dividends declared and paid by a foreign company outside India** in respect of shares which derive their value substantially from assets situated in India **would not be deemed to be income accruing or arising in India** by virtue of the provisions of Explanation 5 to section 9(1)(i).

Readers Note:

54.32 INCOME BY WAY OF INTEREST

Section:- Explanation to section 9(1)(v)- commentary

When interest is payable by an Indian branch of a foreign bank to its overseas head office, it is deductible while computing income of Indian Branch.

Moreover, in the hands of recipient head office, the same is not taxable in India as payer and recipient are the same. As per various judicial rulings, tax is not deductible by the payer Indian branch.

Therefore, in order to provide clarity and certainty on the issue of taxability of interest payable by the Permanent Establishment (PE) of a non-resident engaged in banking business to the head office, an Explanation has been inserted in section 9(1)(v).

As per this Explanation, in the case of a nonresident, being a person engaged in the business of banking, any interest payable by the PE in India of such non-resident to the head office or any PE or any other part of such non-resident outside India, shall be deemed to accrue or arise in India.
Such interest shall be chargeable to tax in addition to any income attributable to the PE in India.

Further, the PE in India shall be deemed to be a person separate and independent of the non-resident person of which it is a PE and the provisions of the Act relating to computation of total income, determination of tax and collection and recovery would apply accordingly.

Further, the PE in India has to deduct tax at source on any interest payable to either the head office or any other branch or PE, etc. of the non-resident outside India.
Permanent establishment includes a fixed place of business through which the business of the enterprise is wholly or partly carried on.

Practical 38

Foreign Bank has opened branch in New Delhi with the permission of Reserve Bank of India. During previous year under 2015-16, New Delhi Branch paid interest to its Head Office. The New Delhi Branch had not deducted TDS on the ground that interest earned by Head Office is not taxable in India since payer and recipient are the same. Discuss the validity of contention raised by New Delhi Branch and other tax consequences if any.

Solution

Considering the amendment made to section 9(1) (v), New Delhi Branch of Foreign Bank and its Head Office are treated as separate person. Further, interest earned by Head Office shall be deemed to accrue or arise in India and therefore, it is subject to tax in India. Considering the provisions of section 195 of the Act, New Delhi branch is liable to deduct TDS. Non-deduction would result in disallowance of interest claimed as expenditure by the New Delhi Branch (PE) and may also attract levy of interest and penalty in accordance with relevant provisions of the Income Tax Act, 1961.

Readers Note:

54.33 INCOME BY WAY OF ROYALTY

Section:- Explanation to section 9(1)(vi)

Explanation 2 to section 9 (1)(vi) deals with the term 'royalty'.

Royalty means consideration (including any lump sum consideration but excluding any consideration which would constitute income by way of capital gains) for the following-

(i) the transfer of all or any rights in respect of a patent, invention, model, design, secret formula or process or trademark in similar property,

(ii) the imparting of any information covering the working of or the use of a patent, invention, model, design, secret formula or process or trademark or similar property,

(iii) the use of any patent, invention, model, design, secret formula or trademark or similar property,

(iv) the imparting of any information regarding technical, industrial, commercial or scientific knowledge, experience or skill,

(v) the use or right to use any industrial, commercial or scientific equipment but not including amounts referred to in section 44 BB,

(vi) The transfer of all or any rights in respect of any copyright literary artistic or scientific work, including films or video tapes for use in connection with radio broadcasting but not considered for the sale, distribution or exhibition of cinematographic films or

(vii) The rendering of services in connection with activities referred to in sub-clause (i) to (vi).

Explanation 3 - For the purposes of this clause, "computer software" means any computer programme recorded on any disc, tape, perforated media or other information storage device and includes any such programme or any customized electronic data.

Explanation 4 - Explanation 4 has been inserted to clarify that the transfer of all or any rights in respect of any right, property or information includes transfer of all or any rightful for use or right to use a computer software (including granting of a license) irrespective of the medium through which such right is transferred.

Explanation 5 - Explanation 5 has been inserted to clarify that the royalty includes consideration in respect of any right, property or information, whether or not—

a. the possession or control of such right property or information is with the payer;
b. such right, property or information is used directly by the payer;
c. the location of such right, property or information is in India.

Explanation 6- Explanation 6 has been inserted to clarify that the expression "process" includes transmission by satellite (including up-linking, amplification, conversion for down-linking of any signal), cable, optic fiber or by any other similar technology, whether or not such process is secret.

Practical 39

A foreign company has entered into an agreement with an Indian company on 1st February 2002 under which industrial equipment belonging to the former has been leased to the latter for an annual lumpsum payment of $ 50,000. How will the lease rent be taxed in the hands of the foreign company?

Solution

- Under clause (iva) of Explanation 2 to section 9(1)(vi), the expression "royalty" would include any lump sum consideration for the use of or the right to use of any industrial, commercial or scientific equipment.
- Under section 44D, no deduction will be allowed in respect of any expenditure or allowance in computing the income by way of royalty, received from the Government or an Indian concern in pursuance of an agreement made between 01.04.1976 and 31.03.2003.
- Assuming that foreign company does not have permanent establishment in India and the lease agreement is approved by the Central Government, under section 115A, income-tax payable on such royalty under an agreement entered into after 31st March, 1976 will be 10%.
- The above tax treatment shall be subject to the provisions of the Double Taxation Avoidance Agreement between India and the country in which the foreign company is assessed.

Readers Note:

54.34 INCOME BY WAY OF FEES FOR TECHNICAL SERVICES

Section:- Explanation 2 to section 9(1)(vii)

***Explanation 2* to section 9 (1) (vii)** deals with this term

"Fees for technical services" means any consideration (including any lump sum consideration) for the rendering of any managerial, technical or consultancy services (including the provision of services of technical or other personnel)

but

does not include consideration for any construction, assembly, mining or like project undertaken by the recipient or consideration which would be income of the recipient chargeable under the head "Salaries".

Practical 40

JJ Limited, a company incorporated in Australia has entered into an agreement with KK Limited, an Indian company for rendering technical services to the latter for setting up a fertilizer plant in Orissa. As per the agreement, JJ Limited rendered both off-shore services and on-shore services to KK Limited at fee of Rs. 1 crore and Rs. 1.5 crore, respectively. JJ Limited is of the view that it is not liable to tax in India in respect of fee of Rs. 1 crore as it is for rendering services outside India. Discuss the correctness of the view of JJ Limited.

Solution

- The Explanation below section 9(2) clarifies that income by way of, inter alia, fees for technical services from services utilized in India would be deemed to accrue or arise in India under section 9(1)(vii) in case of a non-resident and be included in his total income, whether or not such services were rendered in India.
- In this case, the technical services rendered by the foreign company, JJ Ltd., were for setting up a fertilizer plant in Orissa. Therefore, the services were utilized in India. Consequently, as per section 9(2), the fee of Rs. 2.5 crore for technical services rendered by JJ Ltd. (both off - shore and on-shore services) to KK Ltd. is deemed to accrue or arise in India and includible in the total income of JJ Ltd.
- Therefore, the view of JJ Ltd. that it is not liable to tax in India in respect of fee of Rs. 1 crore (as it is for rendering services outside India) is not correct.

Readers Note:

54.35 INCOME BY WAY OF INTEREST, ROYALTY OR FEES FOR TECHNICAL SERVICES

Section:- Explanation to section 9

For the removal of doubts, it is hereby declared that for the purposes of this section, income by way of interest, royalty or fees for technical services of a non-resident shall always be deemed to accrue or arise in India, whether or not,—

(i) the non-resident has a residence or place of business or business connection in India; or

(ii) the non-resident has rendered services in India.

Practical 41

"Income of a non-resident by way of fees for technical services, interest and royalty, from services utilized in India would not be deemed to accrue or arise to him in India unless the services are rendered in India" – Discuss the correctness or otherwise of the statement.

Or

Kawasaki Yokogawa Ltd (KYL), Japanese company has entered into an agreement with KATA Limited, Indian Company. As per terms and conditions (a) KYL provide know-how for manufacturing specified goods by post (b) If employees / workers of KATA Limited wants to be trained then such employees will visit Japan and will be trained there. KYL does not have permanent establishment in INDIA. KATA Limited is going to use this know-how in INDIA. And for this arrangement, KATA Limited has to pay 5 Lakh Japanese Yen to KYL. KYL denies tax liability in India on the ground that no services are rendered in India. Verify the correctness of the contention made by KYL.

Or

A non-resident German company, which did not have a permanent establishment in India, entered into an agreement for execution of electrical work in India. Separate payments were made towards drawings & designs, which were described as "Engineering Fee". The assessee contended that such business profits should be taxable in Germany as there is no business connection within the meaning of section 9(1)(i) of the Income-tax Act, 1961.

Solution

Solution for non-resident KYL

- First of all, payment made to KYL, is a royalty income as per definition.
- As per explanation to section 9, if royalty income is payable by a resident to non-resident, shall be deemed to accrue or arise in India and liable to be taxed in India in the hands of non-resident, if such royalty payment is in connection with business or profession carried on in India.
- Further, explanation to 9 inserted by Finance Act, 2007 and further amended by Finance Act, 2010 reads as under:-

  For the removal of doubts, it is hereby declared that for the purposes of this section, income by way of interest, royalty or fees for technical services of a non-resident shall always be deemed to accrue or arise in India, whether or not,—
  - *the non-resident has a residence or place of business or business connection in India; or*
  - **the non-resident has rendered services in India.**

  (Effective retrospectively from 1st June, 1976)
- Considering all these provisions, payment received by KYL is a royalty income to be taxed in India irrespective of the fact that it has permanent establishment in India or not and further irrespective of the fact that it has rendered services in India or not.

Solution for non-resident German Company

- Fees for technical services is taxable under section 9(1)(vii). In this case, the separate payments made towards drawings and designs (described as “engineering fee”) are in the nature of fee for technical services and, therefore, it is taxable in India by virtue of section 9(1)(vii) **[Aeg Aktiengesllschaft v. CIT (2004) 267 ITR 209 (Kar.)]**.
- 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.

Readers Note

54.36 PRESENCE OF ELIGIBLE FUND MANAGER IN INDIA NOT TO CONSTITUTE BUSINESS CONNECTION IN INDIA OF SUCH ELIGIBLE INVESTMENT FUND ON BEHALF OF WHICH HE UNDERTAKES FUND MANAGEMENT ACTIVITY

Section:- 9A

In order to facilitate location of fund managers of off-share funds in India a specific provision **(Section 9A)** has been introduced in the Income Tax Act (with effect from the assessment year 2016-17):

As per this provision,

a. the tax liability in respect of income arising to the Fund from investment in India would be neutral to the fact as to whether the investment is made directly by the fund or through engagement of fund manager located in India; and

b. that income of the fund from the investments outside India would not be taxable in India solely on the basis that the Fund management activity in respect of such investments have been undertaken through a fund manager located in India.

Business connection [Section 9A(1)]

In the case of an "eligible investment fund", the fund management activity carried out through an "eligible fund manager" acting on behalf of such fund shall not constitute business connection in India of the said fund.

Residential Status [Section 9A(2)]

An "eligible fund manager" shall not be said to be resident in India merely because the "eligible fund manager" undertaking fund management activities on its behalf is located in India.

The Eligible Investment Fund[Section 9A(3)]

The eligible investment fund means a fund established or incorporated or registered outside India, which collects funds from its members for investing it for their benefit and fulfils the following conditions, namely:—

(a) the fund is not a person resident in India;

(b) the fund is a resident of a country or a specified territory with which an agreement referred to in sub-section (1) of section 90 or sub-section (1) of section 90A has been entered into *[or is established or incorporated or registered in a country or a specified territory notified by the Central Government in this behalf]*;– bracket inserted by Finance Act, 2016

(c) the aggregate participation or investment in the fund, directly or indirectly, by persons resident in India does not exceed five per cent of the corpus of the fund;

(d) the fund and its activities are subject to applicable investor protection regulations in the country or specified territory where it is established or incorporated or is a resident;

(e) the fund has a minimum of twenty-five members who are, directly or indirectly, not connected persons;

(f) any member of the fund along with connected persons shall not have any participation interest, directly or indirectly, in the fund exceeding ten per cent;

(g) the aggregate participation interest, directly or indirectly, of ten or less members along with their connected persons in the fund, shall be less than fifty per cent;

(h) the fund shall not invest more than twenty per cent of its corpus in any entity;

(i) the fund shall not make any investment in its associate entity;

(j) the monthly average of the corpus of the fund shall not be less than one hundred crore rupees:

Provided that if the fund has been established or incorporated in the previous year, the corpus of fund shall not be less than one hundred crore rupees at the end of such previous year;

Provided further *that nothing contained in this clause shall apply to a fund which has been wound up in the previous year;* ***[w.r.e.f. A.Y.2016-17-Amendment made by Finance Act, 2017]***

(k) the fund shall not carry on or control and manage, directly or indirectly, any business in India or ~~from India;~~ Words omitted by Finance Act, 2016

(l) the fund is neither engaged in any activity which constitutes a business connection in India nor has any person acting on its behalf whose activities constitute a business connection in India other than the activities undertaken by the eligible fund manager on its behalf;

(m) the remuneration paid by the fund to an eligible fund manager in respect of fund management activity undertaken by him on its behalf is not less than the arm's length price of the said activity :

Provided that the conditions specified in clauses (e), (f) and (g) shall not apply in case of an investment fund set up by the Government or the Central Bank of a foreign State or a sovereign fund, or such other fund as the Central Government may subject to conditions if any, by notification in the Official Gazette, specify in this behalf.

The Eligible Fund Manager [Section 9A(4)]

The eligible fund manager, in respect of an eligible investment fund, means any person who is engaged in the activity of fund management and fulfils the following conditions, namely:—

(a) the person is not an employee of the eligible investment fund or a connected person of the fund;

(b) the person is registered as a fund manager or an investment advisor in accordance with the specified regulations;

(c) the person is acting in the ordinary course of his business as a fund manager;

(d) the person along with his connected persons shall not be entitled, directly or indirectly, to more than twenty per cent of the profits accruing or arising to the eligible investment fund from the transactions carried out by the fund through the fund manager.

Reporting [Section 9A(5) read with Section 271FAB, 273B]

Every eligible investment fund shall, in respect of its activities in a financial year, furnish within 90 days from the end of the financial year, a statement in the prescribed form to be prescribed income-tax authority containing information relating to the fulfilment of the relevant conditions or any information or document which may be prescribed.

In case of non-furnishing of the prescribed information or document or statement, a penalty of Rs.5 lakh shall be leviable on the fund. [Section 271FAB]

However, no penalty shall be imposable for such failure if it is proved that there was reasonable cause for such failure **[Section 273B].**

Clarification [Section 9A(6), (7) and (8)]

Nothing contained in this section shall apply to exclude any income from the total income of the eligible investment fund, which would have been so included irrespective of whether the activity of the eligible fund manager constituted the business connection in India of such fund or not.

Nothing contained in this section shall have any effect on the scope of total income or determination of total income in the case of the eligible fund manager.

The provisions of this section shall be applied in accordance with such guidelines and in such manner as the Board may prescribe in this behalf.

Interpretation [Section 9A(9)]

For the purposes of this section,—

(a) "associate" means an entity in which a director or a trustee or a partner or a member or a fund manager of the investment fund or a director or a trustee or a partner or a member of the fund manager of such fund, holds, either individually or collectively, share or interest, being more than fifteen per cent of its share capital or interest, as the case may be;

(b) "connected person" shall have the meaning assigned to it in clause (4) of section 102 which reads as under:-

"connected person" means any person who is connected directly or indirectly to another person and includes,—

(a) *any relative of the person, if such person is an individual;*

(b) *any director of the company or any relative of such director, if the person is a company;*

(c) *any partner or member of a firm or association of persons or body of individuals or any relative of such partner or member, if the person is a firm or association of persons or body of individuals;*

(d) *any member of the Hindu undivided family or any relative of such member, if the person is a Hindu undivided family;*

(e) *any individual who has a substantial interest in the business of the person or any relative of such individual;*

(f) *a company, firm or an association of persons or a body of individuals, whether incorporated or not, or a Hindu undivided family having a substantial interest in the business of the person or any director, partner, or member of the company, firm or association of persons or body of individuals or family, or any relative of such director, partner or member;*

(g) *a company, firm or association of persons or body of individuals, whether incorporated or not, or a Hindu undivided family, whose director, partner, or member has a substantial interest in the business of the person, or family or any relative of such director, partner or member;*

(h) *any other person who carries on a business, if—*

(i) *the person being an individual, or any relative of such person, has a substantial interest in the business of that other person; or*

(ii) *the person being a company, firm, association of persons, body of individuals, whether incorporated or not, or a Hindu undivided family, or any director, partner or member of such company, firm or association of persons or body of individuals or family, or any relative of such director, partner or member, has a substantial interest in the business of that other person;*

(c) "corpus" *means the total amount of funds raised for the purpose of investment by the eligible investment fund as on a particular date;*

(d) "entity" *means any entity in which an eligible investment fund makes an investment;*

(e) "specified regulations" *means the Securities and Exchange Board of India (Portfolio Managers) Regulations, 1993 or the Securities and Exchange Board of India (Investment Advisers) Regulations, 2013, or such other regulations made under the Securities and Exchange Board of India Act, 1992 which may be notified by the Central Government under this clause.*

54.37 REPRSENTATIVE ASSESSEE AND HIS LIABILITIES AS WELL AS RIGHTS

Section:- 160 to 163

Practical 42

Who is termed as representative assessee for the purpose of Income Tax Act?

Solution

As per section 160 (1) of the Act, "representative assessee" means—

(i) in respect of the income of a non-resident specified in sub-section (1) of section 9, the agent of the non-resident, including a person who is treated as an agent under section 163;

(ii) in respect of the income of a minor, lunatic or idiot, the guardian or manager who is entitled to receive or is in receipt of such income on behalf of such minor, lunatic or idiot;

(iii) in respect of income which the Court of Wards, the Administrator-General, the Official Trustee or any receiver or manager appointed by or under any order of a court, receives or is entitled to receive, on behalf or for the benefit of any person, such Court of Wards, Administrator-General, Official Trustee, receiver or manager;

(iv) in respect of income which a trustee appointed under a trust declared by a duly executed instrument in writing whether testamentary or otherwise receives or is entitled to receive on behalf or for the benefit of any person, such trustee or trustees;

(v) in respect of income which a trustee appointed under an oral trust receives or is entitled to receive on behalf or for the benefit of any person, such trustee or trustees.

As per section 160(2), every representative assessee shall be deemed to be an assessee for the purposes of this Act.

Readers Note:

Practical 43

Throw a light on the liabilities of representative assessee under Income Tax Act?

Solution

Section 161 deals with the liabilities of representative assessee which has been summarized as under:

(a) The representative assessee has the same duties, responsibilities and liabilities, under the provisions of the Act as applicable to the assessee. The tax shall be levied upon him and recovered from him in the like manner and to the same extent as it would be leviable upon and recovered from the person represented by him.

(b) If a particular amount has been assessed as income in the case of a person as a representative assessee, the same amount of income cannot be assessed in his case in any other capacity.

Readers Note:

Practical 44

What are the rights of representative assessee under Income Tax Act?

Solution

Section 162 deals with the rights of representative assessee which has been summarized as under:

(a) Every representative assessee, who pays any amount under the Act is entitled to recover from the person on -whose behalf it is paid or he can retain the money belonging to such person -which is in his possession or may come to him in his representative capacity to the extent so required.

(b) Any representative assessee or "any person who apprehends that he is liable to be assessed in respect of any other person, may out of the money or assets of such other person in his possession, retain to the extent of the estimated liability. If there is any disagreement, the representative assessee, may secure from the Assessing Officer, a certificate estimating the liability and authorising him to retain the money pending final settlement. Such certificate issued shall be treated as warrant authorizing retention of money or assets.

(c) At the time of final settlement, the amount recoverable from the representative assessee cannot exceed the amount specified in the certificate except to the extent of availability of assets of such other person in the possession of the representative assessee at that time.

Readers Note:

Practical 45

Who may be regarded as an agent of non-resident under Income Tax Act?

Solution

Section 163 provides as under:

For the purposes of this Act, "agent", in relation to a non-resident, includes any person in India—

(a) who is employed by or on behalf of the non-resident; or

(b) who has any business connection with the non-resident; or

(c) from or through whom the non-resident is in receipt of any income, whether directly or indirectly; or

(d) who is the trustee of the non-resident;

and includes also any other person who, whether a resident or non-resident, has acquired by means of a transfer, a capital asset in India.

No person shall be treated as the agent of a non-resident unless he has had an opportunity of being heard by the Assessing Officer as to his liability to be treated as such.

Readers Note:

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55 – DOUBLE TAXATION RELIEF

55.1 MEANING OF DOUBLE TAXATION AND WHY IT ARISES AND WHAT IS THE REMEDY?

Double taxation generally means taxation of same income of a person in more than one country. The main reason behind double taxation is that countries across the world different rules for taxing income. Basically, there are two main rules of income taxation:

(a) Source rule: Under this rule, the income may be subject to tax in the country where the source of such income exists (i.e., where the business establishment is situated or where the asset/ properly is located) whether the income earner is a resident in that country or not.)

(b) Residence rule: Under this rule, person may be taxed on the basis of his residential status in a country. Generally, if a person is resident of a country, he may have to pay tax on any income earned outside that country as well.

Further, countries like India follows mixture of above rules.

Therefore, problem of double taxation arise if a person is taxed in respect of any income on the basis of source rule in one country and on the basis of residence rule in another country or the basis of mixture of above two rules.

In order to overcome the hardship faced by tax payers due to double taxation, countries adopt two ways:

(a) Bilateral relief

(b) Unilateral relief.

55.2 WHERE THERE IS AGREEMENT WITH FOREIGN COUNTRIES [BILATERAL RELIEF]

Section:- 90

(1) Section 90(1)

The Central Government may enter into an agreement with the Government of any country outside India to provide

(a) for grant of double taxation relief, for avoidance of double taxation by way of following methods:

i. Exemption method: - Under this method, the relief is provided to the assessee by taxing a particular income in only one of the two countries, which would otherwise have been taxed in both the countries.

ii. Tax relief method: - Under this method, the income of the assessee is taxable in both countries in accordance with their respective tax laws/DTAAs. However, the country of which the tax payer is a resident, allows him credit for the tax charged on the doubly taxed income in the other country.

(b) for exchange of information for the prevention of evasion or avoidance of Income Tax;

(c) for recovery of income-tax.

Explanation 1.—For the removal of doubts, it is hereby declared that the charge of tax in respect of a foreign company at a rate higher than the rate at which a domestic company is chargeable, shall not be regarded as less favourable charge or levy of tax in respect of such foreign company.

Explanation 4 has been inserted by the Finance Act, 2017, w.e.f. A.Y. 2018-19:

For the removal of doubts, it is hereby declared that where any term used in an agreement entered into under sub-section (1) is defined under the said agreement, the said term shall have the same meaning as assigned to it in the agreement; and where the term is not defined in the said agreement, but defined in the Act, it shall have the same meaning as assigned to it in the Act and explanation, if any, given to it by the Central Government.

(2) Section 90(2)

Where the Central Government has entered into DTAA with the Government of any country outside India or specified territory outside India, , then, in relation to the assessee to whom such agreement applies, **the provisions of this Act shall apply to the extent they are more beneficial to that assessee.**

(3) Section 90(4)

An assessee, not being a resident, to whom DTAA applies, shall not be entitled to claim any relief under such agreement unless a **certificate of his being a resident in any country outside India or specified territory outside India**, as the case may be, is obtained by him from the Government of that country or specified territory.

(4) Section 90(5)

The assessee referred to in sub-section (4) shall also provide such other documents and information, as may be prescribed. (see notification given below)

- **Notification No. 39/2012 dated 17.09.2012**

  Tax Residence Certificate – **Form & Contents prescribed**

  The Central Board of Direct Taxes has, through this notification, inserted **new Rule 21AB** which shall come into force on 1.4.2013. The said Rule provides that the Certificate for claiming relief by a non-resident under an agreement referred to in sections 90 and 90A should contain the following particulars in form no. 10F :

  (i) Name of the assessee;
  (ii) Status (individual, company, firm etc.) of the assessee;
  (iii) Nationality (in case of individual);
  (iv) Country or specified territory of incorporation or registration (in case of others);
  (v) Assessee's tax identification number in the country or specified territory of residence or in case there is no such number, then, a unique number on the basis of which the person is identified by the Government of the country or the specified territory;
  (vi) Residential status for the purposes of tax;
  (vii) Period for which the certificate is applicable; and
  (viii) Address of the applicant for the period for which the certificate is applicable;

Such certificate should be duly verified by the Government of the country or the specified territory of which the person claims to be a resident for the purposes of tax.

In addition, the CBDT has also prescribed the form for an assessee, who is a resident in India, to make an application to the Assessing Officer for obtaining a certificate of residence for the purposes of an agreement referred to in section 90 and 90A. It has also prescribed the form in which the Assessing Officer, on receipt of such an application by the assessee and on being satisfied in this regard, shall issue a certificate of residence to such an assessee.

Note:- The **submission of TRC containing prescribed particulars shall be a necessary but not sufficient condition for availing benefits of the agreements** referred to in these sections. In effect, further conditions can be stipulated for claiming treaty benefits, in addition to the requirement of submission of TRC.

Practical 1

The Income-tax Act, 1961 provides for taxation of a certain income earned by Mr. X. The Double Taxation Avoidance Agreement, which applies to Mr. X, excludes the income earned by Mr. X from the purview of tax. Is Mr. X liable to pay tax on the income earned by him? Discuss.

Solution

- Section 90(2) makes it clear that where the Central Government has entered into a Double Taxation Avoidance Agreement with a country outside India, then in respect of an assessee to whom such agreement applies, the provisions of the Act shall apply to the extent they are more beneficial to the assessee. This means that where tax liability is imposed by the Act, the Double Taxation Avoidance Agreement may be resorted to for reducing or avoiding the tax liability.
- However, as per section 90(4), the assessee, in order to claim relief under the agreement, has to obtain a certificate [Tax Residence Certificate (TRC)] from the Government of that country, declaring the residence of the country outside India. Further, he also has to provide prescribed information (as discussed in above notification) Form No. 10F.
- The Supreme Court has held, in CIT v. P.V.A.L. Kulandagan Chettiar (2004) 267 ITR 654, that in case of any conflict between the provisions of the Double Taxation Avoidance Agreement and the Income-tax Act, 1961, the provisions of the Double Taxation Avoidance Agreement would prevail over those of the Income-tax Act, 1961.
- Mr. X is, therefore, not liable to pay tax on the income earned by him provided he submits the Tax Residence Certificate obtained from the government of the other country, and provides such other documents and information as may be prescribed.

Readers Note:

Practical 2

Cosmos Limited, a company incorporated in Mauritius, has a branch office in Hyderabad opened in April, 2015. The Indian branch has filed return of income for assessment year 2017-18 disclosing income of Rs. 50 lacs. It paid tax at the rate applicable to domestic company i.e. 30% plus education cess on the basis of paragraph 2 of Article 24 (Non-Discrimination) of the Double Taxation Avoidance Agreement between India and Mauritius, which reads as follows:

"The taxation on a permanent establishment which an enterprise of a Contracting State has in the other Contracting State shall not be less favourably levied in that other State than the taxation levied on enterprises of that other State carrying on the same activities in the same circumstances."

However, the Assessing Officer computed tax on the Indian branch at the rate applicable to a foreign company i.e. 40% plus education cess.

Is the action of the Assessing Officer in accordance with law?

Solution

- Under section 90(2), where the Central Government has entered into an agreement for avoidance of double taxation with the Government of any country outside India or specified territory outside India, as the case may be, 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 the assessee. Thus, in view of paragraph 2 of the Article 24 (Non-discrimination of the Double Taxation Avoidance Agreement (DTAA), it appears that the Indian branch of Cosmos Limited, incorporated in Mauritius, is liable to tax in India at the rate applicable to domestic company (30%), which is lower than the rate of tax applicable to a foreign company (40%).
- However, Explanation 1 to section 90 clarifies that the charge of tax in respect of a foreign company at a rate higher than the rate at which a domestic company is chargeable, shall not be regarded as less favourable charge or levy of tax in respect of such foreign company. Therefore, in view of this Explanation, the action of the Assessing Officer in levying tax@40% on the Indian branch of Cosmos Ltd. is in accordance with law.

Readers Note:

Practical 3

Arif is a resident of both India and another foreign country in the previous year 2017-18. He owns immovable properties (including residential house) in both the countries. He earned income of Rs. 50 lacs from rubber estates in the foreign country during the financial year 2017-18. He also sold some house property situated in foreign country resulting in short-term capital gain of Rs. 10 lacs during the year. Arif has no permanent establishment of business in India. However, he has derived rental income of Rs. 6 lacs from property let out in India and he has a house in Lucknow where he stays during his visit to India.

Article 4 of the Double Taxation Avoidance Agreement between India and the foreign country where Arif is a resident, provides that “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)”.

You are required to state with reasons whether the business income of Arif arising in foreign country and the capital gains in respect of sale of the property situated in foreign country can be taxed in India.

Solution

- Section 90(1) of the Income-tax Act, 1961 empowers the Central Government to enter into an agreement with the Government of any country outside India for avoidance of double taxation of income under the Indian law and the corresponding law of that country. 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.
- Arif has residential houses both in India and foreign country. Thus, he has a permanent home in both the countries. However, he has no permanent establishment of business in India. The Double Taxation Avoidance Agreement (DTAA) with foreign country 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.

  Arif owns rubber estates in a foreign country from which he derives business income. However, Arif has no permanent establishment of his business in India. Therefore his personal and economic relations with foreign country are closer, since foreign country is the place where –

  (a) the property is located and

  (b) the permanent establishment (PE) has been set-up

  Therefore, he shall be deemed to be resident of the foreign country for A.Y. 2018-19.
- The fact of the case and issues arising therefrom 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 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, Arif has to obtain a certificate [Tax Residency Certificate (TRC)] declaring his residence of the country outside India from the Government of that country. Further, he also has to provide such other documents and information, as may be prescribed.
- Therefore, in this case, Arif is not liable to income tax in India for A.Y. 2018-19 in respect of business income and capital gains arising in the foreign country provided he furnishes the Tax Residency Certificate and provides such other documents and information as may be prescribed.

Readers Note:

Question 4

Discuss various models of DTAA / Treaties an also types of DTAA

Answer

Models of DTAA

Tax treaties have been based on models such as:

- OECD model (Organisation of Economic CO-operation and Development)

- U.N. Models Double Taxation Convention between developed and developing countries, 1980.

Most of India's treaties are based on OECD models.

Types of DTAA

DTAA can be divided into following types:

(a) Limited agreements : They are generally entered into to avoid double taxation relating to income derived from operation of aircraft, ships, carriage of cargo and freight.

(b) Comprehensive agreements: They are executed in detail which lay down how incomes under various heads may be dealt with by the countries to the agreement.

Readers Note:

Question 5

Explain the term "Permanent Establishment" in accordance with Article 5(2) of Double Taxation Avoidance Agreements (DTAA).

Answer

Article 5(2) of the UN Model reads as follows:

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

Article 5(2) is inclusive and it contains an illustrative list of places which, prima facie, constitute a PE. The common thread in all these examples is that an enterprise can carry on business in State of Source through these establishments.

Readers Note:

Question 6

The concept of Permanent Establishment is one of the most important concepts in determining the tax implications of cross border transactions. Explain the significance thereof, when such transactions are governed by Double Taxation Avoidance Agreements (DTAA).

Answer

Double Taxation Avoidance Agreements (DTAAs) generally contain an Article providing that business income is taxable in the country of residence, unless the enterprise has a permanent establishment in the country of source, and such income can be attributed to the permanent establishment.

That means, if permanent establishment is in other country, then income attributed to that PE shall be taxed in that source country.

As per section 92F(iiia), the term "Permanent Establishment" includes a fixed place of business through which the business of an enterprise is wholly or partly carried on.

Section 9(1)(i) requires existence of business connection for deeming business income to accrue or arise in India. DTAAs however provide that business income is taxable only if there is a permanent establishment in India.

Therefore, in cases covered by DTAAs, where there is no permanent establishment in India, business income cannot be brought to tax due to existence of business connection as per section 9(1)(i).

However, in cases not covered by DTAAs, business income attributable to business connection is taxable.

Readers Note:

55.3 COUNTRIES WITH WHICH NO AGREEMENT EXISTS [UNILATERAL RELIEF]

Section:- 91

Unilateral relief under section 91 will be available, if the following conditions are satisfied:

1) The assessee in question must be resident in India.
2) That some income must have accrued or arisen to him outside India.
3) In respect of that income, the assessee must have paid by deduction or otherwise tax under the law in force in the foreign country in question in which the income outside India has arisen.
4) There shall be no reciprocal arrangement for relief or avoidance from double taxation with the said country.

If all the above conditions are satisfied, such person shall be entitled to deduction from the Indian income-tax payable by him of a sum calculated on such doubly taxed income at the Indian rate of tax or the rate of tax of the said (other) country, whichever is the lower or at the Indian rate of tax if both the rates are equal.

Indian rate of tax means the tax payable on total income divided by the total income.

Rate of tax of other country means income tax and super tax actually paid in that country in accordance with the corresponding laws in force in that country after deduction of all relief due,divided by the whole amount of income as assessed in that country.

As per section 91(2) the unilateral relief is also available in respect of agricultural income in Pakistan on which income-tax is levied in India and income-tax is levied in Pakistan on such agricultural income.

Judicial Rulings

Unilateral Relief under this section is available only in respect of doubly taxed income i.e. that part of income which is included in the total income of assessee. [CIT vs. Dr. R.N. Jhanji 185 ITR 586 (Raj)]

Average foreign tax rate shall be worked out for each foreign country separately and not on aggregate basis, if more than one foreign country's income is involved. [CIT vs. Bombay Burmah Trading Corporation Ltd. 259 ITR 423 (Bom.)]

Practical 7

Nandita, an individual resident retired employee of the Prasar Bharati aged 60 years, is a well-known dramatist deriving income of Rs. 1,10,000 from theatrical works played abroad. Tax of Rs. 11,000 was deducted in the country where the plays were performed. India does not have any Double Tax Avoidance Agreement under section 90 of the Income-tax Act, 1961, with that country. Her income in India amounted to Rs. 5,10,000. In view of tax planning, she has deposited Rs. 1,50,000 in Public Provident Fund and paid contribution to approved Pension Fund of LIC Rs. 32,000. She also contributed Rs. 28,000 to Central Government Health Scheme during the previous year and gave payment of

medical insurance premium of Rs. 26,000 to insure the health of her father, a non-resident aged 84 years, who is not dependent on her. Compute the tax liability of Nandita for the A.Y. **2018-19**.

Solution

Computation of tax liability of Nandita for the A.Y. 2018-19

Particulars	Rs.	Rs.
Indian Income		5,10,000
Foreign Income		1,10,000
Gross Total Income		6,20,000
Less: <u>Deduction under section 80C</u>		
Deposit in PPF	1,50,000	
<u>Under section 80CCC</u>		
Contribution to approved Pension Fund of LIC	32,000	
<u>Under section 80CCE</u>		
The aggregate deduction under section 80C, 80CCC and 80CCD(1) has to be restricted to Rs. 1,50,000	1,50,000	
<u>Under section 80D</u>		
Contribution to Central Government Health Scheme Rs. 28,000 is also allowable as deduction u/s section 80D. Since she is a resident senior citizen, the deduction is allowable to a maximum of Rs. 30,000.	28,000	
Medical insurance premium of Rs. 26,000 paid for father aged 84 years. Since the father is a non-resident in India, he will not be entitled for the higher deduction of Rs. 30,000 eligible for a senior citizen, who is resident in India. Hence, the deduction will be restricted to maximum of Rs. 25,000.	25,000	2,03,000
Total Income		**4,17,000**
Tax on Total Income		
Income-tax	5,850	
Less: Rebate u/s 87A	Nil	
	5,850	
Add : Education cess @ 2%	117	
Add: SHEC @ 1%	59	6,026
Average rate of tax in India (i.e. Rs. 6,026/ Rs. 4,17,000 × 100) 1.45%		
Average rate of tax in foreign country (i.e. Rs. 11,000/ Rs. 1,10,000 ×100) 10%		
Rebate under section 91 on Rs. 1,10,000 @ 1.45% (lower of average Indian-tax rate or average foreign tax rate)		(1,595)
Tax payable in India		4,431

Readers Note:

Practical 8

Mr. Kamesh, 45 years, resident in India furnishes you the following particulars of income earned in India, Country "X" and Country "Y" for the previous year **2017-18**. India has not entered into double taxation avoidance agreement with these two countries.

Particulars	Rs.
Income from profession carried on in India	7,50,000
Agricultural income in Country "X" (gross)	50,000
Dividend received from a company incorporated in Country "Y" (gross)	1,50,000
Royalty income from a literary book from Country "X" (gross)	6,00,000
Expenses incurred for earning royalty	50,000
Business loss in Country "Y" (Proprietary business)	65,000
Rent from a house situated in Country "Y" (gross)	2,40,000
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 10% & 25%, respectively. Royalty earned from Country "X" has been brought into India in convertible foreign exchange within a period of 6 months from the end of the previous year. Compute total income & tax payable by Mr. Kamesh in India for **A.Y. 18-19**.

Solution

Computation of total income of Mr. Kamesh for A.Y.2018-19

Particulars	Rs.	Rs.
Income from House Property [House situated in country Y]		
Gross Annual Value	2,40,000	
Less: Municipal taxes (assumed as paid in that country)	10,000	
Net Annual Value	2,30,000	
Less: Deduction under section 24 – 30% of NAV	69,000	
Income from House Property [A]		**1,61,000**
Profits and Gains of Business or Profession		
Income from profession carried on in India	7,50,000	
Less: Business loss in country Y set-off	65,000	
Profits and Gains of Business or Profession [B]		**6,85,000**
Income from Other Sources		
Agricultural income in country X	50,000	
Dividend received from a company in country Y	1,50,000	
Royalty income from a literary book from Country X (after deducting expenses of Rs. 50,000)	5,50,000	
Income from Other Sources [C]		**7,50,000**
Gross Total Income [A + B + C]		**15,96,000**
Less: Deduction under Chapter VIA		
Under section 80QQB – Royalty income of a resident from literary work		3,00,000
Total Income		**12,96,000**

Computation of tax liability of Mr. Kamesh for A.Y.2018-19

Particulars	Rs.
Tax on total income [30% of Rs. 2,96,000 + Rs.1,12,000]	2,01,300
Add: Education cess@2%	4,026
Secondary and higher education cess @ 1%	2,013
	2,07,339
Less: Rebate under section 91 (See Working Note below)	69,360
Tax Payable	**1,37,979**
Tax payable (rounded off)	**1,37,980**

Working Note: Calculation of Rebate under section 91

Particulars	Rs.	Rs.
Average rate of tax in India [i.e., Rs. 2,07,339 / Rs. 12,96,000 x 100]	16%	
Average rate of tax in country X	10%	
Doubly taxed income pertaining to country X		
Agricultural Income	50,000	
Royalty Income [Rs. 6,00,000 – Rs. 50,000 (Expenses) – Rs. 3,00,000 (deduction under section 80QQB)]	2,50,000	
	3,00,000	
Rebate under section 91 on Rs. 3,00,000 @10% [being the lower of average Indian tax rate (16%) and foreign tax rate (10%)]		30,000
Average rate of tax in country Y	25%	
Doubly taxed income pertaining to country Y		
Income from house property	1,61,000	
Dividend	1,50,000	
	3,11,000	
Less: Business loss set-off	65,000	
	2,46,000	
Rebate under section 91 on Rs. 2,46,000 @16% (being the lower of average Indian tax rate (16%) and foreign tax rate (25%)]		39,360
Total rebate under section 91 (Country X + Country Y)		69,360

Notes:

(1) Rental Income has been taken as GAV in the absence of other information relating to fair rent, municipal value etc.

(2) Doubly taxed income includes only that part of income which is included in the assessee's total income.– CIT v. Dr. R.N. Jhanji (1990) 185 ITR 586 (Raj.).

(3) Average foreign tax rate shall be worked out for each foreign country separately and not on aggregate basis, if more than one foreign country's income is involved. [CIT vs. Bombay Burmah Trading Corporation Ltd. 259 ITR 423 (Bom.)]

Readers Note:

55.4 ADOPTION BY CENTRAL GOVERNMENT OF AGREEMENTS BETWEEN SPECIFIED ASSOCIATION FOR DOUBLE TAXATION RELIEF

Section:- 90A

Section 90A provides for the following:-

1. There is a specified association in India
2. It enters into an agreement with any specified association in a specified territory outside India
3. The Central Government may, by notification in the Official Gazette, make the necessary provisions for adopting and implementing such agreement-
   (a) for grant of double taxation relief, for avoidance of double taxation;
   (b) for exchange of information for the prevention of evasion or avoidance of Income Tax;
   (c) for recovery of income-tax.
4. In relation to any assessee to whom the said agreements applies, the provisions of the Income Tax Act shall apply to the extent they are more beneficial to the assessee.

Question 9

Indian company would like to import manufacturing technology under foreign collaboration. Advise Indian company with regard to the care to be exercised from the perspective of Income Tax Act while entering into such foreign collaboration.

Answer

Readers Note:

56 – ADVANCE RULINGS

56.1 MEANING OF ADVANCE RULING AND RESTRICTIONS ON APPLICATION

Section:- 245N and 245R(2)

Who Can Apply?	Advance 'ruling' means –	Circumstances in which Authority (AAR) will not allow the application
A non-resident who has undertaken or proposes to undertake a transaction;	a determination by the Authority in relation to a transaction which has been undertaken or is proposed to be undertaken by a non-resident applicant; and such determination shall include the determination of any question of law or of fact specified in the application; or	where the question raised in the application: (a) is already pending before any income-tax authority, the ITAT or any court (b) involves determination of fair market value of any property (c) relates to a transaction which is designed *prima facie* for the avoidance of income-tax
A resident who has undertaken or proposes to undertake a transaction with a non-resident	a determination by the Authority in relation to the tax liability of a non-resident arising out of a transaction which has been undertaken or is proposed to be undertaken by a resident applicant with a non-resident, and such determination shall include the determination of any question of law or of fact specified in the application; or	where the question raised in the application: (a) is already pending before any income-tax authority, the ITAT or any court (b) involves determination of fair market value of any property (c) relates to a transaction which is designed *prima facie* for the avoidance of income-tax
A resident falling within notified class or category **Notified Resident means** a resident, who has undertaken or proposed to be undertaken one or more transactions valuing rupees one hundred crore or more in total. **[Notification 73/ 2014]**	a determination by the Authority in relation to the tax liability of a resident arising out of a transaction which has been undertaken or is proposed to be undertaken by a such applicant, and such determination shall include the determination of any question of law or of fact specified in the application;	where the question raised in the application: (a) is already pending before any income-tax authority, the ITAT or any court (b) involves determination of fair market value of any property (c) relates to a transaction which is designed *prima facie* for the avoidance of income-tax

A resident falling within notified class or category of persons. (PSU)	a determination or decision by the Authority in respect of an issue relating to computation of total income which is pending before any income-tax authority or the Appellate Tribunal and such determination or decision shall include the determination or decision of any question of law or of fact relating to such computation of total income specified in the application.	where the question raised in the application: (a) is already pending before any court (b) involves determination of fair market value of any property

Practical 1

If applicant is non-resident then with reference to which previous year, his status shall be determined for the purpose of making an application to AAR?

Solution

AAR-New Delhi, while dealing with the above issue in case of **Robert W. Smith v. CIT [1994]** made following observation:

It cannot be the "previous year" in which the application is made for an application may be made very early in a financial year and may even have to be disposed of long before the end of the financial year. In such cases, the full picture of the applicant's stay in India during the previous year may not be always available by the date of the application or even by the date of its disposal by the authority.

The only "previous year" with reference to which the status of the applicant is determinable for purpose of section 245N, must be the "previous year" preceding the financial year in which the application is made.

Readers Note:

Practical 2

AAR will not allow application where the question raised in the application is already pending before any income-tax authority, the ITAT or any court. In this context, how to interpret the word "already pending"?

Solution

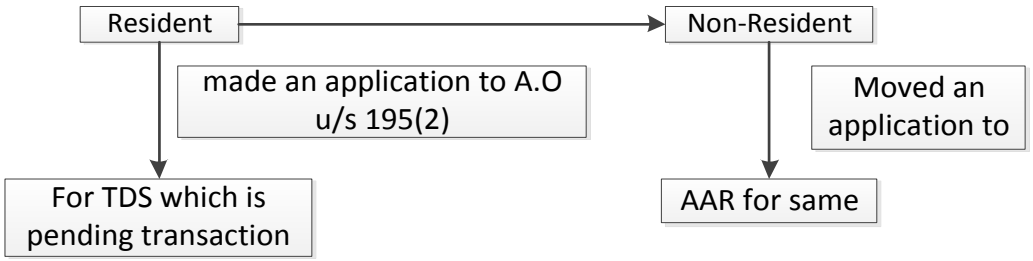
AAR-New Delhi, while dealing with the above issue in case of **Monte Harris v. CIT [1995]** made following observation:

The words "already pending", shall be interpreted to mean pending as on the date of the application.

Readers Note:

Practical 3

A foreign company entered into contracts with several Indian companies for installation of mobile telephone system and made an application to the Authority for Advance Rulings for advance ruling on the rate of withholding tax on receipts from Indian companies. One of the Indian companies had also made an application to the Assessing Officer under section 195(2) of the Act, for determination of the rate at which tax is deductible on payment to the said foreign company. The Authority for Advance Rulings rejected the application of the foreign company on the ground that the question raised in the application is already pending before an income tax authority. Is the rejection of the application of the foreign company justified in law?



Solution

- In the above case, no application had been filed by the applicant (foreign company) before any income-tax authority/Appellate Tribunal/court, raising the question raised in the application filed with AAR.
- One of the Indian companies, however, had raised the question before the Assessing Officer, not on the applicant's behalf or with a view to benefit the applicant, but only to safeguard its own interest, as it had a statutory duty to deduct the proper amount of tax from payments made to a non-resident under section 195(2) of the Act. Although the question raised pertains to one of the payments made or to be made to the non-resident applicant, it was not one pending determination before any income-tax authority in the applicant's case.
- Therefore, as held by the AAR in Ericsson Telephone Corporation India **AB v. CIT (1997) 224 ITR 203,** the application filed by the Indian company before the Assessing Officer cannot be treated to have been filed by applicant (foreign company).
- Hence, it would not be proper to reject the application of the foreign company.

Readers Note:

Practical 4

Give the instance of a transaction prima facie held to be for the avoidance of income-tax for the purpose of this chapter.

Solution

AAR-New Delhi in case of X. Ltd. [1996] not allowed the application of companies which were fully-owned subsidiaries of British Company and were residents of Mauritius and made investments in shares in an Indian bank because the purpose of investment by British company through applicant-companies instead of directly, was found to be for avoidance of tax.

Readers Note:

56.2 APPLICATION FOR ADVANCE RULING

Section:- 245Q

- 4 copies of application in such form and manner as may be prescribed stating question on which the advance ruling is sought.
- Application shall be accompanied by a fee of Rs. 10,000 or such fee as may be prescribed, whichever is higher.
- Application may be withdrawn by the applicant within 30 days from the date of the application.

Filing fees before AAR:- Notification No. 74/ 2014

Category of applicant	Category of case	Fee (Rs)
Public Sector Undertaking (PSU)	All Cases	10,000
Other Applicants	Amount of one or more transaction, entered into or proposed to be undertaken, in respect of which ruling is sought does not exceed Rs. 100 crore.	2,00,000
	Amount of one or more transaction, entered into or proposed to be undertaken, in respect of which ruling is sought exceeds Rs. 100 crore but does not exceed Rs. 300 crore.	5,00,000
	Amount of one or more transaction, entered into or proposed to be undertaken, in respect of which ruling is sought exceeds Rs. 300 crore.	10,00,000

Practical 5

Janeman Limited, an Indian company would like to enter transaction valuing Rs. 85 crore with Jackson Inc, US Company. Janenman Limited would like to seek advance ruling for its tax liability arising out of this transaction. Whether Janeman Limited can approach Authority of Advance Ruling (AAR)?

What would have been your answer, if value of proposed transaction is Rs. 185 Crore? What would be the filing fees for approaching AAR?

Solution

As per amendment made by Finance Act, 2014 read with rules, Resident can seek advance ruling for its tax liability if value of one or more transactions exceeds Rs. 100 crore. But in the given case, value of proposed transaction is Rs. 85 crore only, therefore, Janeman Limited, an Indian company cannot seek advance ruling for its tax liability.

If value of proposed transaction is Rs. 185 crore, then Janeman Limited is eligible to seek advance ruling for its tax liability. For that purpose, it has to pay fees Rs. 5,00,0000 along with application in a prescribed form.

Readers Note:

Practical 6

Q, a non-resident, made an application to the Authority for Advance Rulings on **2.7.2017** in relation to a transaction proposed to be undertaken by him. On **31.8.2017**, he decides to withdraw the said application. Can he withdraw the application on **31.8.2017**?

Solution

Section 245Q(3) Act provides that an applicant may withdraw the application within 30 days from the date of the application. In the present case, more than 30 days have elapsed since the date of application by Q to the AAR, he cannot withdraw the application.

However**, AAR, in M.K.Jain AAR No.644 of 2004,** has observed that section 245Q(3) does not preclude the AAR from permitting withdrawal of the application after the period of 30 days, if the circumstances of the case so justify.

Readers Note:

56.3 PROCEDURE ON RECEIPT OF APPLICATION

Section:- 245R

- On receipt of an application, the Authority shall forward a copy thereof to the Principal Commissioner or Commissioner and, if necessary, call upon him to furnish the relevant records.
- The Authority may, after examining the application and the records called for, by order, either allow or reject the application.
- However, no application shall be rejected unless an opportunity has been given to the applicant of being heard. Further, where the application is rejected, reasons for such rejection shall be given in the order.
- A copy of every order rejecting application shall be sent to the applicant and to the Principal Commissioner or Commissioner.
- Where an application is allowed, the Authority shall, after examining such further material as may be placed before it by the applicant or obtained by the Authority, pronounce its advance ruling on the question specified in the application.
- On a request received from the applicant, the Authority shall, before pronouncing its advance ruling, provide an opportunity to the applicant of being heard, either in person or through a duly authorised representative.
- The Authority shall pronounce its advance ruling in writing within six months of the receipt of application.
- A copy of the advance ruling pronounced by the Authority, duly signed by the Members and certified in the prescribed manner shall be sent to the applicant and to the Principal Commissioner or Commissioner.

56.4 APPELLATE AUTHORITY NOT TO PROCEED IN CERTAIN CASES.

Section:- 245RR

No income-tax authority or the Appellate Tribunal shall proceed to decide any issue in respect of which an application has been made by a resident applicant under section 245Q (1).

56.5 APPLICABILITY OF ADVANCE RULING.

Section:- 245S

- The advance ruling pronounced by the Authority shall be binding only—
  (a) on the applicant who had sought it;
  (b) in respect of the transaction in relation to which the ruling had been sought; and
  (c) on the Principal Commissioner or Commissioner, and the income-tax authorities subordinate to him, in respect of the applicant and the said transaction.
- The advance ruling shall continue to be binding as aforesaid unless there is a change in law or facts on the basis of which the advance ruling has been pronounced.

Practical 7

Mr. Balram is a non-resident. The appeal pertaining to the assessment year **2015-16** is pending before the Income-tax Appellate Tribunal, the issue involved being computation of export profit and tax thereon. The same issue persists for the assessment year **2016-17** as well. Mr. Balram's brother Mr. Krishna has obtained an advance ruling under Chapter XIX – B of Income-tax Act, 1961 from the Authority for Advance Ruling on an identical issue. Mr. Balram proposes to use the said ruling for his assessment pertaining to the assessment year **2016-17**. Can he do so?

Solution

- As discussed earlier, the advance ruling pronounced by the AAR shall be binding only on the applicant who had sought it and in respect of the specific 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 said transaction.
- In view of the above provision, Mr. Balram cannot use the advance ruling, obtained on an identical issue by his brother, for his assessment pertaining to the assessment year **2016-17.**
- Though the ruling of the Authority for Advance Rulings is not binding on others but there is no bar on the Tribunal for assessment year **2015-16** taking a view in consonance with the reasoning of the Authority for Advance Rulings. **[CIT v. P. Sekar Trust (2010) 321 ITR 305 (Mad.)].**

Readers Note:

56.6 ADVANCE RULING TO BE VOID IN CERTAIN CIRCUMSTANCES.

Section:- 245T

- Where the Authority finds, on a representation made to it by the Principal Commissioner or Commissioner or otherwise, that an advance ruling pronounced by it has been obtained by the applicant by fraud or misrepresentation of facts, it may, by order, declare such ruling to be void *ab initio* and thereupon all the provisions of this Act shall apply to the applicant as if such advance ruling had never been made.
- A copy of such order shall be sent to the applicant and the Principal Commissioner or Commissioner.

56.7 POWERS OF AUTHORITY

Section:- 245U

- The Authority shall have all the powers of a civil court under the Code of Civil Procedure, 1908.
- The Authority shall be deemed to be a civil court for the purposes of section 195 of the Code of Criminal Procedure, 1973 and every proceeding before the Authority shall be deemed to be a judicial proceeding within the meaning of sections 193 and 228, and for the purpose of section 196, of the Indian Penal Code.

56.8 PROCEDURES OF AUTHORITY

Section:- 245U

The Authority shall have power to regulate its own procedure in all matters arising out of the exercise of its powers under this Act.

56.9 CONSTITUTION OF AUTHORITY OF ADVANCE RULING

Section:- 245-O

Section 245-O has been amended with effect from October 1, 2014. The amended provisions are given below

1. The Central Government shall constitute an Authority for giving advance rulings, to be known as "Authority for Advance Rulings".

2. The Authority shall consist of a Chairman and such number of Vice-chairmen, Revenue Members and Law Members as the Central Government may by notifications appoint.

3. A person shall be qualified for appointment as –

Chairman	Who has been a Judge of the Supreme Court or the Chief Justice of a High Court or at least seven years a Judge of a High Court
Vice-Chairman	Who has been Judge of a High Court
Revenue Member	(i) From the Indian Revenue Service, who is, or is qualified to be, a Member of the Board, (ii) From the Indian Customs and Central Excise Service, who is, or is qualified to be, a Member of Central Board of Excise and Customs, on the date of occurrence of a vacancy.
Law Member	From the Indian Legal Service, who is, *or is qualified to be*, an Additional Secretary to the Government of India on the date of occurrence of a vacancy.

4. The terms and conditions of service and the salaries and allowances payable to the Members shall be such as may be prescribed.

5. The Central Government shall provide to the Authority with such officers and employees, as may be necessary, for the efficient discharge of the functions of the Authority under the Act.

6. The powers and functions of the Authority may be discharged by its Benches as may be constituted by the Chairman from amongst the Members thereof.

7. In the event of the occurrence of any vacancy in the office of the Chairman by reason of his death, resignation or otherwise, the senior-most Vice-chairman shall act as the Chairman until the date on which a new Chairman, appointed in accordance with the provisions of this Act to fill such vacancy, enters upon his office.

8. In case the Chairman is unable to discharge his functions owing to absence, illness or any other cause, the senior-most Vice-Chairman shall discharge the functions of the Chairman until the date on which the Chairman resumes his duties.]

9. A Bench shall consist of the Chairman or the Vice-chairman and one revenue Member and one law Member.

The Authority shall be located in the National Capital Territory of Delhi and its Benches shall be located at such places as the Central Government may, by notification specify.

57 – TRANSFER PRICING AND OTHER ANTI-AVOIDANCE MEASURES

UNIT A – INTERNATIONAL TRANSACTIONS

57.1 OBJECTIVE OF INTRODUCING CHAPTER-X:- KNOWN AS: "TRANSFER PRICING"

- There is a possibility that two or more entities belonging to the same multinational group can fix up their prices for goods and services and allocate profits among the enterprises within the group in such a way that there may be either no profit or negligible profit in the jurisdiction which taxes such profits and substantial profit in the jurisdiction which is tax haven or where the tax liability is minimum. This may adversely affect a country's share of due revenue.

- The increasing participation of multinational groups in economic activities in India has given rise to new and complex issues emerging from transactions entered into between two or more enterprises belonging to the same multinational group. The profits derived by such enterprises carrying on business in India can be controlled by the multinational group, by manipulating the prices charged and paid in such intra-group transactions, which may lead to erosion of tax revenue.

- As a result Government set up an Expert Group to examine the issues relating to transfer pricing. As an outcome, transfer pricing provisions have been brought in by the Finance Act, 2001 with a view to provide a statutory framework which can lead to computation of reasonable, fair and equitable profits and tax in India, in the case of such multinational enterprises.

- With effect from assessment year 2013-14, section 92BA has been inserted to extend applicability of transfer pricing to specified domestic transactions also.

57.2 CONDITIONS FOR APPLICABILITY OF ARM'S LENGTH PRICE IN THE INTERNATIONAL TRANSACTION

Section:- 92A, 92B and 92F (iii)

(1) Condition 1: There must be two or more enterprise.

Meaning of Enterprise [Section 92F(iii)]

Enterprise means a person(including permanent establishment) who engages or has been engaged or proposed to engage in the following activities:

(a) Any activity relating to the production, storage, supply, distribution, acquisition or control of articles or goods:

(b) Know-how, patents, copyrights, trade-marks, licenses, franchises or any other business or commercial rights of similar nature or any data, documentation, drawing or specification relating to any patent, invention, model, design, secret formula or process, of which the other enterprise is the owner or in respect of which the other enterprise has exclusive rights:

(c) Any activity relating to the provision of services of any kind:

(d) Carrying out any work in pursuance of a contract (e.g. construction contract).

(e) Investment activity:

(f) Activity relating to provision of loan

(g) Business of acquiring, holding, underwriting or dealing with shares, debenture or other securities of any body corporate.

A person would be an enterprise irrespective of the fact that it carries on the abovementioned activity or business directly or through one or more of its units or divisions or subsidiaries.

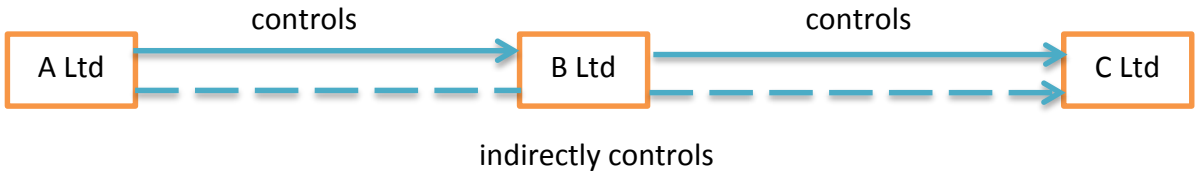
(2) Condition 2: Enterprises must be an Associated Enterprises [Section 92A]

- One enterprise would be regarded an associated enterprise of another, if-

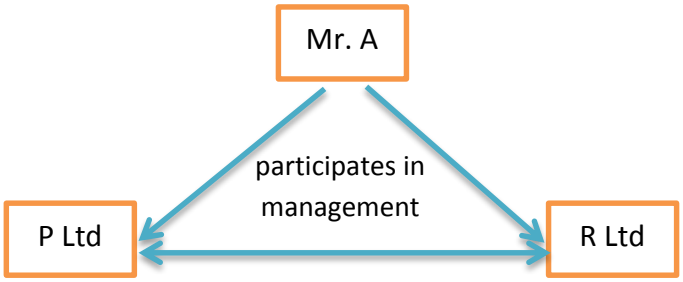
a. it participates, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise; or

Example of "Direct Participation"

Example of "Indirect Participation"



b. in respect of it one or more persons who participate, directly or indirectly, or through one or more intermediaries, in its management or control or capital, are the same persons who participate, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise.



- **Deemed Associated Enterprises**

For the purpose of this section, two enterprises shall be deemed to be associated enterprises if, at any time during the previous year:-

(i) Voting power criteria

One enterprise holds, directly or indirectly, shares carrying not less than twenty-six per cent of the voting power in the other enterprise.

E.g.: PQR INC. holds 26% voting power in ABC Private Ltd., then PQR INC. and ABC Private Ltd. are deemed to be associated enterprise.

(ii) Voting power by common person criteria

Any person or enterprise holds, directly or indirectly, shares carrying not less than twenty-six percent of the voting power in each of such enterprises.

E.g.: Mr. A holds 26% of shareholding in both Kharate Sofware Private Ltd. and Milan Softech INC., then Kharate Software and Milan Softech INC. are deemed to be associated enterprise.

(iii) Loan criteria

A loan advanced by one enterprise to the other enterprise constitutes not less than fifty-one percent of the book value of the total assets of the other enterprise.

E.g.: Book value of total assets of Indian Company is Rs.100 crores. The loan given by Foreign Company to such Indian Company is Rs. 55 crores, then Indian Company and Foreign Company are deemed to be associated enterprise.

(iv) Guarantor criteria

One enterprise guarantees not less than ten percent of the total borrowings of the other enterprise.

E.g.: Indian company raised borrowing from various Banks. Total borrowing raised by the Indian company was Rs. 50 crores, of which Rs. 12 crore (from SBI) was guaranteed by Foreign Company, then Indian Company and Foreign Company are deemed to be associated enterprise.

(v) Appointment in board of directors by other enterprise

More than half of the board of directors or members of the governing board, or one or more of the executive directors or executive members of the governing board of one enterprise, are appointed by the other enterprise.

E.g.: Foreign Company has seven directors on its Board. Out of that, Indian company has appointed 4 directors. In such case, Foreign Company and Indian Company are deemed to be associated enterprise.

(vi) Appointment in board of directors of two different enterprises by common person

More than half of the board of directors or members of the governing board, or one or more of the executive directors or members of the governing board, of each of the two enterprises are appointed by the same person or persons.

E.g. Mr. A appointed 4 directors out of 7 directors of ABC Ltd. and appointed one executive director on the board of PQR Ltd. In such case, ABC Ltd. and PQR Ltd. are deemed to be associated enterprise since a common person i.e. Mr. A appointed more than half of the directors in ABC Ltd. and appointed one executive director in PQR Ltd.

(vii) Dependence on Intangibles

The manufacture or processing of goods or articles or business carried out by one enterprise is wholly dependent on the use of know-how, patents, copyrights, trade-marks, licences, franchises or any other business or commercial rights of similar nature, or any

data, documentation, drawing or specification relating to any patent, invention, model, design, secret formula or process, of which the other enterprise is the owner or in respect of which the other enterprise has exclusive rights.

(viii) Dependence on raw material supply in manufacturing process

Ninety percent or more of the raw materials and consumables required for the manufacture or processing of goods or articles carried out by one enterprise, are supplied by the other enterprise, or by persons specified by the other enterprise, and the prices and other conditions relating to the supply are influenced by such other enterprise.

There are two situations dealt with in this clause and they are as follows:

90% or more of the raw materials and consumables required for manufacturing or processing of goods or articles carried out by one enterprise (say enterprise, A) are supplied

(i) by the other enterprise (say enterprise B),

(ii) by the person (say enterprise C) specified by the enterprise B,

and

the prices and other conditions relating to supply are influenced by the enterprise B, then enterprise A and enterprise B shall be deemed to be the associated enterprise.

(ix) Dependence on sale

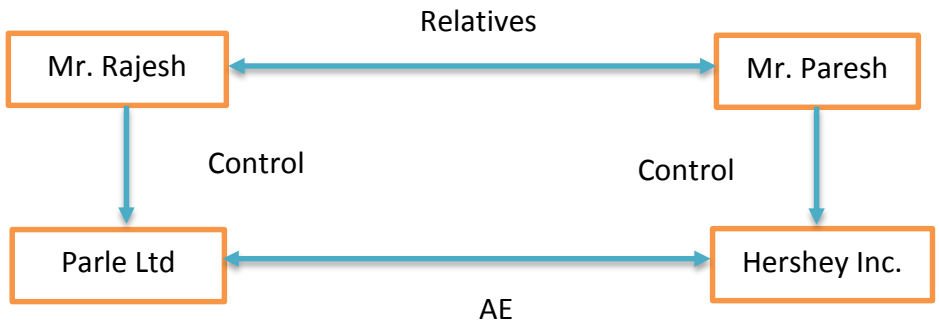
The goods or articles manufactured or processed by one enterprise, are sold to the other enterprise or to persons specified by the other enterprise and the prices and other conditions relating thereto are influenced by such other enterprise.

While in clause (viii), a minimum criteria of 90% has been mentioned, no such quantification has been done in clause (ix). This clause covers only sale of goods manufactured or processed and not the sale of traded goods.

(x) Individual Control:

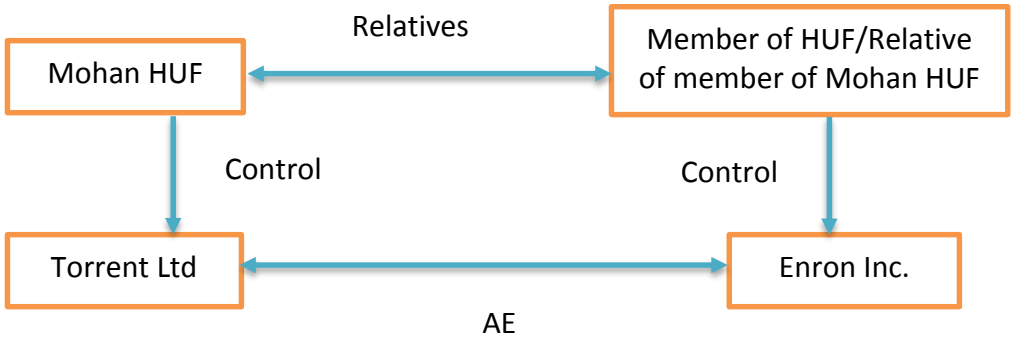
Where one enterprise is controlled by an individual, the other enterprise is also controlled by such individual or his relative or jointly by such individual and relative of such individual.

E.g. Mr. Rajesh has 36% voting power in Parle Ltd. while his brother Mr. Paresh has 40% voting power in Hershey Inc. Then, Parle Ltd. and Hershey Inc. shall be deemed to be associated enterprise.



(xi) Control by Hindu Undivided Family (HUF)

Where one enterprise is controlled by a Hindu undivided family, the other enterprise is controlled by a member of such Hindu undivided family, or by a relative of a member of such Hindu undivided family, or jointly by such member and his relative.



(xii) Holding in a firm, association of persons or body of individuals

where one enterprise is a firm, association of persons or body of individuals the other enterprise holds not less than ten percent interest in such firm, association of persons or body of individuals.

(xiii) Mutual interest relationship

There exists between the two enterprises, any relationship of mutual interest, as may be prescribed.

(3) Condition 3: International Transaction should be carried out by the Associated Enterprises [Section 92B]

- **Meaning of International Transaction**

An international transaction means following transaction(s) between two or more associated enterprises where, either or both of whom are non-residents:-

1. A transaction in nature of (a) purchase, sale or lease of intangible property or (b) provision of services or (c) lending or borrowing money.
2. A transaction having a bearing on the profits, income, losses or assets of such associated enterprises.
3. A transaction having mutual agreement or arrangement between two or more associated enterprises for (a) allocation or appointment of, or (b) contributing to, any cost or expense incurred (or to be incurred) regarding a benefit, service or facility provided (or to be provided) to any one or more of such associated enterprise.

- **Deemed International Transaction**

Section 92B(2) provides that a transaction entered into by an enterprise with a person other than an associated enterprise shall, for the purposes of sub-section (1), be deemed to be a transaction entered into between two associated enterprises subject to fulfilment of certain conditions. Refer following practical for detailed understanding of "Deemed international transaction".

Practical 1

On 10/06/2016, A Ltd., a resident entity has entered into an agreement for sale of goods with PQR Ltd., another resident entity but unrelated to A Ltd.

PQR Ltd. had already entered into an agreement (prior agreement) for the sale of same goods to C Inc. (unrelated to PQR Ltd.), a non-resident entity.

For the purpose of chapter "Transfer Pricing", C Inc. and A Ltd. are associated enterprises.

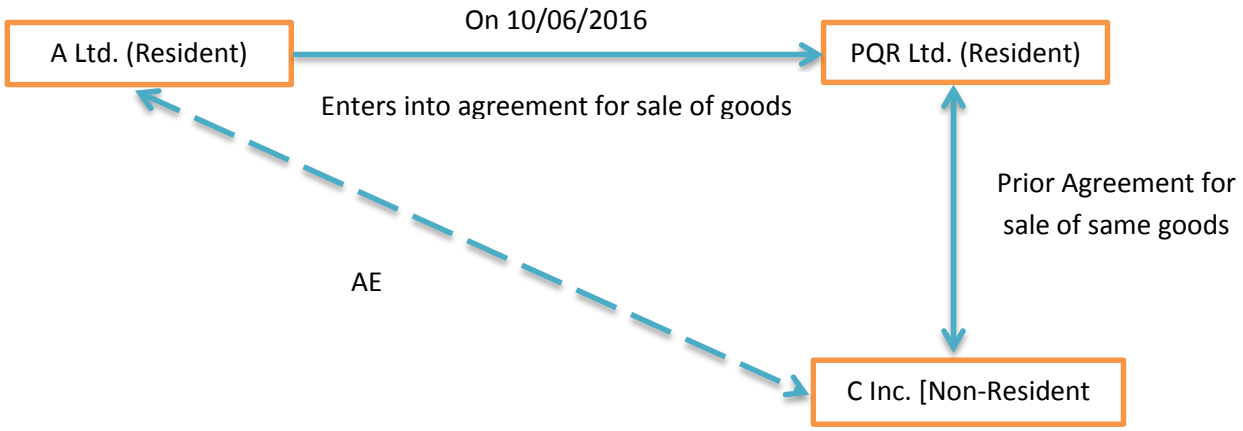
A Ltd. claims that provisions of "transfer pricing" shall not be applicable to it because of following grounds:

(i) A Ltd. and PQR Ltd. are not associated enterprises

(ii) Since A Ltd. and PQR Ltd. both are residents therefore transaction entered into by them is not an international transaction.

Verify the contention of A Ltd.

Solution



On close reading of section 92B(2), a transaction **(i.e. sale of goods)** entered into by an enterprise **(i.e. by A Ltd.)** with a person other than an associated enterprise **(i.e. with PQR Ltd.)** shall be deemed to be a transaction entered into between two associated enterprises, if there exists a prior agreement in relation to the relevant transaction between such other person (**i.e. there is a prior agreement of PQR Ltd**.) and the associated enterprise (**i.e. with C Inc.)** , whether such other person is a non-resident or not **(i.e. whether PQR Ltd. is a non-resident or not).**

Therefore, considering the provisions of section 92B(2), A Ltd. is deemed to have entered into an international transaction with PQR Ltd and therefore, it is subject to transfer pricing regulations.

Readers Note:

- **Explanation to Section 92B**

  Section 92B has been amended with retrospective effect from the assessment year 2002-03, to clarify that "international transaction" shall include—

  (a) the purchase, sale, transfer, lease or use of **tangible property** including building, transportation vehicle, machinery, equipment, tools, plant, furniture, commodity or any other article, product or thing;

  (b) the purchase, sale, transfer, lease or use of **intangible property**, including the transfer of ownership or the provision of use of rights regarding land use, copyrights, patents,

trademarks, licences, franchises, customer list, marketing channel, brand, commercial secret, know-how, industrial property right, exterior design or practical and new design or any other business or commercial rights of similar nature;

(c) capital financing, including any type of long-term or short-term **borrowing, lending** or guarantee, purchase or sale of marketable securities or any type of advance, payments or deferred payment or receivable or any other debt arising during the course of business;

(d) provision of services, including provision of market research, market development, marketing management, administration, technical service, repairs, design, consultation, agency, scientific research, legal or accounting service;

(e) a transaction of **business restructuring or reorganisation**, entered into by an enterprise with an associated enterprise, irrespective of the fact that it has bearing on the profit, income, losses or assets of such enterprises at the time of the transaction or at any future date;

- **Meaning of Intangible property**

  Further, the expression "intangible property" shall include for the aforesaid purpose the following:-

  (a) marketing related intangible assets, such as, trademarks, trade names, brand names, logos;

  (b) technology related intangible assets, such as, process patents, patent applications, technical documentation such as laboratory notebooks, technical know-how;

  (c) artistic related intangible assets, such as, literary works and copyrights, musical compositions, copyrights, maps, engravings;

  (d) data processing related intangible assets, such as, proprietary computer software, software copyrights, automated databases, and integrated circuit masks and masters;

  (e) engineering related intangible assets, such as, industrial design, product patents, trade secrets, engineering drawing and schema-tics, blueprints, proprietary documentation;

  (f) customer related intangible assets, such as, customer lists, customer contracts, customer relationship, open purchase orders;

  (g) contract related intangible assets, such as, favourable supplier, contracts, licence agreements, franchise agreements, non-compete agreements;

  (h) human capital related intangible assets, such as, trained and organised work force, employment agreements, union contracts;

  (i) location related intangible assets, such as, leasehold interest, mineral exploitation rights, easements, air rights, water rights;

  (j) goodwill related intangible assets, such as, institutional goodwill, professional practice goodwill, personal goodwill of professional, celebrity goodwill, general business going concern value;

  (k) methods, programmes, systems, procedures, campaigns, surveys, studies, forecasts, estimates, customer lists, or technical data;

  (l) any other similar item that derives its value from its intellectual content rather than its physical attributes.

57.3 DETERMINATION OF THE ARM'S LENGTH PRICE

Section:- 92C and 92F(iii)

- **If conditions mentioned in Para 2 are satisfied, then**
  (a) any income arising from an international transaction shall be computed having regard to arm's length price.
  (b) Allowance for any expense or interest arising from international transaction shall also be determined having regard to arm's length price.

- **Meaning of Arm's length price [section 92 F(iii)]**
  Arm's length price is the price which is applied or proposed to be applied in a transaction between persons other than associated enterprises, in uncontrolled conditions.
  Therefore, following three elements of arm's length price are:
  (a) The price which is applied or proposed to be applied in a transaction;
  (b) The transaction is taking place between persons other than associated enterprises; and
  (c) The transaction is taking place in an uncontrolled conditions.

- **Methods relevant for determination of Arm's Length Price [Section 92 C(1)]**
  The arm's length price shall be determined by any of the following methods, being the most appropriate method, having regard to (a) nature of transactions (b) class of associated persons (c) functions performed by associated persons (d) other factors as the Board may prescribe.
  1. Comparable uncontrolled price method
  2. Resale Price Method
  3. Cost Plus Method
  4. Profit split Method
  5. Transaction Net Margin Method
  6. Such other Method as may be prescribed

- **Comparability of the international transaction with an uncontrolled transaction:- First step towards determination of Arm's Length Price**
  The comparability of one transaction with another shall be judged with reference to the following factors namely –
  (a) The specific characteristics of the property or services transferred in either transaction
  (b) The functions performed taking into account assets employed or to be employed and the risks assumed by the respective parties to the transactions
  (c) The contractual terms (whether or not such terms are formal or in writing) of the transactions which lay down explicitly or implicitly how the responsibilities risks and benefits are to be divided between the respective parties to the transactions
  (d) Conditions prevailing in the markets in which the respective parties to the transactions operate including the geographical location and size of the markets costs of labour and capital in the markets overall economic development and level of competition and whether the markets are wholesale or retail.

When two transactions are deemed to be comparable

An uncontrolled transaction shall be comparable to an international transactions, if –

(a) None of the differences (if any) between the transactions being compared or between the enterprises entering into such transaction are likely to materially affect the price or cost charged or paid in or the profit arising from such transactions in the open market or

(b) Reasonable accurate adjustments can be made to eliminate the material effects of such differences.

Data to be used for comparison

In case, the most appropriate method for determination of ALP of a transaction entered into on or after 1.4.2014, is the resale price method or cost plus method or the transactional net margin method, then, then the data to be used for analyzing the comparability of an uncontrolled transaction with an international transaction shall be –

(a) the data relating to the current year; or

(b) the data relating to the financial year immediately preceding the current year, if the data relating to the current year is not available at the time of furnishing the return of income by the assessee, for the assessment year relevant to the current year.

However, where the data relating to the current year is subsequently available at the time of determination of arm's length price of an international transaction or a specified domestic transaction during the course of any assessment proceeding for the assessment year relevant to the current year, then, such data shall be used for such determination irrespective of the fact that the data was not available at the time of furnishing the return of income of the relevant assessment year.

- **Most appropriate method : Second Step towards determination of Arm's Length Price**

  The most appropriate method shall be the method which provides the most reliable measure of an arm's length price in relation to an international transaction.

  For the purpose of selecting the most appropriate method, the following factors shall be taken into account, namely-

  (a) The nature and class of the international transaction

  (b) The class or classes of associated enterprises entering into the transaction and the functions performed by them taking into consideration assets employed or risk assumed

  (c) The availability coverage and reliability of data necessary for application of the method

  (d) The degree of comparability existing between the international transaction and the uncontrolled transaction and between the enterprises entering into such transactions.

  (e) The extent to which reliable and accurate adjustments can be made to account for differences if any between the transactions being compared and the enterprises entering into such transactions.

  (f) The nature extent and reliability of assumptions required to be made in application of a method.

- **Where more than one price is determined by the most appropriate method [Third proviso to section 92C(2)]**

  In respect of international transaction or specified domestic transaction undertaken on or after 1.4.2014, where more than one price is determined by the most appropriate method, then the ALP shall be computed in the prescribed manner (based on "range concept" to be specified by way of Rules).

- **Non-applicability of provisions of "transfer pricing" [Section 92(3)]**

  Section 92 (3) provides that the provisions of transfer pricing shall not be applicable in a case where the application of arm's length price has the effect of reducing income chargeable to tax or increasing the loss, as the case may be, computed on the basis of entries made in the books of account of the previous year in which the international transaction or specified domestic transaction was entered into.

57.4 MAINTENANCE AND KEEPING OF INFORMATION AND DOCUMENT BY PERSONS ENTERING INTO AN INTERNATIONAL TRANSACTION OR SPECIFIED DOMESTIC TRANSACTION

Section:- 92D and Rule 10D

- **Information and documents to be kept and maintained**

  Every person who has entered into an international transaction or specified domestic transaction shall keep and maintain the following information and documents namely-

  a. A description of the ownership structure of the assessee enterprise with details of shares or other ownership interest held by other enterprises;
  b. A profile of the multinational group of which the assessee enterprise is part along with the name address, legal, status and country of tax residence of each of the enterprise comprised in the group with whom international transactions have been entered into by the assessee, and ownership linkages among them;
  c. A broad description of the business of the assessee and the industry in which the assessee operates and of the business of the associated enterprises with whom the assessee has transacted;
  d. The nature and terms (including prices) of international transactions entered into with each associated enterprise details of property transferred or services provided and the quantum and the value of each such transaction or class of such transaction;
  e. A description of the functions performed risks assumed and assets employed or to be employed by the assessee and by the associated enterprises involved in the international transaction;
  f. A record of the economic and market analyses, forecasts, budgets or any other financial estimates prepared by the assessee for the business as a whole and for each division or product separately which may have a bearing on the international transactions entered into by the assessee;

g. A record of uncontrolled transactions taken into account for analysing their comparability with the international transactions entered into including a record of the nature terms and conditions relating to any uncontrolled transaction with third parties which may be of relevance to the pricing of the international transactions;

h. A record of the analysis performed to evaluate comparability of uncontrolled transactions with the relevant international transaction;

i. A description of the method considered for determining the arm's length price, in relation to each international transaction or class of transaction the method selected as the most appropriate method along with explanations as to why such method as so selected and how such method was applied in each case;

j. A record of the actual working carried out for determining the arm's length price including details of the comparable data and financial information used in applying the most appropriate method and adjustments if any which were made to account for differences between the international transaction and the comparable uncontrolled transactions or between the enterprises entering into such transactions;

k. The assumptions policies and price negotiations if any which have critically affected the determination of the arm's length price;

l. Details of the adjustments, if any made to transfer prices to align them with arm's length prices determined under these rules and consequent adjustment made to the total income for tax purpose;

m. Any other information data or document including information or data relating to the associated enterprise which may be relevant for determination of the arm's length price.

It is further provided that where the aggregate value of international transaction does not exceed Rs. 1 crore, it will not be obligatory to maintain the above information and documents. However, such assessee shall be required to substantiate that income arising from international transactions entered into by him has been computed in accordance with section 92.

- **Authentic documentation**

The information specified above shall be supported by authentic documentation which may include the following:

(a) Official publications, reports, studies and data bases from the Government of the country of residences of the associated enterprise or of any other country;

(b) Reports of market research studies carried out by institutions of national or international repute;

(c) Price publications including stock exchange and commodity market quotations;

(d) Published accounts and financial statements relating to the business affairs of the associated enterprise;

(e) Agreements and contracts entered into with associated enterprises or with unrelated enterprises in respect of transactions similar the international transactions;

(f) Letters and other correspondence documenting any terms negotiated between the assessee and the associated enterprise;

(g) Documents normally issued in connection with various transactions under the accounting practices followed.

- **Time limit by which information and document mentioned above to be made available**
  The information specified above should be made available by the assessee on or before the due date of submission of return of income.

- **Fresh documentation need not be maintained in case of continuity of international transaction more than one year**
  Where an international transaction continues to have effect over more than one previous year fresh documentation need not be maintained separately in respect of each previous year unless there is any significant change in the nature or terms of the international transaction in the assumption made or in any other factor.
  However, in case of significant change, fresh documentation as may be necessary, shall be maintained detailing the impact of the change on pricing of the international transaction.

- **Period for which above information and documents to be maintained**
  The information and documents specified in above shall be kept and maintained for a period of 8 years from the end of the relevant assessment year.

- **Furnishing information or document to the assessing officer or Commissioner (Appeals)**
  The Assessing Officer or Commissioner (Appeals) may in the course of any proceeding under this Act require any person who has entered into an international transaction to furnish any information or document in respect thereof within a period of 30 days from the date of receipt of notice issued in this regard.
  The Assessing Officer or the Commissioner (Appeals) may, on an application made by such person, extend the above period by a further period not exceeding 30 days.

57.5 REPORT FROM ACCOUNTANT

Section:- 92E

Every person who has entered into an international transaction or specified domestic transaction during a previous year shall obtain a report from an accountant and furnish such report on or before the specified date (30th November of assessment year) in the prescribed form [Form No. 3CEB] duly signed and verified in the prescribed manner by such accountant and setting forth such particulars as may be prescribed.

57.6 DETERMINATION OF ARM'S LENGTH PRICE BY ASSESSING OFFICER IN CERTAIN CASES AND COMPUTATION OF TOTAL INCOME

Section:- 92C(3) and 92C(4)

- **Determination of arm's length price by the Assessing officer**
  Subject to following, the Assessing officer may proceed to determine the arm's length in relation to international transaction or specified domestic transaction:

(1) The proceeding for assessment of income is pending before him.

(2) The Assessing Officer has material or information or document in his possession.

(3) On the basis of such material or information or document, the Assessing Officer is of the 'opinion' that the -

(a) Arm's length price charged or paid in an international transaction or specified domestic transaction has not been determined in accordance with the section 92C(1) and 92 C(2); or

(b) Assessee has not kept and maintained information and document related to an international transaction or specified domestic transaction in accordance with the provisions contained in Section 92 D(1) and rules made in this behalf;

(c) Information or data used for consulting the arm's length price is not reliable or correct; or

(d) Assessee has failed to furnish within the time specified any information or document which was required to be furnished under section 92 D(3).

- **Opportunity of being heard must be given before determination of ALP by the assessing officer**
  However, opportunity of being heard shall be given by the Assessing Officer by serving a notice calling upon the assessee to show cause, on a date and time to be specified in the notice, why the arm's length price should not be so determined on the basis of material or information or document in the possession of the Assessing Officer.

- **Computation of total income by the assessing officer after determination of arm's length price**
  The Assessing Officer may compute the total income of the assessee having regard to arm's length price determined above.

- **No deduction under section 10AA or Chapter VIA on enhancement made by the assessing officer**
  If the total income is enhanced by the assessing officer as mentioned above, then no deduction u/s 10AA or under Chapter VIA shall be allowed in respect of the increased quantum of total income.
- **Computation of total income of payee associated enterprise not required in certain circumstances**
  Computation of total income of payee associated enterprise is not required if –
  (a) Total income of payer associated enterprise has been computed by the assessing officer and
  (b) Tax has been deducted or deductible at source by the payer enterprise.

57.7 REFERENCE TO TRANSFER PRICING OFFICER

Section:- 92CA

- Section 92CA provides that the Assessing Officer (if he considers it necessary or expedient to do so) may, with the previous approval of the Commissioner, refer the matter of determination of arm's length price (ALP) in respect of an international transaction or specified domestic transaction to the Transfer Pricing Officer (TPO).
  For the purposes of this section, "Transfer Pricing Officer" means a Joint Commissioner or Deputy Commissioner or Assistant Commissioner authorised by the Board to perform all or any of the functions of an Assessing Officer specified in sections 92C and 92D in respect of any person or class of persons.

- The TPO is further empowered to determine ALP of an international transaction or specified domestic transaction noticed by him in the course of proceedings before him, even if the said transaction was not referred to him by the Assessing Officer, provided that such international transaction or specified domestic transaction was not reported by the taxpayer as per the requirement cast upon him under section 92E.
- The Transfer Pricing Officer, thereafter, shall serve a notice on the assessee requiring him to produce or cause to be produced on a date to be specified therein, any evidence on which the assessee may rely in support of the computation made by him of the arm's length price in relation to the international transaction or specified domestic transaction.
- After hearing the asseessee and the evidence the assessee may produce, including any information or documents referred to in section 92D(3) and after considering such evidence as the Transfer Pricing Officer may require on any specified points and after taking into account all relevant materials which he has gathered, the Transfer Pricing Officer shall, by order in writing, determine the arm's length price in relation to the international transaction or specified domestic transaction and send a copy of his order to the Assessing Officer and to the assessee.
- **On receipt of the order from TPO, the Assessing Officer <u>shall</u> proceed to compute the total income of the assessee in conformity with the arm's length price as so determined by the Transfer Pricing Officer.**
- With a view to rectifying any mistake apparent from the record, the Transfer Pricing Officer may amend any order passed by him, and the provisions of section 154 shall apply accordingly.
- The Transfer Pricing Officer may, for the purposes of determining the arm's length price under this section, exercise all or any of the powers specified in
  - Section 131(1) – clause (a) to (d)
  - Section 133(6)
  - Section 133A

UNIT B – DOMESTIC TRANSACTIONS

57.8 SPECIFIED DOMESTIC TRANSACTIONS

Section:- 92BA

Section 92BA has been inserted with effect from the assessment year 2013-14. It provides the meaning of "specified domestic transaction" with reference to which the income is to be computed under section 92, having regard to arm's length price. The following transactions are covered within the meaning of "specified domestic transactions" if the aggregate of these transactions entered into by the assesse in a previous year exceeds Rs. 5 crore ***[Rs. 20 crore w.e.f A.Y. 2016-17 as amended by Finance Act, 2015]***.

(a) ~~any expenditure in respect of which payment has been made or is to be made to a person referred to in section 40A(2)(b);~~ **Omitted w.e.f. A.Y. 2017-18**

(b) any transaction referred to in section 80A;

(c) any transfer of goods or services referred to in section 80-IA(8) **[Refer example given below]**;

(d) any business transacted between the assessee and other person as referred to in section 80-IA(10);

(e) any transaction, referred to in any other section under Chapter VI-A or section 10AA, to which provisions section 80-IA(8)/(10) are applicable; or

(f) any other transaction as may be prescribed,

Any allowance for an expenditure or interest or allocation of any cost or expense or any income in relation to the above domestic transactions shall be computed having regard to the arm's length price. For this purpose, arm's length price shall be determined within the parameters of sections 92 to 92F.

Example: Profit shifting from ineligible unit to eligible unit for section 80-IA

Actual Scenario before altering prices

Particulars	Unit A - eligible for section 80 IA	Unit B – Ineligible Unit
Tax Rate	-	30%
Revenue from related party	**150**	
Other Income	300	250
Expenses in relation to related party	-	**(150)**
Other Expenses	(200)	(30)
Profit / (Loss)	**250**	**70**
Tax	0	**21**

Shifting of Profits by altering prices

Particulars	Unit A – eligible for 80 IA	Unit B – Ineligible Unit
Tax Rate	-	30%
Revenue from related party	**220**	
Other Income	300	250
Expenses in relation to related party	-	**(220)**
Other Expenses	(200)	(30)
Profit / (Loss)	**320**	**0**
Tax	0	0

Practical 2

Ganga Ltd., a domestic company, has two units Chambal and Damodar. The Chambal unit, which commenced business two years back, is engaged in the business of developing an irrigation project. The Damodar unit is carrying on the business of trading in water pumps. During the previous year 2017-18, the Damodar unit transferred water pumps amounting to Rs. 19.5 crores to the Chambal unit. Further, Ganga Ltd hires vehicles owned by Mr. Krishna's daughter and paid hiring charges of Rs. 1.5 crores during the previous year **2017-18**. Mr. Krishna, a resident Indian, holds 30% equity share capital in Ganga Ltd.

Discuss whether the above transactions fall within the meaning of "specified domestic transaction"?

Solution

The Chambal Unit is eligible for deduction@100% of the profits derived from its eligible business (i.e., the business of developing an infrastructure facility, being an irrigation project) under section 80-IA. However, the Damodar Unit is not engaged in any "eligible business". Since the Damodar Unit has transferred water pumps to the Chambal Unit, it is an inter-Unit transfer of goods between eligible business and other business. Therefore, this transaction falls within the meaning of "specified domestic transaction" to attract transfer pricing provisions.

The payment of hiring charges has been made to a related person referred to in section 40A(2)(b) i.e., relative (i.e., daughter) of Mr. Krishna, who has substantial interest in the business of Ganga Ltd. **However, due to amendment made by Finance Act, 2017, this transaction does not fall within the meaning of "specified domestic transaction" under section 92BA.**

It is imperative to note here that; abovementioned transactions would be treated as a "specified domestic transaction" to attract transfer pricing provisions only if the aggregate of such transactions as specified in section 92BA during the year by Ganga Ltd. exceeds a sum of Rs. 20 crore.

Since aggregate of these transactions is Rs. 19.5 crore which is not exceeding Rs. 20 crore. Therefore, the said transactions are outside the purview of "specified domestic transaction".

Readers Note:

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57.9 TRANSFER PRICING RULES MADE APPLICABLE TO SPECIFIED DOMESTIC TRANSACTIONS AS WELL

Notification:- 41/2013 dated 10.06.2013

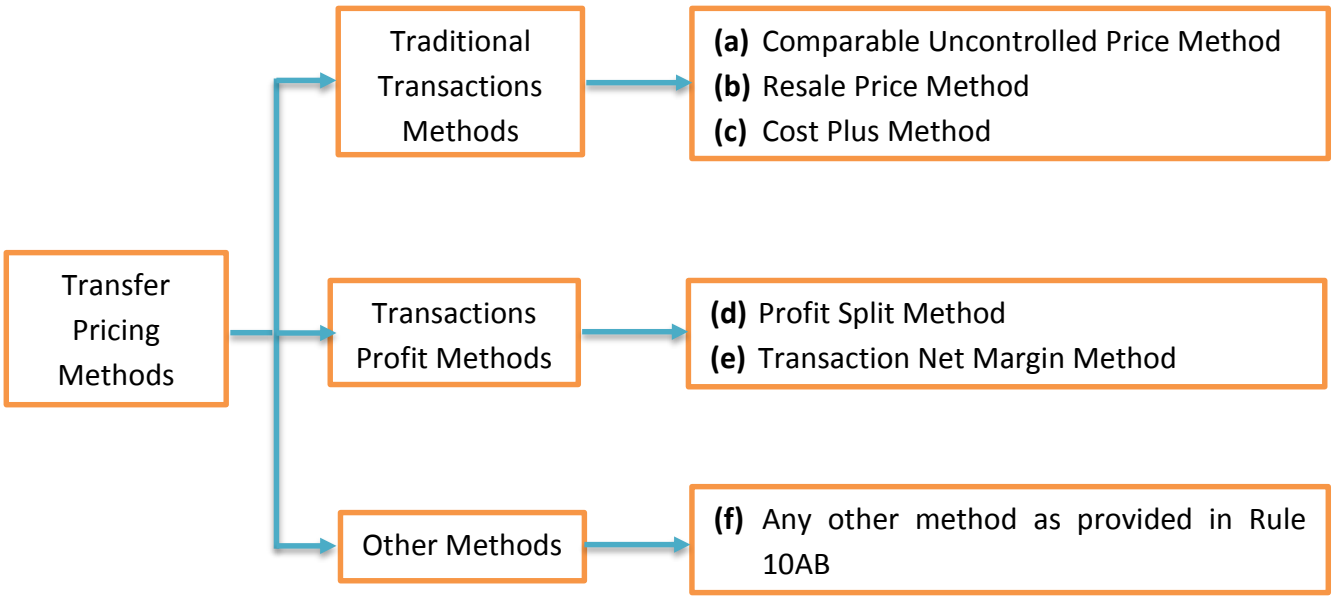
With effect from A.Y 2013-14, the transfer pricing provisions have been extended to Specified Domestic Transactions. Accordingly, the transfer pricing rules prescribed for international transactions have been suitably amended to make the same applicable for specified domestic transactions, as well.

Rule No.	Particulars	Amendment
10A	Meaning of expressions used in computation of Arm's length price	**Definition of "associated enterprise" and "enterprise" included** **"Associated Enterprise" shall -** **(i)** have the same meaning as assigned to it in section 92A; and **(ii)** in relation to a specified domestic transaction entered into by an assessee, include -- (A) the persons referred to in section 40A(2)(b) in respect of a transaction referred to in section 40A(2)(a); (B) other units or undertakings or businesses of such assessee in respect of a transaction referred to in section 80A or section 80-IA(8); (C) any other person referred to in section 80- IA(10) in respect of a transaction referred to therein; (D) other units, undertakings, enterprises or business of such assessee, or other person referred to in section 80-IA(10) or in respect of a transaction referred to in section 10AA or the transactions referred to in Chapter VI-A to which the provisions of section 80-IA(8) or section 80-IA(10) are applicable; **"Enterprise"** shall have the same meaning as assigned to it in clause (iii) of section 92F and shall, for the purposes of a specified domestic transaction, include a unit, or an enterprise, or an undertaking or a business of a person who undertakes such transaction.
10AB	Other methods of determination of ALP	This Rule provides that for the purpose of section 92C(1)(f), the other method for determination of the arm's length price in relation to an international transaction shall be any method which takes into account the price which has been charged or paid or would have been charged or paid, for the same or similar uncontrolled transaction, with or between non-associated enterprises, under similar circumstances, considering all the relevant facts. This Rule has now been made applicable to specified domestic transactions as well.

10B	Determination of ALP under section 92C	The methods for determination of arm's length price specified in this Rule for the purpose of section 92C(2) in relation to an international transaction shall also be made applicable in respect of specified domestic transactions.
10C	Most appropriate method	Sub-rule (1) provides that, for the purposes of section 92C(1), the most appropriate method shall be the method which is best suited to the facts and circumstances of each particular international transaction, and which provides the most reliable measure of an arm's length price in relation to an international transaction. Sub-rule (2) specifies the factors to be taken into account in selecting the most appropriate method. This Rule is now made applicable in respect of a specified domestic transaction as well.
10D	Information and documents to be kept and maintained under section 92D	Sub-rule (1) requires every person who has entered into an international transaction to maintain the requisite information and documents as detailed thereunder. As per sub-rule (2), maintenance of information and documents shall not apply where the aggregate value of international transactions does not exceed 1 crore rupees. However, sub-rule (1) shall be applicable for every specified domestic transaction.
10E	Report from an accountant to be furnished under section 92E	This rule provides for submission of audit report from a chartered accountant by every person who has entered into an international transaction. This provision would now apply to a person entered into a specified domestic transaction as well.

UNIT C – METHODS FOR DETERMINATION OF ARM'S LENGTH PRICE

57.10 TRANSFER PRICING METHODS – SIX METHODS (a) to (f)

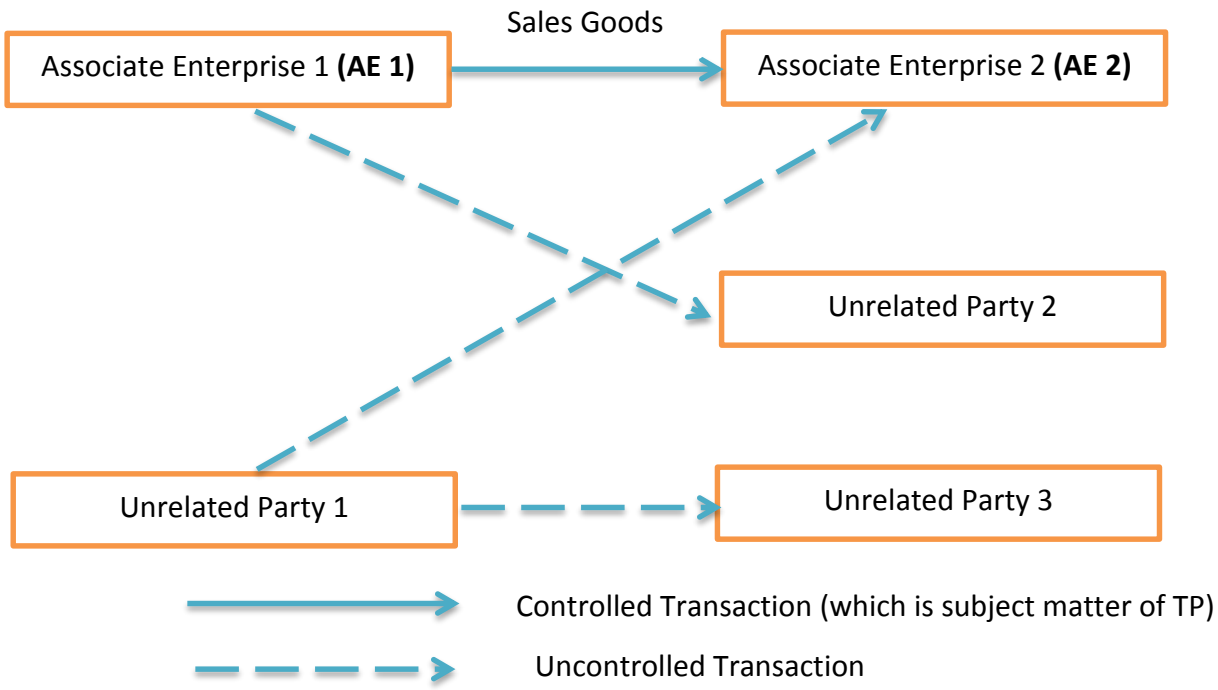


57.11 COMPARABLE UNCONTROLLED PRICE METHOD [CUP]

A. The price charged or paid for property transferred or services provided in a comparable uncontrolled transaction or a number of such transactions, is identified;

B. Such price is adjusted to account for differences, if any, between the international transaction or (the specified domestic transaction) and the comparable uncontrolled transactions or between the enterprises entering into such transactions which could materially affect the price in the open market;

C. The adjusted price arrived at under (b) *above* is taken to be an arm's length price in respect of the property transferred or services provided in the international transaction or the specified domestic transaction.



Practical 3

Kio, a company based at Japan and AB Ltd, an Indian Company are Associated Enterprises. AB Ltd manufactures Cellular Phones and sells them to Kio, Japan and also to Geel, a Company based at Beijing. During the year AB Ltd supplied 2,50,000 Cellular Phones to Kio, Japan at a price of Rs. 3,000 per unit and 35,000 units to Geel at a price of Rs. 4,800 per unit. The transactions of AB Ltd with Kio and Geel are comparable subject to the following considerations -

(a) Sales to Kio is on FOB basis, sales to Geel are CIF basis. Freight and Insurance paid by Kio for each unit is Rs. 700.

(b) Sales to Geel are under a free warranty for Two Years whereas sales to Kio are without any such warranty. The estimated cost of executing such warranty is Rs. 500.

(c) Since Kio's order was huge in volume, quantity discount of Rs. 200 per unit was offered to it.

Compute Arm's Length Price and amount of increase in Total Income of AB Ltd, if any, due to such Arm's Length Price

Solution

Computation of Arm's Length Price of Products sold to Kio Japan by AB Ltd

Particulars	Rs.	Rs.
Price per Unit in a Comparable Uncontrolled Transaction		4,800
Less: Adjustment for Differences -		
(a) Freight and Insurance Charges	(700)	
(b) Estimated Warranty Costs	(500)	
(c) Discount for Voluminous Purchase	(200)	(1,400)
Arm's Length Price for Cellular Phone sold to Kio Japan		**3,400**

Computation of Increase in Total Income of AB Ltd.

Particulars	Rs.	Rs.
Arm's Length Price per Unit		3,400
Less: Price at which actually sold to Kio Japan		(3,000)
Increase in Price per Unit		400
No. of Units sold to Kio Japan		2,50,000
Therefore, increase in Total Income of AB Ltd (2,50,000 × Rs.400)		10 Crores

Readers Note:

57.12 RESALE PRICE METHOD [RPM]

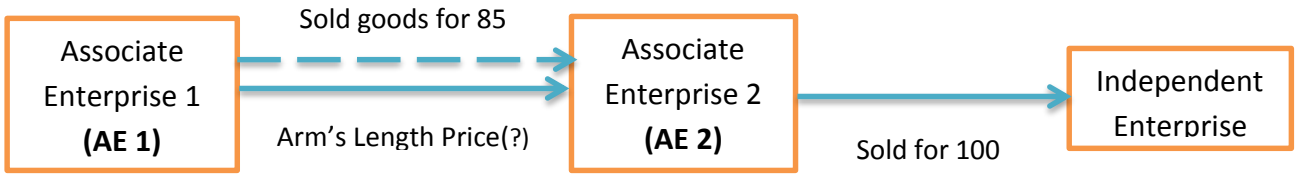
A. The price at which property purchased or services obtained by the enterprise from an associated enterprise is resold or are provided to an unrelated enterprise is identified;

B. Such resale price is reduced by the amount of a normal gross profit margin accruing to the enterprise or to an unrelated enterprise from the purchase and resale of the same or similar property or from obtaining and providing the same or similar services in a comparable uncontrolled transaction or a number of such transactions;

C. The price so arrived at is further reduced by the expenses incurred by the enterprise in connection with the purchase of property or obtaining of services;

D. The price so arrived at is adjusted to take into account the functional and other differences including differences in accounting practices, if any, between the international transaction or (specified domestic transaction) and the comparable uncontrolled transactions, or between the enterprises entering into such transactions which could materially affect the amount of gross profit margin in the open market;

E. The adjusted price arrived at under (d) above is taken to be an arm's length price in respect of the purchase of the property or obtaining of the services by the enterprise from the associated enterprise.



Resale price	100
Gross Profit Margin (20% on sale)	
Arm's Length Price (?)	

Practical 4

MNO Ltd. and Roxy Inc. of U.S.A are associated enterprises. MNO Ltd. imports 3,000 motors bikes from Roxy Inc. at Rs.50,000 per bike. These are sold in India at Rs.55,000 per bike. Also, MNO Ltd. imported exactly similar motor bikes from Hold Inc. of Japan (unrelated party) and sold outside at a Gross Profit of 20% on Sales.

Roxy Ltd, offered a quantity discount of Rs. 1,500 per motor vehicle. Hold Inc., however, offered only Rs.500 per bike as quantity discount. The freight and insurance from Roxy USA cost MNO Ltd. Rs.1,500 per bike whereas in respect of purchase from Hold Inc. MNO Ltd. had to pay Rs.500 as freight charges and there was no insurance cost to the assessee.

Determine the Arm's Length Price and the amount of increase in Total Income of Rani Ltd.

Solution

A. Computation of Arm's Length Price of Products bought from MNO Ltd.

Particulars	**Rs.**
Resale Price of Goods Purchased from MNO Ltd.	55,000
Less: Adjustment for differences	
(a) Normal gross profit margin @ 20% of sale price [20% × Rs. 55,000]	(11,000)
(b) Incremental Quantity Discount by MNO Ltd. [Rs. 1,500 – Rs. 500]	(1,000)
(c) Difference in Purchase related Expenses [Rs. 1,500 – Rs. 500]	(1,000)
Arms Length Price	**42,000**

B. Computation of Increase in Total Income of Rani Ltd

Particulars	Rs.
Price at which actually bought	50,000
Less : Arm's Length Price per unit under Resale Price Method	(42,000)
Decrease in Purchase Price per bike	8,000
No. of Units purchased	3,000
Increase in Total Income of Rani Ltd [3,000 Units × Rs. 8000]	2,40,00,000

Readers Note:

57.13 COST PLUS METHOD [CPM]

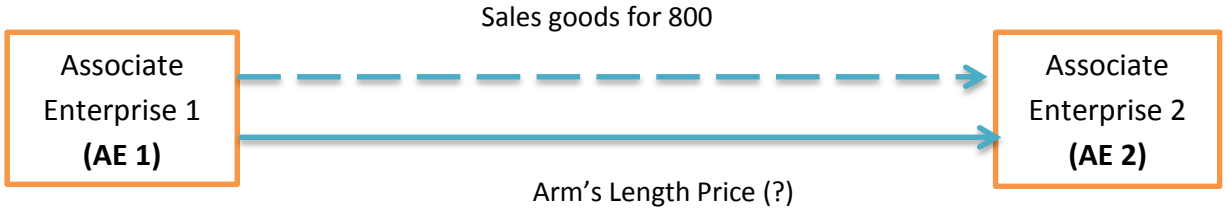
A. The direct and indirect costs of production incurred by the enterprise in respect of property transferred or services provided to an associated enterprise, are determined;

B. The amount of a normal gross profit mark-up to such costs (computed according to the same accounting norms) arising from the transfer or provision of the same or similar property or services by the enterprise or by an unrelated enterprise in a comparable uncontrolled transaction or a number of such transactions is determined;

C. The normal gross profit mark-up referred to in (b) above is adjusted to take into account the functional and other differences if any between the international transaction or (the specified domestic transaction) and the comparable uncontrolled transactions or between the enterprises entering into such transactions, which could materially affect such profit mark-up in the open market;

D. The costs referred to in (a) above are increased by the adjusted profit mark-up arrived at under (c) above:

E. The sum so arrived at is taken to be an arm's length price in relation to the supply of the property or provision of services by the enterprise.



Cost of Associate Enterprise (AE 1)	500
+ Gross Profit Mark-up (50%)	
Arm's Length Price	

Practical 5

NANO Inc., a German Company, holds 45% of equity in Hitech Ltd., an Indian Company. Hitech Ltd. is engaged in development of software and maintenance of the same for customers across the globe. Its clientele includes NANO Inc.

During the financial year 2015-16, Hitech Ltd. had spent 2400 man hours for developing and maintaining software for NANO Inc. with each hour being billed at Rs. 1,300. Cost incurred by Hitech Ltd. for executing work for NANO Inc. amounts to Rs. 20 lakhs.

Hitech Ltd. had also undertaken developing software for Modi Industries, for which Hitech Ltd. had billed at Rs. 2,700 per man hour. The persons working for Modi Industries and NANO Inc. were part of the same team and were of matching credentials and calibre. Hitech Ltd. made a gross profit of 60% on Modi Industries work. Hitech Ltd.'s transactions with NANO Inc. are comparable to transactions with Modi Industries, subject to the following differences:

(i) NANO Inc. gives technical knowhow support to Hitech Ltd., which can be valued at 8% of the normal gross profit. Modi Industries does not provide any such support.

(ii) Since the work for NANO Inc. involved huge number of man hours, a quantity discount of 14% of normal gross profits was given.

(iii) Hitech Ltd. had offered 90 days credit to NANO Inc., the cost of which is measured at 2% of the normal billing rate. No such credit was offered to Modi Industries.

Compute arm's length price as per cost plus method and the amount of increase in total income of Hitech Ltd.

Solution

Computation of Arm's Length Price as per Cost Plus Method

Particulars	(%)
Gross Profit Mark up in case of Modi Industries [an unrelated party]	60.00
Less: Differences to be adjusted	
Value of technical know-how (8% of 60%)	(4.80)
Quantity discount to Nano Inc. (14% of 60%)	(8.40)
	46.80
Add: Cost of credit to Nano Inc., an associated enterprise (2% of 100%)	2.00
Arm's length gross profit mark up	48.80

Computation of Increase in Total Income of Hitech Ltd

Particulars	Rs.
Cost incurred by Hitech Ltd. for executing Nano Inc's work. [100% - 48.8%=51.2%]	20,00,000
Add: Adjusted gross profit (Rs. 20,00,000 x 48.8/51.2)	19,06,250
Arm's length billed value	39,06,250
Less: Actual Billed Income in the case of Nano Inc (Rs. 1300 x 2400 man hours)	31,20,000
Total Income of Hitech Ltd to be increased by	7,86,250

Readers Note:

57.14 PROFIT SPLIT METHOD [PSM]

This method may be applicable mainly in international transactions (or specified domestic transactions) involving transfer of unique intangibles or in multiple international transactions (or specified domestic transactions) which are so interrelated that they cannot be evaluated separately for the purpose of determining the arm's length price of any one transaction.

A. The combined net profit of the associated enterprises arising from the international transactions (or specified domestic transactions) in which they are engaged, is determined;

B. The relative contribution made by each of the associated enterprises to the earning of such combined net profit is then evaluated on the basis of the functions performed assets employed or to be employed and risks assumed by each enterprise and on the basis of reliable external market data which indicates how such contribution would be evaluated by unrelated enterprises performing comparable functions in similar circumstances;

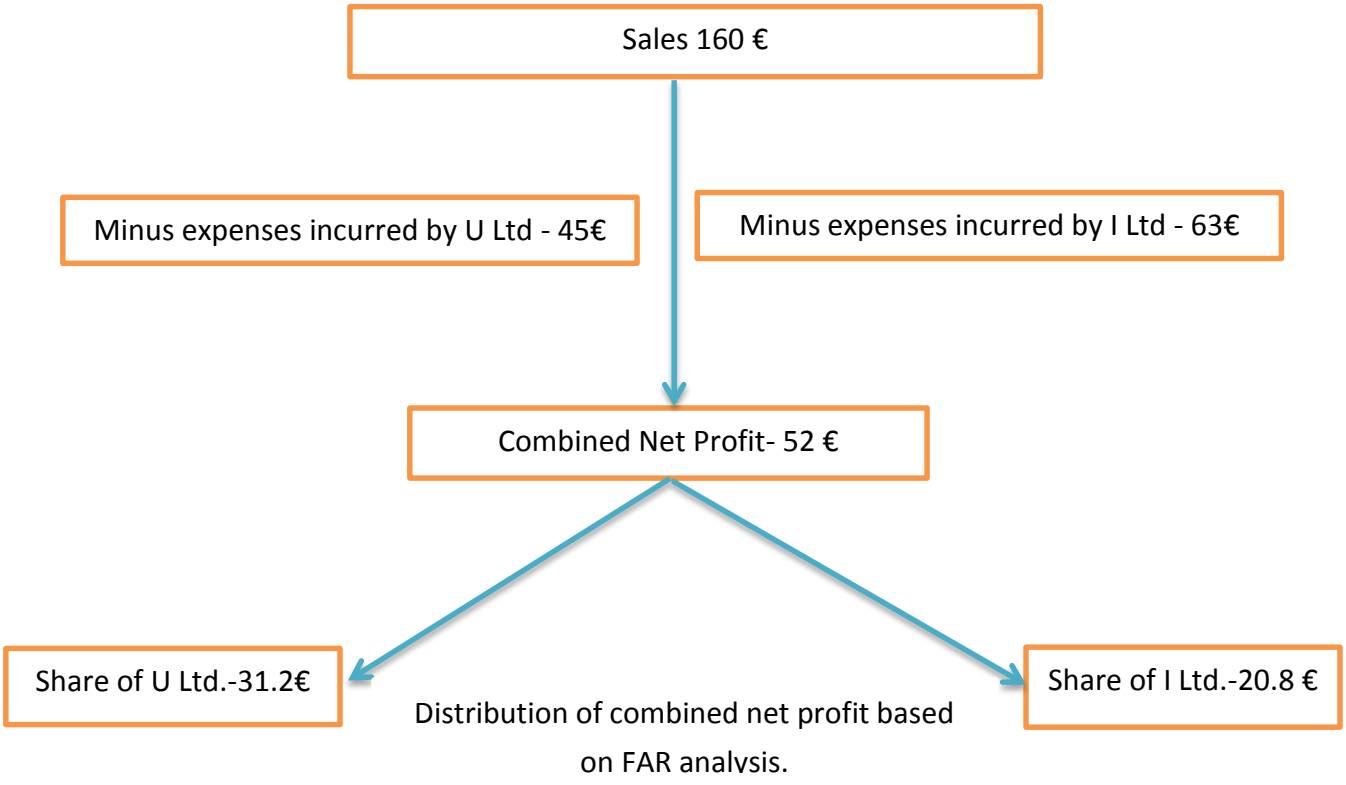
C. The combined net profit is then split amongst the enterprises in proportion to their relative contributions as evaluated under (b) above;

D. The profit thus apportioned to the assessee is taken into account to arrive at an arm's length price in relation to the international transaction (or the specified domestic transaction)

Practical 6

U Ltd. - Foreign co. holds 40% equity of I Ltd., Indian co. I Ltd. purchased goods from U ltd. at 90 € per piece. Thereafter, I Ltd. sell these goods in India at 160 € per piece to unrelated parties. Cost/expenses incurred by U Ltd. is 45 € per piece, while cost incurred by I Ltd. in India is 63 € per piece. Considering asset employed, risk assumed and function performed, factor for distribution of profit between U Ltd. and I Ltd. is 60:40. Decide whether transaction between U Ltd. & I Ltd. is at arm's length price.

Solution



Distribution of combined net profit based on FAR analysis.

The Arm's length shall be :- 45€ plus 31.2€ = 76.2€

Readers Note:

Practical 7

HUM Medical Equipments Inc. (HUM) of Canada has received an order from a leading UK based Hospital for development of a hi -tech medical equipment which will integrate the best of software and latest medical examination tool to meet varied requirements. The order was for 2,50,000 Euros.

To execute the order, HUM joined hands with its subsidiary CARE Components Inc. (CCI) of USA and Bioinformatics India Ltd (BIL), an Indian Company. CCI holds 40% of BIL. HUM paid to CCI and BIL Euro 70,000 and Euro 80,000 respectively and kept the balance for itself. In the entire transaction, a profit of Euro 80,000 is earned. Bioinformatics India Ltd incurred a Total Cost of Euro 75,000 in execution of its work in the above contract. The Relative Contribution of HUM, CCI and BIL may be taken at 35%, 25% and 40% respectively.

Compute the Arm's Length Price and the incremental Total Income of Bioinformatics India Ltd, if any due to adopting Arm's Length Price determined in this case.

Solution

	Particulars	Euros.
(A)	**Share of each of the Associates in the Combined Net Profit of 80,000 Euros**	
	Share of BIL [Contribution of 40% x 80,000]	32,000
	Share of CCI [Contribution of 25% x 80,000]	20,000
	Share of HUM[Contribution of 35% x 80,000]	28,000
(B)	**Computation of Incremental Total Income of BIL**	
	Total Cost to Bioinformatics India Ltd	75,000
	Add: Share in the Profit to BIL (from above)	32,000
	Revenue of BIL on the basis of Arm's Length Price	1,07,000
	Less: Revenue Actually received by BIL	(80,000)
	Increase in Total Income of BIL	27,000

Readers Note:

57.15 TRANSATIONAL NET MARGIN METHOND [TNMM]

A. The net profit margin realized by the enterprise from an international transaction (or specified domestic transaction) entered into with an associated enterprise is computed in relation to costs incurred or sales effected or assets employed or to be employed by the enterprise or having regard to any other relevant base;

B. The net profit margin realized by the enterprise or by an unrelated enterprise from a comparable uncontrolled transaction or a number of such transactions is computed having regard to the same base;

C. The net profit margin referred to in (b) (supra) arising in comparable uncontrolled transactions is adjusted to take into account the differences if any between the international transaction (or the specified domestic transaction) and the comparable uncontrolled transactions, or between the enterprises entering into such transactions which could materially affect the amount of net profit margin in the open market;

D. The net profit margin realized by the enterprise and referred to in (a) above is established to be the same as the net profit margin referred to in (c) above;

E. The net profit margin thus established is then taken into account to arrive at an arm's length price in relation to the international transaction.

Given Price	USD 10,000
Cost of Goods Sold	?
Gross Profit	?
Operating Expenses	USD 2000
Net Profit (5% of Price)	USD 400

The AE1 has purchased raw materials from its AE2 and manufactures goods for sale to third parties. The similar transaction is entered into by unrelated parties with net margin of 5% of sale price. Thus, if AE1 earns net margin of 5% of sale price, then its transaction of purchase of raw materials from AE2 will be at arm's length

57.16 OTHER METHOD AS MAY BE PRESCRIBED BY THE BOARD

Notification No. 18/2012 dated 23.05.2012

Rule 10AB inserted to provide for "Other method of determination of arm's length price"

Accordingly, Rule 10AB has been inserted in the Income-tax Rules, 1962 to provide that for the purposes of section 92C(1)(f), the **other method** for determination of the arms' length price in relation to an international transaction **shall be any method which takes into account the price which has been charged** or paid, or would have been charged or paid, for the same or similar uncontrolled transaction, with or between **non-associated enterprises, under similar circumstances, considering all the relevant facts.**

57.17 HOW TO DETERMINE ALP WHEN MORE THAN ONE PRICE IS DETERMINED? – RANGE CONCEPT

Third proviso to Section 92 C (2) and Notification:- 83/2015, dated 19.10.2015 (Rule : 10CA)

- Where more than one price is determined by the most appropriate method, the arm's length price in relation to an international transaction or specified domestic transaction undertaken on or after the 1st day of April, 2014, shall be computed in such manner as may be prescribed.
- Accordingly, Central Board of Direct Taxes (CBDT) has, vide Notification No. 83/2015 dated 19th October, 2015 ,issued the final rules *(Rule 10CA)* to give effect to 'range concept' which were introduced by Finance Act, 2014.
- **Rule 10 CA (4) provides that, the 'range concept' shall be applicable when:**
  (a) the MAM is either Comparable Uncontrolled Price (CUP) Method, RPM, CPM, or TNMM; and
  (b) there are at least 6 comparables.

Where these conditions are not fulfilled, 'arithmetic mean' shall apply, along with the tolerance range benefit (3% or 1%) as discussed below : vide notification no. 50/ 2017 dated 09.06.2017

"Where the variation between the arm's length price determined under section 92C and the price at which the international transaction or specified domestic transaction has actually been undertaken does not exceed one percent of the latter in respect of wholesale trading and three percent of the latter in all other cases, the price at which the international transaction or specified domestic transaction has actually been undertaken shall be deemed to be the arm's length price for Assessment Year 2017-2018 and Assessment Year 2018-19"

- For the determination of the quartiles, the margins in the data set (i.e., set of comparable companies) are required to be arranged in ascending order and the arm's length range would be data points lying between the 35th and 65th percentile of the data set.
- If the transaction price falls within the range, then the same shall be deemed to be the ALP. If the transaction price falls outside the range, the ALP shall be taken to be the Median of the data set.
- The computation mechanism of range is explained by way of illustrations below:

Illustration 1

Where the data set comprises 7 data points (arranged in ascending order), and the percentiles computed are not whole numbers

Percentile	Formula	Result	Value to be selected
35th	Total no. of data points in dataset x 35%=[7 x 35%]	2.45	3rd Value*
65th	Total no. of data points in dataset x 65% = [7 x 65%]	4.55	5th Value*
Median	Total no. of data points in datasets x 50% = [7 x 0.5]	3.50	4th Value*

* Value referred to here is the place value in the data set as arranged in ascending order.

Illustration 2

Where the data set comprises 20 data points (arranged in ascending order), and the percentiles computed are whole numbers.

Percentile	Formula	Result	Value to be selected
35th	Total no. of data points in dataset x 35%=[20 x 35%]	7	Mean of 7th & 8th Value
65th	Total no. of data points in dataset x 65% = [20 x 65%]	13	Mean of 13th & 14th Value
Median	Total no. of data points in datasets x 50% = [20 x 0.5]	10	Mean of 10th & 11th Value

Practical 8

In a given case the dataset of 20 prices arranged in ascending order is as under :

Sl. No.	Prices (in Rs. Thousand)	Sl. No.	Prices (in Rs. Thousand)
1	42.00	11	48.45
2	43.00	12	48.48
3	44.00	13	48.50
4	44.50	14	49.00
5	45.00	15	49.10
6	45.25	16	49.35
7	47.00	17	49.50
8	48.00	18	49.75
9	48.15	19	50.00
10	48.35	20	50.15

You are required to find out whether following transactions have been carried out Arm's Length Price? If not, then what shall be the Arm's Length Price?

Transaction 1 : Rs. 48,000

Transaction 2 : Rs. 46,500

Solution

The data place of the thirty-fifth and sixty-fifty percentile is determined as follows:

Thirty-fifth percentile place = 20* (35/100) = 7.

Sixty-fifth percentile place = 20* (65/100) = 13.

Since the thirty-fifth percentile place is a whole number, it shall be the average of the prices at the seventh and next higher, i.e.; eighth place. This is (47+48)/2 = Rs.47,500.

Similarly, the sixty-fifth percentile will be average of thirteenth and fourteenth place prices. This is (48.5+49)/2=Rs.48,750

Thus, the arm's length range in this case shall be from Rs.47,500 to Rs.48,750.

The median of the range (the fiftieth percentile place) = 20*(50/100)=10

Since the fiftieth percentile place is a whole number, it shall be the average of the prices at the tenth and next higher, i.e.; eleventh place. This is (48.35+48.45)/2= Rs.48,400.

Considering the above,

Particulars	Has it been carried out at ALP?	What shall be the ALP?
Transaction 1		
Transaction 2		

Readers Note:

Practical 9

Tiku Private Ltd., an Indian company, provides software support services to XYZ Inc.(U.S.A), for a consideration of Rs. 50 lakhs. It charges Rs. 51 lakhs and Rs. 53 lakhs for similar services rendered to PQR Inc. and MNO Inc., respectively. XYZ Inc. and Tiku Pvt. Ltd are associated enterprises. Whether the transfer price charged by Tiku Private Ltd. shall be accepted?

Solution

Following Comparable Uncontrolled Price (CUP) Method and considering the Rule 10CA(7), ALP = (Rs. 51 lakhs + 53 lakhs) / 2 = Rs. 52 Lakh

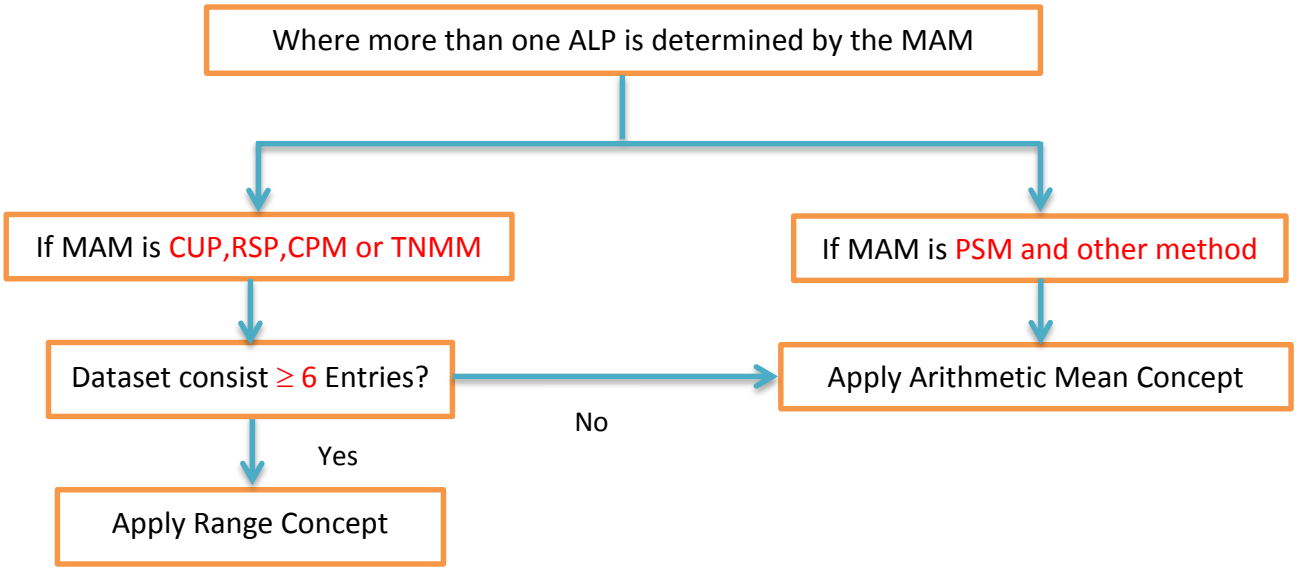
On the other hand Transfer price = Rs. 50,00,000

Permissible variation is 3% of transfer price being Rs.1.5 lac resulting into a range of [48.5 lac to 51.5 lac]

Since the ALP being Rs. 52 Lac does not fall within the range, transfer price charged by Tiku Pvt. Ltd. shall not be accepted.

Readers Note:

Summary of Range Concept



57.18 USE OF MULTIPLE YEAR DATA AND RANGE CONCEPT

Notification:- 83/2015, dated 19.10.2015

- As per the notification issued by CBDT, use of multiple year data (of the comparable companies for the purpose of comparability analysis) is applicable only in cases where RPM, CPM or TNMM has been selected as the Most Appropriate Method.
- Thus, in cases where CUP, PSM or Other Method are selected as the Most Appropriate Method, multiple year data of comparable companies cannot be used.
- For each comparable selected (under RPM, CPM or TNMM), the data of the current year is required to be considered. In case such data is not available at the time of furnishing the return of income, data pertaining to up to two preceding financial years may be used.

- If a comparable is selected on the basis of preceding year data, but is not found to be comparable for the current year for qualitative or quantitative reasons, then such comparable would need to be rejected from the data set.
- When using multiple year data, data for each comparable shall be the weighted average of the selected years.
- The weighted average of the prices of such transactions shall be computed in the following manner, namely:-

Sr. No.	Method used determine to the prices	Manner of computation of weighted average of the prices
(i)	The resale price method	By assigning weights to the quantum of sales which has been considered for arriving at the respective prices
(ii)	The cost plus method	By assigning weights to the quantum of costs which has been considered for arriving at the respective prices
(iii)	The transactional net margin method	By assigning weights to the quantum of costs incurred or sales effected or assets employed or to be employed, or as the case may be, any other base which has been considered for arriving at the respective prices

Practical 10

The data for the current year of the comparable uncontrolled transactions or the entities undertaking such transactions is available at the time of furnishing return of income by the assessee and based on the same, seven enterprises have been identified to have undertaken the comparable uncontrolled transaction in the current year. All the identified comparable enterprises have also undertaken comparable uncontrolled transactions in a period of two years preceding the current year. The Profit level Indicator (PLI) used in applying the most appropriate method is operating profit as compared to operating cost (OP/OC). The weighted average shall be based upon the weight of OC as computed below :

Sl. No.	Name	Year 1	Year 2	Year 3 [Current Year]	Aggregation of OC and OP	Weighted Average
1	2	3	4	5	6	7
1	A	OC = 100 OP = 12	OC = 150 OP = 10	OC = 225 OP = 35	Total OC = 475 Total OP = 57	OP/OC = 12%
2	B	OC = 80 OP = 10	OC = 125 OP = 5	OC = 100 OP = 10	Total OC = 305 Total OP = 25	OP/OC = 8.2%
3	C	OC = 250 OP = 22	OC = 230 OP = 26	OC = 250 OP = 18	Total OC = 730 Total OP = 66	OP/OC = 9%
4	D	OC = 180 OP = (-)9	OC = 220 OP = 22	OC = 150 OP = 20	Total OC = 550 Total OP = 33	OP/OC = 6%

5	E	OC = 140 OP = 21	OC = 100 OP = (-)8	OC = 125 OP = (-)5	Total OC = 365 Total OP = 8	OP/OC = 2.2%
6	F	OC = 160 OP = 21	OC = 120 OP = 14	OC = 140 OP = 15	Total OC = 420 Total OP = 50	OP/OC = 11.9%
7	G	OC = 150 OP = 21	OC = 130 OP = 12	OC = 155 OP = 13	Total OC = 435 Total OP = 46	OP/OC = 10.57%

Solution

F*rom the above, the dataset will be constructed as follows :*

Sr. No.	**1**	**2**	**3**	**4**	**5**	**6**	**7**
Values	2.2%	6%	8.2%	9%	10.57%	11.9%	12%

For construction of the arm's length range the data place of thirty-fifth and sixty-fifth percentile shall be computed in the following manner, namely:

Total no. of data points in dataset *(35/100)

Total no. of data points in dataset *(65/100)

Thus, the data place of the thirty-fifth percentile = 7*0.35=2.45.

Since this is not a whole number, the next higher data place, i.e. the value at the third place would have at least thirty five per cent of the values below it. The thirty-fifth percentile is therefore value at the third place, i.e. 8.2%.

The data place of the sixty-fifth percentile is = 7*0.65=4.55.

Since this is not a whole number, the next higher data place, i.e. the value at the fifth place would have at least sixty five per cent of the values below it. The sixty-fifth percentile is therefore value at fifth place, i.e. 10.57%.

The arm's length range will be beginning at 8.2% and ending at 10.57%.

Therefore, if the transaction price of the international transaction or the specified domestic transaction has OP/OC percentage which is equal to or more than 8.2% and less than or equal to 10.57%, it is within the range. The transaction price in such cases will be deemed to be the arm's length price and no adjustment shall be required. However, if the transaction price is outside the arm's length range, say 6.2%, then for the purpose of determining the arm's length price the median of the dataset shall be first determined in the following manner:

The data place of median is calculated by first computing the total number of data point in the dataset * (50/100). In this case it is 7*0.5=3.5.

Since this is not a whole number, the next higher data place, i.e. the value at the fourth place would have at least fifty per cent of the values below it (median).

The median is the value at fourth place, i.e., 9%. Therefore, the arm's length price shall be considered as 9% and adjustment shall accordingly be made.

Readers Note:

Practical 11

The data of the current year is available in respect of enterprises A, C, E, F and G at the time of furnishing the return of income by the assessee and the data of the financial year preceding the current year has been used to identify comparable uncontrolled transactions undertaken by entrprises B and D. Further, if the enterprises have also undertaken comparable uncontrolled transactions in earlier years as detailed in the table, the weighted average and dataset shall be computed as below:

Sl. No.	Name	Year 1	Year 2	Year 3 [Current Year]	Aggregation of OC and OP	Weighted Average
1	2	3	4	5	6	7
1	A	OC = 100 OP = 12	OC = 150 OP = 10	OC = 225 OP = 35	Total OC = 475 Total OP = 57	OP/OC = 12%
2	B	OC = 80 OP = 10	OC = 125 OP = 5		Total OC = 205 Total OP = 15	OP/OC = 7.31%
3	C	OC = 250 OP = 22	OC = 230 OP = 26	OC = 250 OP = 18	Total OC = 730 Total OP = 66	OP/OC = 9%
4	D		OC = 220 OP = 22		Total OC = 220 Total OP = 22	OP/OC = 10%
5	E			OC = 100 OP = (-)5	Total OC = 100 Total OP = (-)5	OP/OC = (-)5%
6	F	OC = 160 OP = 21	OC = 120 OP = 14	OC = 140 OP = 15	Total OC = 420 Total OP = 50	OP/OC = 11.9%
7	G	OC = 150 OP = 21	OC = 130 OP = 12	OC = 155 OP = 13	Total OC = 435 Total OP = 46	OP/OC = 10.57%

Solution

From the above, the dataset will be constructed as follows :

Sl. No.	1	2	3	4	5	6	7
Values	(-)5%	7.31%	9%	10%	10.57%	11.9%	12%

If during the course of assessment proceedings, the data of the current year is available and the use of such data indicates that B has failed to pass any qualitative or quantitative filter or for any other reason the transaction undertaken is not a comparable uncontrolled transaction, then, B shall not be considered for inclusion in the dataset. Further, if the data available at this stage indicates a new comparable uncontrolled transaction undertaken by enterprise H, then, it shall be included. The weighted average and dataset shall be recomputed as under :

Sl. No.	Name	Year 1	Year 2	Year 3 [Current Year]	Aggregation of OC and OP	Weighted Average
1	2	3	4	5	6	7
1	A	OC = 100 OP = 12	OC = 150 OP = 10	OC = 225 OP = 35	Total OC = 475 Total OP = 57	OP/OC = 12%
2	C	OC = 250 OP = 22	OC = 230 OP = 26	OC = 250 OP = 18	Total OC = 730 Total OP = 66	OP/OC = 9%
3	D		OC = 220 OP = 22	OC = 150 OP = 20	Total OC = 370 Total OP = 42	OP/OC = 11.35%
4	E			OC = 100 OP = (-)5	Total OC = 100 Total OP = (-)5	OP/OC = (-)5%
5	F	OC = 160 OP = 21	OC = 120 OP = 14	OC = 140 OP = 15	Total OC = 420 Total OP = 50	OP/OC = 11.9%
6	G	OC = 150 OP = 21	OC = 130 OP = 12	OC = 155 OP = 13	Total OC = 435 Total OP = 46	OP/OC = 10.57%
7	H	OC = 150 OP = 12		OC = 80 OP = 10	Total OC = 230 Total OP = 22	OP/OC = 9.56%

From the above, the dataset will be constructed as follows :

Sl. No.	1	2	3	4	5	6	7
Values	(-)5%	9%	9.56%	10.57%	11.35%	11.9%	12%

Readers Note:

Question

What are the difficulties arises in applying the arm's length principle?

Answer

The arm's length principle, although survives upon the international consensus, does not necessarily mean that it is perfect. There are difficulties in applying this principle in a number of situations.

(a) The most serious problem is the need to find transactions between independent parties which can be said to be exact compared to the controlled transaction.

(b) It is important to appreciate that in an MNE system, a group first identifies the goal and then goes on to create the associated enterprise and finally, the transactions entered into. This procedure obviously does not apply to independent enterprises. Due to these facts, there may be transactions within an MNE group which may not be between independent enterprises.

(c) Further, the reductionist approach of splitting an MNE group into its component parts before evaluating transfer pricing may mean that the benefits of economies of scale, or integration between the parties, is not appropriately allocated between the MNE group.

(d) The application of the arm's length principle also imposes a burden on business, as it may require the MNE to do things that it would otherwise not do (i.e. searching for comparable transactions, documenting transactions in detail, etc).

(e) Arm's length principle involves a lot of cost to the group.

Readers Note:

57.19 EXTRA PRACTICALS

Practical 12

X Inc., a company in U.S.A. sells gift articles to its Indian subsidiary A Ltd. @$5 per gift article. The assessing officer notice that X Inc. sells same gift articles to another company B Ltd. in India @$4.5 per gift article. Total income of A Ltd. for the relevant assessment year is Rs.15,00,000 after making payment for 1000 gift articles @$5. Compute the total income of A Ltd to be determined by the assessing officer. Assume 1 US $=Rs. 65 for the sake of simplicity. Will computation of total income of X Inc. is required by the assessing officer under chapter transfer pricing?

Solution

Arm's length price in respect of gift article shall be $4.5 per gift article following CUP method.

Computation of total income in the hands of A Ltd. by the assessing officer

Particulars	Rs.
Total Income reported by A Ltd.	15,00,000
Add: Amount paid to X Inc. ($5 X 1000 X Rs. 65)	3,25,000
Less: Purchase to be recorded at Arm's length price ($4.5 X 1000 X 65)	2,92,500
Total Income	**15,32,500**

Computation of total income of X Inc.

As discussed earlier, computation of payee associated enterprise (X Inc) is not required if-

(a) Total income of payer associated enterprise (A Ltd.) has been computed by the A.O and

(b) Tax has been deducted or deductible at source by the payer enterprise.

Readers Note:

Practical 13

Suppose in the above problem X Inc. sells gif article @ $6 to B Ltd. in India, find out the total income of A Ltd. to be determined by the assessing officer.

Solution

Arm's length price in respect of gift article shall be $ 6 per gift article following CUP method.

Computation of total income in the hands of A Ltd. by the assessing officer

Particulars	Rs.
Total Income reported by A Ltd.	15,00,000
Add: Amount paid to X Inc. ($5 X 1000 X Rs. 65)	3,25,000
Less: Purchase to be recorded at Arm's length price ($6 X 1000 X 65)	3,90,000
Total Income	**14,35,000**

By virtue of section 92(3) one cannot reduce taxable income by applying arm's length price.

Therefore income of A Ltd. will be Rs. 15,00,000.

Readers Note:

Practical 14

EF Limited, an Indian company, is engaged in manufacturing electronic components. 74% of shares of the company are held by EF Inc., incorporated in USA. EF Limited has borrowed funds from EF Inc. at LIBOR plus 150 points. The LIBOR prevalent at the time of borrowing is 4% for US $. The borrowings allowed under the External Commercial Borrowings guidelines issued under Foreign Exchange Management Act are LIBOR plus 200 basis points. Discuss whether the borrowing made by EF Limited is at arm's length ('LIBOR' means London Inter-Bank Offer Rate).

Solution

EF Inc., USA and EF Limited, the Indian company are associated enterprises since the former holds 74% shares in the latter.

The arm's length rate of interest can be determined by using CUP method having regard to the rate of interest on external commercial borrowing permissible as per guidelines issued under FEMA Act.

The interest rate permissible is LIBOR plus 200 basis points i.e., 4% + 2% = 6%, which can be taken as the arm's length rate. The interest rate applicable on the borrowing by EF Limited, India from EF Inc., USA, is LIBOR plus 150 basis points i.e., 4% + 1.5% = 5.5%. Since the rate of interest, i.e. 5.5% is less than the arm's length rate of 6%, the borrowing made by the EF Ltd. is not at arm's length.

However, in this case, the taxable income of EF Ltd., India, would be lower if the arm's length rate is applied. Hence, no adjustment is required since the law of transfer pricing will not apply if there is a negative impact on the existing profits.

Readers Note:

Practical 15

Anush Motors Ltd., an Indian company declared income of Rs. 300 crores computed in accordance with Chapter IV-D but before making any adjustments in respect of the following transactions for the year ended on 31.3.2017:

(i) 10,000 cars sold to Rida Ltd. which holds 30% shares in Anush Motors Ltd. at a price which is less by $ 200 each car than the price charged from Shingto Ltd.

(ii) Royalty of $ 1,20,00,000 was paid to Kyoto Ltd. for use of technical know-how in the manufacturing of car. However, Kyoto Ltd. had provided the same know-how to another Indian company for $ 90,00,000.

(iii) Loan of Euro 1000 crores carrying interest @ 10% p.a. advanced by Dorf Ltd., a German company, was outstanding on 31.3.2017. The total book value of assets of Anush Motors Ltd. on the date was Rs. 90,000 crores. The said German company had also advanced a loan of similar amount to another Indian company @ 9% p.a. Total interest paid for the year was EURO 100 crores.

Explain in brief the provisions of the Act affecting all these transactions and compute the income of the company chargeable to tax for A.Y.2017-18 keeping in mind that the value of 1$ and of 1 EURO was Rs.63 and Rs.84, respectively, throughout the year.

Solution

Any income arising from an international transaction, where two or more "associated enterprises" enter into a mutual agreement or arrangement, shall be computed having regard to arm's length price as per the provisions of Chapter X of the Act.

Section 92A defines an "associated enterprise" and more particularly section 92A(2) speaks of thirteen situations when the two enterprises shall be deemed to associated enterprises. Applying the provisions of section 92A(2) to the given facts, "Anush Motors Ltd." and the followings are the "associated enterprises":-

Rida Ltd., because this company holds shares carrying more than 26% of the voting power in Anush Motors Ltd.;

Kyoto Ltd., since this company is the sole owner of the technology used by Anush Motors Ltd. in its manufacturing process;

Dorf Ltd., since this company has granted loans which is more than 51% of the book value of total assets of Anush Motors Ltd.

The transactions entered into by Anush Motors Ltd. with different companies are, therefore, to be adjusted as under so as to find out total income for the A.Y. 2017-18.

Particulars	**(Rs.in crores)**
Income of Anush Motors Ltd. as computed under Chapter IV-D, prior to adjustments as per Chapter X	300.00
Add: Difference on account of adjustment in the value of international transactions	
(i) Difference in price of car @ $ 200 each for 10,000 cars ($ 200 x 10,000 x 63)	12.60
(ii) Difference for excess payment of royalty of $ 30,00,000 ($ 30,00,000 x 63)	18.90
(iii) Difference for excess interest paid on loan of EURO 1000 crores(84*1000*1/100)	840.00
Total Income	**1,171.50**

Readers Note:

Practical 16

'Examine the correctness or otherwise of the following with reference to the provisions of the Income-tax Act, 1961.

"Transfer pricing rules shall have no implication where income is computed on the basis of book profits under section 115JB of the Income Tax Act."

Solution

The statement is correct.

Reason: For the purpose of computing book profit for levy of minimum alternate tax, the net profit shown in the profit and loss account prepared in accordance with the Companies Act can be increased/decreased only by the additions and deductions specified in Explanation 1 to section 115JB. No other adjustments can be made to arrive at the book profit for levy of MAT, except where, it is discovered that the profit and loss account is not drawn up in accordance with the relevant Schedule of the Companies Act.

Therefore, transfer pricing adjustments cannot be made while computing book profit for levy of MAT.

Readers Note:

UNIT D – SAFE HARBOUR RULES

57.20 POWER OF BOARD TO MAKE SAFE HARBOR RULES

Section:- 92CB

- The Central Board of Direct Taxes has been empowered to formulate safe harbor rules i.e. to provide the circumstances in which the income-tax authorities shall accept the transfer price declared by the assessee.
- The safe harbour rules were notified in September 2013. In the rules, safe harbour rates were prescribed for specific nature of international transactions.
- The CBDT, vide notification No. 46, dated 7 June 2017, revised the existing safe harbour rules.

57.21 OVERVIEW OF THE REQUIREMENTS AND PROCEDURE TO OPT FOR SAFE HARBOUR

Rule:- 10TE

Requirements

- The benefit of Safe Harbour is available to an eligible assessee (See Rule 10 TB)
- The eligible assessee must have entered into an eligible transaction (Rule 10TC)
- He must have exercised the option of safe harbor and the option exercised by the said assessee is not held to be invalid under Rule 10TE.
- The assessee shall not be entitled to invoke mutual agreement procedure under DTAA for the transactions under Safe Harbour regime.

Procedure (Rule 10 TE)

- To exercise the option of safe harbour, the taxpayer is required to file specified form (Form No 3CEFA or 3CEFB) with the AO on or before due date of furnishing the return of income with required details for:
  (a) the relevant assessment year, in case the option is exercised only for that assessment year; or
  (b) the first of the assessment years, in case the option is exercised for more than one assessment years.
- The taxpayer can opt out of the safe harbour regime from the second year onwards, by filing a declaration to that effect with the AO.

57.22 SAFE HARBOR RULE NOT TO APPLY IN CERTAIN CASES

Rule:- 10TF

Nothing contained in rules 10TA, 10TB, 10TC, 10TD or rule 10TE shall apply in respect of eligible international transactions entered into with an associated enterprise located in any country or territory notified under section 94A (Popularly known as NJA) or in a no tax or low tax country or territory.

57.23 ELIGIBLE ASSESSEE

Rule:- 10TB

(1) Subject to the provisions of sub-rules (2) and (3), the 'eligible assessee' means a person who has exercised a valid option for application of safe harbour rules in accordance with rule 10TE, and—

(i) is engaged in providing software development services or information technology enabled services or knowledge process outsourcing services, with insignificant risk, to a non-resident associated enterprise (hereinafter referred as foreign principal);

(ii) has made any intra-group loan;

(iii) has provided a corporate guarantee;

(iv) is engaged in providing contract research and development services wholly or partly relating to software development, with insignificant risk, to a foreign principal;

(v) is engaged in providing contract research and development services wholly or partly relating to generic pharmaceutical drugs, with insignificant risk, to a foreign principal;

(vi) is engaged in the manufacture and export of core or non-core auto components and where ninety per cent or more of total turnover during the relevant previous year is in the nature of original equipment manufacturer sales**[**; or**]**

(vii) is in receipt of low value-adding intra-group services from one or more members of its group.

(2) For the purposes of identifying an eligible assessee, with insignificant risk, referred to in item (i) of sub-rule (1), the Assessing Officer or the Transfer Pricing Officer, as the case may be, shall have regard to the following factors, namely:—

(a) the foreign principal performs most of the economically significant functions involved, including the critical functions such as conceptualisation and design of the product and providing the strategic direction and framework, either through its own employees or through its other associated enterprises, while the eligible assessee carries out the work assigned to it by the foreign principal;

(b) the capital and funds and other economically significant assets including the intangibles required, are provided by the foreign principal or its other associated enterprises, and the eligible assessee is only provided a remuneration for the work carried out by it;

(c) the eligible assessee works under the direct supervision of the foreign principal or its associated enterprise which not only has the capability to control or supervise but also actually controls or supervises the activities carried out through its strategic decisions to perform core functions as well as by monitoring activities on a regular basis;

(d) the eligible assessee does not assume or has no economically significant realised risks, and if a contract shows that the foreign principal is obligated to control the risk but the conduct shows that the eligible assessee is doing so, the contractual terms shall not be the final determinant;

(e) the eligible assessee has no ownership right, legal or economic, on any intangible generated or on the outcome of any intangible generated or arising during the course of rendering of services, which vests with the foreign principal as evident from the contract and the conduct of the parties.

(3) For the purposes of identifying an eligible assessee, with insignificant risk, referred to in items (iv) and (v) of sub-rule (1), the Assessing Officer or the Transfer Pricing Officer, as the case may be, shall have regard to the following factors, namely:—

(a) the foreign principal performs most of the economically significant functions involved in research or product development cycle, including the critical functions such as conceptualisation and design of the product and providing the strategic direction and framework, either through its own employees or through its other associated enterprises while the eligible assessee carries out the work assigned to it by the foreign principal;

(b) the foreign principal or its other associated enterprises provides the funds or capital and other economically significant assets including intangibles required for research or product development and also provides a remuneration to the eligible assessee for the work carried out by it;

(c) the eligible assessee works under the direct supervision of the foreign principal or its other associated enterprise which has not only the capability to control or supervise but also actually controls or supervises research or product development, through its strategic decisions to perform core functions as well as by monitoring activities on a regular basis;

(d) the eligible assessee does not assume or has no economically significant realised risks, and if a contract shows that the foreign principal is obligated to control the risk but the conduct shows that the eligible assessee is doing so, the contractual terms shall not be the final determinant;

(e) the eligible assessee has no ownership right, legal or economic, on the outcome of the research which vests with the foreign principal and is evident from the contract as well as the conduct of the parties.

57.24 SAFE HARBOUR

Rule:- 10TD

The revised Safe Harbor rules are tabulated below:

Sr. No.	Eligible International Transaction	Circumstances in which tax authorities shall accept the transfer price declared by the assessee
(1)	(2)	(3)
1.	**Provision of software development services** referred to in item (i) of rule 10TC.	**The operating profit margin** declared by the eligible assessee from the eligible international transaction **in relation to operating expense** incurred is - **(i) not less than 17 per cent**, where the value of international transaction does not exceed a sum of one hundred crore rupees; or **(ii) not less than 18 per cent**, where the value of international transaction exceeds a sum of one hundred crore rupees but does not exceed a sum of two hundred crore rupees.

2.	**Provision of information technology enabled services** referred to in item (ii) of rule 10TC.	**The operating profit margin** declared by the eligible assessee from the eligible international transaction **in relation to operating expense** is - **(i) not less than 17 per cent**, where the aggregate value of such transactions entered into during the previous year does not exceed a sum of one hundred crore rupees; or **(ii) not less than 18 per cent**, where the aggregate value of such transactions entered into during the previous year exceeds a sum of one hundred crore rupees but does not exceed a sum of two hundred crore rupees.
3.	**Provision of knowledge process outsourcing services** referred to in item (iii) of rule 10TC.	The value of international transaction does not exceed a sum of two hundred crore rupees and the operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense is - **(i)** not less than 24 per cent. and the Employee Cost in relation to the Operating Expense is at least sixty per cent. **(ii)** not less than 21 per cent. and the Employee Cost in relation to the Operating Expense is forty per cent. or more but less than sixty per cent. or **(iii)** not less than 18 per cent and the Employee Cost in relation to the Operating Expense does not exceed forty per cent.
4.	**Advancing of intra-group loans** referred to in item (iv) of rule 10TC where the amount of loan is denominated **in Indian Rupees** (INR).	The interest rate declared in relation to the eligible international transaction is **not less than the one-year marginal cost of funds lending rate of State Bank of India as on 1st April of the relevant previous year plus**,- (i) **175 basis points**, where the associated enterprise has CRISIL credit rating between AAA to A or its equivalent; (ii) **325 basis points**, where the associated enterprise has CRISIL credit rating of BBB-, BBB or BBB+ or its equivalent; (iii) **475 basis points**, where the associated enterprise has CRISIL credit rating between BB to B or its equivalent; (iv) **625 basis points**, where the associated enterprise has CRISIL credit rating between C to D or its equivalent; or (v) **425 basis points,** where credit rating of the associated enterprise is not available and the amount of loan advanced to the associated enterprise including loans to all associated enterprises in Indian Rupees does not exceed a sum of one hundred crore rupees in the aggregate as on 31st March of the relevant previous year.

5.	**Advancing of intra-group loans** referred to in item (iv) of rule 10TC **where the amount of loan is denominated in foreign currency**.	The interest rate declared in relation to the eligible international transaction is **not less than the six-month London Inter-Bank Offer Rate of the relevant foreign currency as on 30th September of the relevant previous year plus**, - (i) **150 basis points**, where the associated enterprise has CRISIL credit rating between AAA to A or its equivalent; (ii) **300 basis points**, where the associated enterprise has CRISIL credit rating of BBB-, BBB or BBB+ or its equivalent; (iii) **450 basis points**, where the associated enterprise has CRISIL credit rating between BB to B or its equivalent; (iv) **600 basis points**, where the associated enterprise has CRISIL credit rating between C to D or its equivalent; or (v) **400 basis points**, where credit rating of the associated enterprise is not available and the amount of loan advanced to the associated enterprise including loans to all associated enterprises does not exceed a sum equivalent to one hundred crore Indian rupees in the aggregate as on 31st March of the relevant previous year.
6.	**Providing corporate guarantee** referred to in sub-item (a) or sub-item (b) of item (v) of rule 10TC.	The commission or fee declared in relation to the eligible international transaction is at the rate **not less than one per cent per annum on the amount guaranteed.**
7.	**Provision of contract research and development services** wholly or partly **relating to software development** referred to in item (vi) of rule 10TC.	The **operating profit margin** declared by the eligible assessee from the eligible international transaction **in relation to operating expense** incurred is **not less than 24 per cent,** where the value of the international transaction does not exceed a sum of two hundred crore rupees.
8.	**Provision of contract research and development services** wholly or partly **relating to generic pharmaceutical drugs** referred to in item (vii) of rule 10TC.	The **operating profit margin** declared by the eligible assessee from the eligible international transaction **in relation to operating expense** incurred is **not less than 24 per cent**, where the value of the international transaction does not exceed a sum of two hundred crore rupees.
9.	**Manufacture and export of core auto components** referred to in item (viii) of rule 10TC.	The **operating profit margin** declared by the eligible assessee from the eligible international transaction **in relation to operating expense** is **not less than 12 per cent**.
10.	**Manufacture and export of non-core auto components** referred to in item (ix) of rule 10TC.	The **operating profit margin** declared by the eligible assessee from the eligible international transaction **in relation to operating expense** is **not less than 8.5 per cent**.

11.	**Receipt of low value-adding intra-group services** in item (x) of rule 10TC.	**The entire value of the international transaction, including a mark-up not exceeding 5 per cent**., does not exceed a sum of ten crore rupees: **Provided** that the method of cost pooling, the exclusion of shareholder costs and duplicate costs from the cost pool and the reasonableness of the allocation keys used for allocation of costs to the assessee by the overseas associated enterprise, is certified by an accountant.

57.25 RELEVANT DEFINITIONS

Rule:- 10TA

For the purposes of this rule and rule 10TB to rule 10TG,—

(a) "accountant" means an accountant referred to in the Explanation below sub-section (2) of section 288 of the Act and includes any person recognised for undertaking cost certification by the Government of the country where the associated enterprise is registered or incorporated or any of its agencies, who fulfils the following conditions, namely:—

(I) if he is a member or partner in any entity engaged in rendering accountancy or valuation services then,—

(i) the entity or its affiliates have presence in more than two countries; and

(ii) the annual receipt of the entity in the year preceding the year in which cost certification is undertaken exceeds ten crore rupees;

(II) if he is pursuing the profession of accountancy individually or is a valuer then,—

(i) his annual receipt in the year preceding the year in which cost certification is undertaken, from the exercise of profession, exceeds one crore rupees; and

(ii) he has professional experience of not less than ten years.**]**

(aa)] "contract research and development services wholly or partly relating to software development" means the following, namely:—

(i) research and development producing new theorems and algorithms in the field of theoretical computer science;

(ii) development of information technology at the level of operating systems, programming languages, data management, communications software and software development tools;

(iii) development of Internet technology;

(iv) research into methods of designing, developing, deploying or maintaining software;

(v) software development that produces advances in generic approaches for capturing, transmitting, storing, retrieving, manipulating or displaying information;

(vi) experimental development aimed at filling technology knowledge gaps as necessary to develop a software programme or system;

(vii) research and development on software tools or technologies in specialised areas of computing (image processing, geographic data presentation, character recognition, artificial intelligence and such other areas);or

(viii) upgradation of existing products where source code has been made available by the principal **[**except where the source code has been made available to carry out routine functions like debugging of the software**]**;

(b) "core auto components" means,—

(i) engine and engine parts, including piston and piston rings, engine valves and parts cooling systems and parts and power train components;

(ii) transmission and steering parts, including gears, wheels, steering systems, axles and clutches;

(iii) suspension and braking parts, including brake and brake assemblies, brake linings, shock absorbers and leaf springs;

(c) "corporate guarantee" means explicit corporate guarantee extended by a company to its wholly owned subsidiary being a non-resident in respect of any short-term or long-term borrowing.

Explanation.—For the purposes of this clause, explicit corporate guarantee does not include letter of comfort, implicit corporate guarantee, performance guarantee or any other guarantee of similar nature;

(ca) "employee cost" includes,—

(i) salaries and wages;

(ii) gratuities;

(iii) contribution to Provident Fund and other funds;

(iv) the value of perquisites as specified in clause (2) of section 17 of the Act;

(v) employment related allowances, like medical allowance, dearness allowance, travel allowance and any other allowance;

(vi) bonus or commission by whatever name called;

(vii) lump sum payments received at the time of termination of service or superannuation or voluntary retirement, such as gratuity, severance pay, leave encashment, voluntary retrenchment benefits, commutation of pension and similar payments;

(viii) expenses incurred on contractual employment of persons performing tasks similar to those performed by the regular employees;

(ix) outsourcing expenses, to the extent of employee cost, wherever ascertainable, embedded in the total outsourcing expenses:

Provided that where the extent of employee cost embedded in the total outsourcing expenses is not ascertainable, eighty per cent of the total outsourcing expenses shall be deemed to be the employee cost embedded in the total outsourcing expenses;

(x) recruitment expenses;

(xi) relocation expenses;

(xii) training expenses;

(xiii) staff welfare expenses; and

(xiv) any other expenses related to employees or the employment;

(d) "generic pharmaceutical drug" means a drug that is comparable to a drug already approved by the regulatory authority in dosage form, strength, route of administration, quality and performance characteristics, and intended use;

(e) "information technology enabled services" means the following business process outsourcing services provided mainly with the assistance or use of information technology, namely:—

(i) back office operations;

(ii) call centres or contact centre services;
(iii) data processing and data mining;
(iv) insurance claim processing;
(v) legal databases;
(vi) creation and maintenance of medical transcription excluding medical advice;
(vii) translation services;
(viii) payroll;
(ix) remote maintenance;
(x) revenue accounting;
(xi) support centres;
(xii) website services;
(xiii) data search integration and analysis;
(xiv) remote education excluding education content development; or
(xv) clinical database management services excluding clinical trials,

but does not include any research and development services whether or not in the nature of contract research and development services;

(f) "intra-group loan" means loan advanced to wholly owned subsidiary being a non-resident, where the loan—

(i) is sourced in Indian rupees;
(ii) is not advanced by an enterprise, being a financial company including a bank or a financial institution or an enterprise engaged in lending or borrowing in the normal course of business; and
(iii) does not include credit line or any other loan facility which has no fixed term for repayment;

(g) "knowledge process outsourcing services" means the following business process outsourcing services provided mainly with the assistance or use of information technology requiring application of knowledge and advanced analytical and technical skills, namely:—

(i) geographic information system;
(ii) human resources services;
(iii) engineering and design services;
(iv) animation or content development and management;
(v) business analytics;
(vi) financial analytics; or
(vii) market research,

but does not include any research and development services whether or not in the nature of contract research and development services;

(ga) "low value-adding intra-group services" means services that are performed by one or more members of a multinational enterprise group on behalf of one or more other members of the same multinational enterprise group and which,—

(i) are in the nature of support services;
(ii) are not part of the core business of the multinational enterprise group, i.e., such services neither constitute the profit-earning activities nor contribute to the economically significant activities of the multinational enterprise group;

(iii) are not in the nature of shareholder services or duplicate services;

(iv) neither require the use of unique and valuable intangibles nor lead to the creation of unique and valuable intangibles;

(v) neither involve the assumption or control of significant risk by the service provider nor give rise to the creation of significant risk for the service provider; and

(vi) do not have reliable external comparable services that can be used for determining their arm's length price, but does not include the following services, namely:—

(i) research and development services;

(ii) manufacturing and production services;

(iii) information technology (software development) services;

(iv) knowledge process outsourcing services;

(v) business process outsourcing services;

(vi) purchasing activities of raw materials or other materials that are used in the manufacturing or production process;

(vii) sales, marketing and distribution activities;

(viii) financial transactions;

(ix) extraction, exploration, or processing of natural resources; and

(x) insurance and reinsurance;**]**

(h) "non-core auto components" mean auto components other than core auto components;

(i) "no tax or low tax country or territory" means a country or territory in which the maximum rate of income-tax is less than fifteen per cent;

(j) "operating expense" means the costs incurred in the previous year by the assessee in relation to the international transaction during the course of its normal operations including **[**costs relating to Employee Stock Option Plan or similar stock-based compensation provided for by the associated enterprises of the assessee to the employees of the assessee, reimbursement to associated enterprises of expenses incurred by the associated enterprises on behalf of the assessee, amounts recovered from associated enterprises on account of expenses incurred by the assessee on behalf of those associated enterprises and which relate to normal operations of the assessee and**]** depreciation and amortisation expenses relating to the assets used by the assessee, but not including the following, namely:—

(i) interest expense;

(ii) provision for unascertained liabilities;

(iii) pre-operating expenses;

(iv) loss arising on account of foreign currency fluctuations;

(v) extraordinary expenses;

(vi) loss on transfer of assets or investments;

(vii) expense on account of income-tax; and

(viii) other expenses not relating to normal operations of the assessee:

Provided that reimbursement to associated enterprises of expenses incurred by the associated enterprises on behalf of the assessee shall be at cost:

Provided further that amounts recovered from associated enterprises on account of expenses incurred by the assessee on behalf of the associated enterprises and which relate to normal operations of the assessee shall be at cost;

(k) "operating revenue" means the revenue earned by the assessee in the previous year in relation to the international transaction during the course of its normal operations **[**including costs relating to Employee Stock Option Plan or similar stock-based compensation provided for by the associated enterprises of the assessee to the employees of the assessee**]** but not including the following, namely:—

(i) interest income;
(ii) income arising on account of foreign currency fluctuations;
(iii) income on transfer of assets or investments;
(iv) refunds relating to income-tax;
(v) provisions written back;
(vi) extraordinary incomes; and
(vii) other incomes not relating to normal operations of the assessee.

(l) "operating profit margin" in relation to operating expense means the ratio of operating profit, being the operating revenue in excess of operating expense, to the operating expense expressed in terms of percentage;

(la) "relevant previous year" means the previous year relevant to the assessment year in which the option for safe harbour is validly exercised;

(m) "software development services" means,—

(i) business application software and information system development using known methods and existing software tools;
(ii) support for existing systems;
(iii) converting or translating computer languages;
(iv) adding user functionality to application programmes;
(v) debugging of systems;
(vi) adaptation of existing software; or
(vii) preparation of user documentation,

but does not include any research and development services whether or not in the nature of contract research and development services.

Practical 17

Examine the following transactions and discuss whether the transfer price declared by the following assessees, who have exercised a valid option for application of safe harbour rules, can be accepted by the Income-tax Authorities –

	Assessee	International Transaction	Aggregate value of transactions entered into in the P.Y.2017-18 (Rs.in crore)	Declared Operating Margin (Rs.in crore)	Operating Expense (Rs.in crore)
(1)	A Ltd., an Indian company	Provision of system support services to X Inc., which is a "specified foreign company" in relation to A Ltd.	95	12	75
(2)	B Ltd., an Indian company	Provision of data processing services with the use of information technology to Y Inc., its foreign subsidiary	180	30	150
(3)	C & Co., a partnership firm registered under the Partnership Act, 1932	Provision of contract R & D services relating to development of internet technology, to XYZ & Co., a foreign firm, which holds 12% interest in C & Co.	175	30	150
(4)	D Ltd., an Indian company	Provision of contract R & D services relating to generic pharmaceutical drug, to ABC Inc., a foreign company which guarantees 15% of the total borrowings of D Ltd.	50	9	30
(5)	Sole proprietary concern of Mr.E, solely engaged in the original manufacture and export of automobile transmission and steering parts.	100% export of automobile transmission and steering parts to LMN LLP, a foreign LLP, controlled by Mr.E jointly with his relatives.	12	1	10
(6)	F Ltd. an Indian company, solely engaged in the original manufacture and export of non-core auto components.	100% export of non-core auto components to GKG Inc., a foreign company. F Ltd. appoints two-thirds of the Board of Directors of GKG Inc.	12	1	10

In all the above cases, it may be assumed that the Indian entity which provides the services assumes insignificant risk. It may also be assumed that the foreign entities referred to above are non-resident in India.

Would your answer change, if in any of the cases mentioned above, the foreign entity is located in a notified jurisdictional area?

Solution

(1) X Inc. is a specified foreign company in relation to A Ltd. Therefore, the condition of A Ltd. holding shares carrying not less than 26% of the voting power in X Inc is satisfied. Hence, X Inc. and A Ltd. are deemed to be associated enterprises. Therefore, provision of systems support services by A Ltd., an Indian company, to X Inc., a foreign company, is an international transaction between associated enterprises, and consequently, the provisions of transfer pricing are attracted in this case.

Systems support services falls within the definition of "software development services", and hence, is an eligible international transaction. Since A Ltd. is providing software development services to a non-resident associated enterprise and has exercised a valid option for safe harbour rules, it is an eligible assessee.

Since the value of international transactions entered does not exceed Rs.100 crore, A Ltd. should have declared an operating profit margin of not less than 17% in relation to operating expense, to be covered within the safe harbour rules. However, since A Ltd. has declared an operating profit margin of only 16% $\left(i.e., \frac{12}{75} \times 100\right)$, the same is not in accordance with the circumstance mentioned in Rule 10TD. Hence, it is not binding on the income-tax authorities to accept the transfer price declared by A Ltd.

(2) Y Inc., a foreign company, is a subsidiary of B Ltd., an Indian company. Hence, Y Inc. and B Ltd. are associated enterprises. Therefore, provision of data processing services by B Ltd., an Indian company, to Y Inc., a foreign company, is an international transaction between associated enterprises, and consequently, the provisions of transfer pricing are attracted in this case. Data processing services with the use of information technology falls within the definition of "information technology enabled services", and is hence, an eligible international transaction. Since B Ltd. is providing data processing services to a non-resident associated enterprise and has exercised a valid option for safe harbour rules, it is an eligible assessee.

Since the aggregate value of transactions entered into in the P.Y.2017-18 exceeds Rs. 100 crore but does not exceed Rs. 200 crore, B Ltd. should have declared an operating profit margin of not less than 18% in relation to operating expense, to be covered within the scope of safe harbour rules. In this case, since B Ltd. has declared an operating profit margin of 20% $\left(i.e., \frac{30}{150} \times 100\right)$, the same is in accordance with the circumstance mentioned in Rule 10TD. Hence, the income-tax authorities shall accept the transfer price declared by B Ltd in respect of such international transaction.

(3) XYZ & Co., a foreign firm holds 12% interest in C & Co., an Indian firm. Therefore, the condition of one enterprise, being a foreign firm, holding not less than 10% interest in another enterprise, being an Indian firm, is satisfied. Hence, XYZ & Co. and C & Co. are deemed to be associated enterprises. Therefore, provision of contract R & D services relating to software development by C & Co., an

Indian firm, to XYZ & Co., a foreign firm, is an international transaction between associated enterprises, and consequently, the provisions of transfer pricing are attracted in this case.

Development of internet technology falls within the meaning of "contract R&D services wholly or partly relating to software development", and hence, is an eligible international transaction. Since C & Co., an Indian firm, is providing contract R & D services to a non-resident associated enterprise and has exercised a valid option for safe harbour rules, it is an eligible assessee.

Since the value of the international transaction does not exceed Rs. 200 crore, C & Co. should have declared an operating profit margin of not less than 24% in relation to operating expense, to be covered within the safe harbour rules. However, since C & Co. has declared an operating profit margin of only 20% $\left(i.e., \frac{30}{150} \times 100\right)$, the same is not in accordance with the circumstance mentioned in Rule 10TD. Hence, it is not binding on the income-tax authorities to accept the transfer price declared by C & Co.

(4) ABC Inc., a foreign company, guarantees 15% of the total borrowings of D Ltd., an Indian company. Since ABC Inc. guarantees not less than 10% of the total borrowings of D Ltd., ABC Inc. and D Ltd. are deemed to be associated enterprises. Therefore, provision of contract R & D services relating to generic pharmaceutical drug by D Ltd., an Indian company, to ABC Inc., a foreign company, is an international transaction between associated enterprises, and consequently, the provisions of transfer pricing are attracted in this case.

Provision of contract R& D services in relation to generic pharmaceutical drug is an eligible international transaction. Since D Ltd. is providing such services to a non-resident associated enterprise and has exercised a valid option for safe harbour rules, it is an eligible assessee.

Since the value of the international transaction does not exceed Rs. 200 crore, D Ltd. should have declared an operating profit margin of not less than 24% in relation to operating expense, to be covered within the scope of safe harbour rules. In this case, since D Ltd. has declared an operating profit margin of 30% $\left(i.e., \frac{9}{30} \times 100\right)$, the same is in accordance with the circumstance mentioned in Rule 10TD. Hence, the income-tax authorities shall accept the transfer price declared by D Ltd in respect of such international transaction.

(5) LMN LLP, a foreign LLP, is controlled by Mr. E jointly with his relatives. Mr. E also has control over his own sole proprietorship concern. Therefore, the sole proprietorship concern of Mr. E in India and LMN LLP are deemed to be associated enterprises. Automobile transmission and steering parts fall within the meaning of "core auto components", and hence, 100% export of all such parts originally manufactured by the sole proprietorship concern of Mr. E is an eligible international transaction. Since the sole proprietorship concern of Mr. E is solely engaged in the original manufacture and 100% export of such parts and has exercised a valid option for safe harbour rules, it is an eligible assessee.

The sole-proprietorship concern of Mr. E should have declared an operating profit margin of not less than 12% in relation to operating expense, to be covered within the safe harbour rules. However, since A Ltd. has declared an operating profit margin of only 10% $\left(i.e., \frac{1}{10} \times 100\right)$, the same is not in accordance with the circumstance mentioned in Rule 10TD. Hence, it is not binding on the income-tax authorities to accept the transfer price declared by Mr. E.

(6) F Ltd. and GKG Inc. are deemed to be associated enterprises since F Ltd. appoints more than half of the Board of Directors of GKG Inc. Manufacture and export of non-core auto components is an eligible international transaction. Since F Ltd. is engaged in original manufacture of non-core auto components and 100% export of the same, it is an eligible assessee. F Ltd. should have declared an operating profit margin of not less than 8.5% in relation to operating expense, to be covered within the scope of safe harbour rules. In this case, since F Ltd. has declared an operating profit margin of 10% $\left(i.e., \frac{1}{10} \times 100\right)$, the same is in accordance with the circumstance mentioned in Rule 10TD. Hence, the income-tax authorities shall accept the transfer price declared by F Ltd in respect of such international transaction.

The safe harbour rules shall not apply in respect of eligible international transactions entered into with an associated enterprise located in a notified jurisdictional area. Therefore, if in any of the cases mentioned above, the foreign entity is located in a NJA, the safe harbour rules shall not be applicable, irrespective of the operating profit margin declared by the assessee.

Readers Note:

57.26 NOTIFICATION – GOVT. COMPANY IN THE BUSINESS OF GENERATION, TRANSMISSION OR DISTRIBUTION OF ELECTRICITY TO OPT SAFE HARBOUR

Notification No. 11/2015, dated 04.02.2015

The CBDT has, vide this notification, in exercise of the powers conferred by section 92CB and 92D, read with section 295, inserted Rules 10TH, 10THA, 10THB, 10THC & 10THD providing the safe harbour rules for specified domestic transactions.

Nature of specified domestic transaction	Circumstances
Supply of electricity, transmission of electricity, wheeling of electricity referred to [in clause (i), (ii) or (iii) of rule 10THB, as the case may be]	The tariff in respect of supply of electricity, transmission of electricity, wheeling of electricity, as the case may be, is determined [or the methodology for determination of the tariff is approved] by the Appropriate Commission in accordance with the provisions of the Electricity Act, 2003 (36 of 2003).

57.27 NOTIFICATION – CO-OPERATIVE SOCIETIES PROCURING AND MARKETING MILK ELIGIBLE TO OPT FOR SAFE HARBOUR RULES

Notification No. 90/2015, dated 18.12.2015

Under section 92CB(2), the CBDT is empowered to make rules for safe harbour. Further, section 92D empowers the CBDT to make rules regarding keeping and maintenance of specified information and document for assessees entering into an international transaction or specified domestic transaction as well as to prescribe the period for which information and documents shall be kept and maintained. Accordingly, in exercise of the powers conferred under such sections, the CBDT has amended Rules 10D, 10THA, 10THB, 10THC and 10THD.

Nature of specified domestic transaction	Circumstances
Purchase of milk or milk products referred to in clause (iv) of rule 10THB.	The price of milk or milk products is determined at a rate which is fixed on the basis of the quality of milk, namely, fat content and Solid Not Fat (SNF) content of milk; and- (a) the said rate is irrespective of,- (i) the quantity of milk procured; (ii) the percentage of shares held by the members in the co-operative society; (iii) the voting power held by the members in the society; and (b) such prices are routinely declared by the cooperative society in a transparent manner and are available in public domain.”.

UNIT E – ADVANCE PRICING AGREEMENTS

57.28 ADVANCE PRICING AGREEMENT (APA)

Section:- 92CC, 92CD and Notification No:- 36/2012 dated 30-08-2012

(1) Advance Pricing Agreement is an agreement between a taxpayer and a taxing authority on an appropriate transfer pricing methodology for a set of transactions over a fixed period of time in future. The APA offers better assurance on transfer pricing methods and are conducive in providing certainty and unanimity of approach.

(2) Types of APA-

(a) Unilateral APAs - Unilateral APA is an arrangement between the tax payer and the Indian tax administration (CBDT)

(b) Bi-lateral/ multilateral APAs- Bilateral / multilateral APA involves not only the taxpayer and the Indian tax administration but also the taxpayer's affiliates (with whom he transacts) and their tax administration.

(3) Sections 92CC and 92CD have been inserted by the Finance Act, 2012 with effect from July 1, 2012 to provide a framework for advance pricing agreement under the Act.

Consider the following FAQ on APA.

Question 18

What is Advance Pricing Agreement (APA)?

Answer

Advance Pricing Agreement (APA) is an agreement between a taxpayer and a taxing authority on an appropriate transfer pricing methodology for a set of transactions over a fixed period of time in future.

Readers Note:

Question 19

State the purpose of APA (Advance Pricing Agreement)?

Answer

APA shall include determination of the arm's length price or specify the manner in which arm's length price shall be determined, in relation to an international transactions to be entered into, by that person.

Readers Note:

Question 20

Who can apply for advance pricing agreement and state the time limit for its withdrawal?

Answer

Any person who has undertaken an international transaction or who is contemplating to undertake an international transaction is eligible to apply for Advance Pricing Agreement(APA). The applicant may withdraw the application for agreement in Form No.3CEE at any time before the finalisation of the terms of the agreement. The fee paid shall not be refunded on withdrawal of application by the applicant.

Readers Note:

Question 21

What is the maximum period for which advance pricing agreement shall remain valid?

Answer

An advance pricing agreement shall remain valid for such period not exceeding 5 consecutive previous years as may be specified in the agreement

Readers Note:

Question 22

Shall APA be made applicable to the international transactions carried out in previous year(s) prior to the date of application?

Answer

With effect from 1st October, 2014, as per provisions of section 92CC (9A), the 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.

E.g. If ABCD Ltd. has entered into an APA for a period of five years starting from previous year 2014-15, then subject to prescribed conditions, it can avail benefit of APA for the following financial years

Previous Years for which benefit available	**Comment**
2010-11	Preceding four previous years for which Roll Back Provision is applicable
2011-12	
2012-13	
2013-14	
2014-15 (Year in respect of which APA was entered)	**Five consecutive Previous years for which APA has been entered into**
2015-16	
2016-17	
2017-18	
2018-19	

Readers Note:

Question 23

How determination of ALP shall be made when taxpayer has entered into APA?

Answer

The manner of determination of arm's length price in a case where APA has been entered into, shall be by any method including those already provided in section 92C(1), with necessary adjustments or variations mentioned in APA.

Readers Note:

Question 24

Discuss the effectiveness of APA.

Answer

The APA shall be binding only on the person and the Commissioner (including income-tax authorities subordinate to him) in respect of the transaction in relation to which the agreement has been entered into. The APA shall not be binding if there is any change, in law, or facts having bearing on such APA.

Readers Note:

Question 25

Under what circumstance may, an advance pricing agreement, be declared to be void ab initio?

Answer

An advance pricing agreement can be declared by the CBDT as void ab initio with the approval of the Central Government, if it has been obtained by fraud or misrepresentation of facts.

Readers Note:

Question 26

In case an advance pricing agreement is entered into, does it have any effect on the return of income of the assessee?

Answer

As per section 92CD, where any person has entered into advance pricing agreement, and he has already furnished return of income under section 139 for any assessment year to which such agreement applies, such person shall furnish a modified return of income within a period of 3 months from the end of the month in which the said agreement was entered into in accordance with and limited to the agreement.

Readers Note:

Question 27

Narrate the procedures relating to pre-filing consultation of advance pricing agreement.

Answer

Every person proposing to enter into APA must file an application in writing making a request for pre-filing consultation. On the receipt of request in Form No.3CEC, the team shall hold consultation with the person referred to in rule 10G (i.e. a person who has undertaken or contemplating to undertake international transaction).

The competent authority in India or his representative shall be associated in pre-filing consultation involving bilateral or multilateral agreement.

The pre-filing consultation shall include - (a) determining the scope of agreement; (b) identify transfer pricing issues; (c) determine the suitability of international transaction for the agreement; and (d) discuss the broad terms of the agreement.

The pre-consultation agreement will not bind the Board or the person to enter into an agreement or initiate the agreement process. It shall not be deemed to mean that the person has applied for entering into an agreement.

Readers Note:

Question 28

What are the terms of APA?

Answer

Terms of APA include –

(i) the international transactions covered by the agreement;

(ii) the agreed transfer pricing methodology, if any;

(iii) determination of arm's length price, if any;

(iv) definition of any relevant term to be used in item (ii) or (iii);

(v) critical assumptions i.e. the factors and assumptions that are so critical and significant that neither party entering into an agreement will continue to be bound by the agreement, if any of the factors or assumptions is changed ;

Readers Note:

Question 29

Narrate the procedure for furnishing Annual Compliance Report by the assessee, where advance pricing agreement has been entered into.

Answer

The assessee shall furnish an annual compliance report in quadruplicate to DGIT (International Taxation) for each year covered in the agreement. Annual compliance report shall be furnished within 30 days of the due date for filing return of income for that year or within 90 days of entering into an agreement, whichever is later.

The DGIT (International Taxation) shall send one copy of annual compliance report to the competent authority, one copy to Commissioner of Income Tax having jurisdiction of the assessee and one copy to the Transfer Pricing Officer having jurisdiction over the assessee.

Readers Note:

Question 30

Write a note on Compliance Audit of Advance Pricing Agreement.

Answer

Compliance Audit of Advance Pricing Agreement (Rule 10P):

(1) The Transfer Pricing Officer having the jurisdiction over the assessee shall carry out the compliance audit of the agreement for each of the year covered in the agreement.

(2) For the purposes of sub-rule(1), the Transfer Pricing Officer may require –

(i) the assessee to substantiate compliance with the terms of the agreement, including satisfaction of the critical assumptions, correctness of the supporting data or information and consistency of the application of the transfer pricing method;

(ii) the assessee to submit any information, or document, to establish that the terms of the agreement has been complied with.

(3) The Transfer Pricing Officer shall submit the compliance audit report, for each year covered in the agreement, to the Director General of Income Tax (International Taxation) in case of unilateral agreement and to the competent authority in India, in case of bilateral or multilateral agreement, mentioning therein his findings as regards compliance by the assessee with terms of the agreement.

(4) The Director General of Income Tax (International Taxation) shall forward the report to the Board in a case where there is finding of failure on part of assessee to comply with terms of agreement and cancellation of the agreement is required.

(5) The compliance audit report shall be furnished by the Transfer Pricing Officer within six months from the end of the month in which the Annual Compliance Report referred to in rule 10 O is received by the Transfer Pricing Officer.

(6) The regular audit of the covered transactions shall not be undertaken by the Transfer Pricing Officer if an agreement has been entered into under rule 10L except where the agreement has been cancelled under rule 10R.

Readers Note:

Question 31

Can the application for advance pricing agreement be amended? If so, state the conditions.

Answer

Yes. The applicant may request in writing for an amendment to the application at any stage before the finalization of the terms of the agreement.

The DGIT for unilateral agreement or the competent authority in India for bilateral or multilateral agreement may allow the amendment if it does not have the effect of altering the nature of application originally filed.

An amendment is possible only if it is accompanied by the additional fee, if any, necessitated by such amendment in accordance with rule 10 - I.

Readers Note:

Question 32

State the reasons for cancellation of advance pricing agreement.

Answer

An agreement shall be cancelled by the Board for any of the following reasons:

(i) the compliance audit has resulted in the finding of failure on the part of the assessee to comply with the terms of the agreement;

(ii) the assessee has failed to file the annual compliance report in time;

(iii) the annual compliance report furnished by the assessee contains material errors; or

(iv) the assessee is not in agreement with the revision proposed in the agreement.

Readers Note:

57.29 NOTIFICATION – RULES FOR ROLLBACK OF APA – AN OVERVIEW

Notification No:- 23/2015 dated 14-03-2015

As discussed earlier, the roll back provision was brought into the Act vide Finance (No. 2) Act 2014, with effect from 1 October, 2014.

The Board has announced detailed rules explaining the roll back provisions and the procedure for giving effect to them. Apart from that, the Board has made another key amendment, wherein pre-filing consultation has been made optional for the taxpayer. Following are the key observation of these Rules.

- Form 3CEDA for the relevant roll back years have been filed before due date.
- Roll back application should cover all the roll back years (i.e., the years falling with the block of four years) in which the international transaction has taken place.
- Roll back provisions shall not be provided, in respect of an international transaction, if the Income-tax Appellate Tribunal has passed an order disposing off an appeal relating to determination of ALP of the international transaction, at any time before signing of the APA agreement; or application of roll back has the effect of reducing total income or increasing the total loss.
- The manner of determining ALP in the roll back years with respect to any particular international transaction will be same as the manner agreed in the regular APA.

57.30 CBDT CIRCULAR CLARIFY CERTAIN ISSUES ARISING OUT OF THE ROLL BACK RULES

Circular No. 10/2015 dated 10.06.2015

Question 1

Under rule 10MA(2)(ii) there is a condition that the return of income for the relevant roll back year has been or is furnished by the applicant before the due date specified in Explanation 2 to section 139(1). It is not clear as to whether applicants who have filed returns under section 139(4) or 139(5) of the Act would be eligible for roll back.

Answer

The return of income under section 139(5) can be filed only when a return under section 139(1) has already been filed. Therefore, the return of income filed under section 139(5) of the Act, replaces the original return of income filed under section 139(1). Hence, if there is a return which is filed under section 139(5) to revise the original return filed before the due date specified in Explanation 2 to sub-section (1) of section 139, the applicant would be entitled for rollback on this revised return of income.

However, rollback provisions will not be available in case of a return of income filed under section 139(4) because it is a return which is not filed before the due date.

Question 2

Rule 10MA(2)(i) mandates that the rollback provision shall apply in respect of an international transaction that is same as the international transaction to which the agreement (other than the rollback provision) applies. It is not clear what is the meaning of the word “same”. Further, it is not clear whether this restriction also applies to the Functions, Assets, Risks (FAR) analysis.

Answer

The international transaction for which a rollback provision is to be allowed should be the same as the one proposed to be undertaken in the future years and in respect of which the agreement has been reached. There cannot be a situation where rollback is finalised for a transaction which is not covered in the agreement for future years. The term same international transaction implies that the transaction in the rollback year has to be of same nature and undertaken with the same associated enterprise(s), as proposed to be undertaken in the future years and in respect of which agreement has been reached. In the context of FAR analysis, the restriction would operate to ensure that rollback provisions would apply only if the FAR analysis of the rollback year does not differ materially from the FAR validated for the purpose of reaching an agreement in respect of international transactions to be undertaken in the future years for which the agreement applies.

The word "materially" is generally being defined in the Advance Pricing Agreements being entered into by CBDT. According to this definition, the word "materially" will be interpreted consistently with its ordinary definition and in a manner that a material change of facts and circumstances would be understood as a change which could reasonably have resulted in an agreement with significantly different terms and conditions.

Question 3

Rule 10MA(2)(iv) requires that the application for rollback provision, in respect of an international transaction, has to be made by the applicant for all the rollback years in which the said international transaction has been undertaken by the applicant. Clarification is required as to whether rollback has to be requested for all four years or applicant can choose the years out of the block of four years.

Answer

The applicant does not have the option to choose the years for which it wants to apply for rollback. The applicant has to either apply for all the four years or not apply at all. However, if the covered international transaction(s) did not exist in a rollback year or there is some disqualification in a rollback year, then the applicant can apply for rollback for less than four years. Accordingly, if the covered international transaction(s) were not in existence during any of the rollback years, the applicant can apply for rollback for the remaining years.

Similarly, if in any of the rollback years for the covered international transaction(s), the applicant fails the test of the rollback conditions contained in various provisions, then it would be denied the benefit of rollback for that rollback year. However, for other rollback years, it can still apply for rollback.

Question 4

Rule 10MA(3) states that the rollback provision shall not be provided in respect of an international transaction for a rollback year if the determination of arm's length price of the said international transaction for the said year has been the 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. Further, Rule 10 RA(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.

There is a need to clarify the phrase "Tribunal has passed an order disposing of such appeal" and on the mismatch, if any, between Rule 10MA(3) and Rule 10RA(4).

Answer

The reason for not allowing rollback for the international transaction for which Appellate Tribunal has passed an order disposing of an appeal is that the ITAT is the final fact finding authority and hence, on factual issues, the matter has already reached finality in that year.

However, if the ITAT has not decided the matter and has only set aside the order for fresh consideration of the matter by the lower authorities with full discretion at their disposal, the matter shall not be treated as one having reached finality and hence, benefit of rollback can still be given. There is no mismatch between Rule 10MA(3) and Rule 10RA(4).

Question 5

Rule 10MA(3)(ii) provides that rollback provision shall not be provided in respect of an international transaction for a rollback year if 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. It may be clarified whether the rollback provisions in such situations can be applied in a manner so as to ensure that the returned income or loss is accepted as the final income or loss after applying the rollback provisions.

Answer

It is clarified that in case the terms of rollback provisions contain specific agreement between the Board and the applicant that the agreed determination of ALP or the agreed manner of determination of ALP is subject to the condition that the ALP would get modified to the extent that it does not result in reducing the total income or increasing the total loss, as the case may be, of the applicant as declared in the return of income of the said year, the rollback provisions could be applied. For example, if the declared income is Rs. 100, the income as adjusted by the TPO is Rs. 120, and the application of the rollback provisions results in reducing the income to Rs. 90, then the rollback for that year would be determined in a manner that the declared income Rs. 100 would be treated as the final income for that year.

Question 6

Rule 10RA(7) states that in case effect cannot be given to the rollback provision of an agreement in accordance with this rule, for any rollback year to which it applies, on account of failure on the part of applicant, the agreement shall be cancelled. It is to be clarified as to whether the entire agreement is to be cancelled or only that year for which roll back fails.

Answer

The procedure for giving effect to a rollback provision is laid down in Rule 10RA. Sub-rules (2), (3), (4) and (6) of the Rule specify the actions to be taken by the applicant in order that effect may be given to the rollback provision. If the applicant does not carry out such actions for any of the rollback years, the entire agreement shall be cancelled.

This is because the rollback provision has been introduced for the benefit of the applicant and is applicable at its option. Accordingly, if the rollback provision cannot be given effect to for any of the rollback years on account of the applicant not taking the actions specified in subrules (2), (3), (4) or (6), the entire agreement gets vitiated and will have to be cancelled.

Question 7

If there is a Mutual Agreement Procedure (MAP) application already pending for a rollback year, what would be the stand of the APA authorities? Further, what would be the view of the APA Authorities, if MAP has already been concluded for a rollback year?

Answer

If MAP has been already concluded for any of the international transactions in any of the rollback year under APA, rollback provisions would not be allowed for those international transactions for that year but could be allowed for other years or for other international transactions for that year, subject to fulfilment of specified conditions in Rules 10MA and 10RA. However, if MAP request is pending for any of the rollback year under APA, upon the option exercised by the applicant, either MAP or application for roll back shall be proceeded with for such year.

Question 8

Rule 10MA(1) provides that the agreement may provide for determining ALP or manner of determination of ALP. However, Rule 10MA(4) only specifies that the manner of determination of ALP should be the same as in the APA term. Does that mean the ALP could be different?

Answer

Yes, the ALP could be different for different years. However, the manner of determination of ALP (including choice of Method, comparability analysis and Tested Party) would be same.

Question 9

Will there be compliance audit for roll back? Would critical assumptions have to be validated during compliance audit?

Answer

Since rollback provisions are for past years, ALP for the rollback years would be agreed after full examination of all the facts, including validation of critical assumptions. Hence, compliance audit for the rollback years would primarily be to check if the agreed price or methodology has been applied in the modified return.

Question 10

Whether applicant has an option to withdraw its rollback application? Can the applicant accept the rollback results without accepting the APA for the future years?

Answer

The applicant has an option to withdraw its roll back application even while maintaining the APA application for the future years. However, it is not possible to accept the rollback results without accepting the APA for the future years. It may also be noted that the fee specified in Rule 10MA(5) shall not be refunded even where a rollback application is withdrawn.

Question 11

For already concluded APAs, will new APAs be signed for rollback or earlier APAs could be revised?

Answer

The second proviso to Rule 10MA(5) provides for revision of APAs already concluded to include rollback provisions.

Question 12

For already concluded APAs, where the modified return has already been filed for the first year of the APA term, how will the time-limit for filing modified return for rollback years be determined?

Answer

The time to file modified return for rollback years will start from the date of signing the revised APA incorporating the rollback provisions.

Question 13

In case of merger of companies, where one or more of those companies are APA applicants, how would the rollback provisions be allowed and to which company or companies would it be allowed?

Answer

The agreement is between the Board and a person. The principle to be followed in case of merger is that the person (company) who makes the APA application would only be entitled to enter into the agreement and be entitled for the rollback provisions in respect of international transactions undertaken by it in rollback years. Other persons (companies) who have merged with this person (company) would not be eligible for the rollback provisions.

To illustrate, if A, B and C merge to form C and C is the APA applicant, then the agreement can only be entered into with C and only C would be eligible for the rollback provisions. A and B would not be eligible for the rollback provisions. To illustrate further, if A and B merge to form a new company C and C is the APA applicant, then nobody would be eligible for rollback provisions.

Question 14

In case of a demerger of an APA applicant or signatory into two or more companies (persons), who would be eligible for the rollback provisions?

Answer

The same principle as mentioned in the previous answer, i.e., the person (company) who makes an APA application or enters into an APA would only be entitled for the rollback provisions, would continue to apply. To illustrate, if A has applied for or entered into an APA and, subsequently, demerges into A and B, then only A will be eligible for rollback for international transactions covered under the APA. As B was not in existence in rollback years, availing or grant of rollback to B does not arise.

UNIT F – CONCEPT OF SECONDARY ADJUSTMENT AND THIN CAPITALISATION

57.31 SECONDARY ADJUSTMENT IN CERTAIN CASES

Section:- 92CE – Effective from A.Y. 2018-19

(1) Meaning

"primary adjustment" to a transfer price, means the determination of transfer price in accordance with the arm's length principle resulting in an increase in the total income or reduction in the loss, as the case may be, of the assessee;

"secondary adjustment" means an adjustment in the books of account of the assessee and its associated enterprise to reflect that the actual allocation of profits between the assessee and its associated enterprise are consistent with the transfer price determined as a result of primary adjustment, thereby removing the imbalance between cash account and actual profit of the assessee.

(2) Applicability of secondary adjustment :- [Section 92CE(1)]

Where a primary adjustment to transfer price,—

(i) has been made suo motu by the assessee in his return of income;

(ii) made by the Assessing Officer has been accepted by the assessee;

(iii) is determined by an advance pricing agreement entered into by the assessee under section 92CC;

(iv) is made as per the safe harbour rules framed under section 92CB; or

(v) is arising as a result of resolution of an assessment by way of the mutual agreement procedure under an agreement entered into under section 90 or section 90A for avoidance of double taxation,

the assessee shall make a secondary adjustment:

(3) When Secondary adjustment not required [Proviso to section 92CE(1)]

Secondary adjustment not required if,—

(i) the amount of primary adjustment made in any previous year does not exceed one crore rupees; and

(ii) the primary adjustment is made in respect of an assessment year commencing on or before the 1st day of April, 2016.

(4) Quantification of Secondary Adjustment [Section 92 CE(2)]

Where, as a result of primary adjustment to the transfer price, there is an increase in the total income or reduction in the loss, as the case may be, of the assessee, the excess money which is available with its associated enterprise, if not repatriated to India within the time as may be prescribed, shall be deemed to be an advance made by the assessee to such associated enterprise and the interest on such advance, shall be computed in such manner as may be prescribed. (Notification 52 / 2017 dated 15-06-2017 tabulated below)

Type of primary adjustment	Time limit for repatriation	Applicable interest rate for delayed receipts	
		Transaction in INR	Transaction in Foreign currency
Adjustment made by the Indian Tax Authority and accepted by the taxpayer	On or before 90 days from the date of relevant order	One year marginal cost of fund lending rate of State Bank of India as of 1 April of the relevant FY plus 325 basis points	Six month London Interbank Offered rate as of 30 September of the relevant FY plus 300 basis points
Suo-moto adjustment by the taxpayer	On or before 90 days from the due date of filing return of income (or modified return as may be applicable in case of an APA)		
Adjustment pursuant to APA, Safe Harbour or MAP			

For the purpose of this section, "excess money" means the difference between the arm's length price determined in primary adjustment and the price at which the international transaction has actually been undertaken.

Practical 33

Infybim Private Limited (IPL) is an Indian company in which Moon Inc.(Foreign Company) holds 26% equity. IPL provides following information:

(a) IPL provides system support services to Moon Inc.

(b) During the year 2017-18, IPL provided services to the tune of Rs. 12 crore.

(c) However, assessing officer determines arm's length price at Rs.15.25 Crore and the same is accepted by IPL.

You are required to discuss the concept of "Primary adjustment" and "Secondary adjustment" assuming that excess money is not repatriated to India by Moon Inc.

Solution

The addition made by assessing officer to the total income of IPL is Rs. 3.25 crore – It is called primary adjustment.

Since this excess Rs. 3.25 crore has not been repatriated by Moon Inc. to IPL, it would be termed as deemed advance (a secondary adjustment) made by IPL to Moon Inc. Thereafter, interest shall be charged on such deemed advance in such manner as may be prescribed.

Reader's Note:

57.32 LIMITATION ON INTEREST DEDUCTIBLE

Section:- 94B – Effective from A.Y. 2018-19

(1) Preference of debt over equity as a measure to finance businesses

Debt and equity are the instruments through which a company is generally financed or capitalized. The manner in which a company is capitalized has a major impact on the amount of taxable profit as the tax laws of countries generally provide for a deduction in respect of interest paid or payable while arriving at the taxable profit. However, the dividend paid on equity contribution is not deductible.

Therefore, the higher the level of debt in a company, and thus, the amount of interest it pays, the lower will be its taxable income. Due to this reason, debt is considered a more tax efficient method of finance than equity. Multinational groups are often able to structure their financing arrangements to maximize tax benefits.

(2) Tax Rules to prevent shifting of profits through excessive interest payments

In order to address this issue, tax rules are in place in each country to fix a ceiling limit on the amount of interest deductible in computing a company's profit for tax purposes. Such rules are designed to counter cross-border shifting of profit through excessive interest payments, with the objective of protecting a country's tax base.

(3) Relevant Action Plan of BEPS

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 Action Plan 4 and recommended certain measures in its final report.

(4) Insertion of provision in the Income-tax Act, 1961 in line with BEPS Action Plan 4

Section 94B has, accordingly, been inserted in the Income-tax Act, 1961, in line with the recommendations of OECD BEPS Action Plan 4, to provide that interest expenses claimed by an entity to its associated enterprises shall not be deductible in computation of income under the "Profits and gains of business or profession" to the extent that it arises from excess interest

Sub - Section (1):- Excess Interest shall not be deductible

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) :

Sub - Section (2):- Determination of Excess Interest

For the purposes of sub-section (1), the excess interest shall mean

(a) an amount of total interest paid or payable in excess of thirty per cent of earnings before interest, taxes, depreciation and amortisation of the borrower in the previous year or

(b) interest paid or payable to associated enterprises for that previous year,

whichever is less.

Sub - Section (3):- Non- applicability of section 94B(1)

Nothing contained in sub-section (1) shall apply to an Indian company or a permanent establishment of a foreign company which is engaged in the business of banking or insurance.

Sub - Section (4):- Carry forward of the excess interest

Where for any assessment year,
the interest expenditure is not wholly deducted against income under the head "PGBP",
so much of the interest expenditure as has not been so deducted,
shall be carried forward to the following assessment year or assessment years,
and
it shall be allowed as a deduction against the profits and gains, if any, of any business or profession carried on by it and assessable for that assessment year to the extent of maximum allowable interest expenditure in accordance with sub-section (2):

Provided that no interest expenditure shall be carried forward under this sub-section for more than eight assessment years immediately succeeding the assessment year for which the excess interest expenditure was first computed.

Sub - Section (5):- Meaning of certain terms

"Debt" means 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";

Deemed debt as per proviso to section 94B(1) : 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.

"permanent establishment" includes a fixed place of business through which the business of the enterprise is wholly or partly carried on.

Practical 34

TATU MFG Ltd. is an Indian subsidiary of JAGUAR Limited, UK based Company. TATU MFG Ltd. has borrowed from JAGUAR Limited. From the following information, find out disallowance to be made under section 94B of the Income Tax Act for the assessment years 2018-19.

Particulars	Rs. (in crore)
Earnings before interest, taxes, depreciation and amortisation	20
Interest to associated enterprise	5
Interest to others	2

Solution

Computation of Excess Interest (disallowance) under section 94 B of the Act for the A.Y. 2018-19

Sr. No.	Lower of	Amount (Rs. in crore)
(a)	Total interest paid or payable in excess of thirty per cent of earnings before interest, taxes, depreciation and amortisation of the borrower in the previous year **(Refer working Note)**	1
(b)	Interest paid or payable to associated enterprises for that previous year	5
(c)	**Excess Interest to be disallowed [Lower of (a) or (b)]**	**1**

Working Note:

Sr. No.	Particulars	Amount (Rs. in crore)
(a)	Total Interest (i.e. Interest to associated enterprise plus Interest to others)	7
(b)	30% of Earnings before interest, taxes, depreciation and amortization	6
(c)	**Total interest paid or payable in excess of thirty per cent of earnings before interest, taxes, depreciation and amortisation of the borrower in the previous year (a-b)**	**1**

Note:- Such excess interest of Rs. 1 Cr. shall be carried forward to the following assessment year or assessment years (maximum 8 years), and it shall be allowed as a deduction against the profits and gains, if any, of any business or profession carried on by it and assessable for that assessment year to the extent of maximum allowable interest expenditure in accordance with section 94B (2).

Reader's Note:

UNIT G – COUNTRY BY COUNTRY REPORTING

57.33 FURNISHING OF REPORT IN RESPECT OF INTERNATIONAL GROUP IN LINE WITH BEPS ACTION PLAN – COUNTRY BY COUNTRY REPORT AND MASTER FILE

Section:-

(1) Requirements as per OECD report on Action 13 of BEPS Action Plan

The report provides for:

(a) revised standards for transfer pricing documentation; and

(b) a template for country-by-country reporting of income, earnings, taxes paid and certain measure of economic activity.

(2) Three-tier structure mandated by BEPS

The BEPS report recommends that countries adopt a standardised approach to transfer pricing documentation; it mandates the following three-tier structure:-

Sr. No.	Document	Information
(a)	Master File	Standardised information relevant for all multinational enterprises (MNE) group members
(b)	Local File	Specific reference to material transactions of the local taxpayer
(c)	Country – by – Country report	Information relating to the global allocation of the MNE's income and taxes paid; and Indicators of the location of economic activity within the MNE group.

(3) Advantages of the three tier structure [as per BEPS Report]:

(a) Taxpayers will be required to articulate consistent transfer pricing positions;

(b) Tax administrations would get useful information to assess transfer pricing risks;

(c) Tax administrations would be able to make determinations about where their resources can most effectively be deployed, and, in the event audits are called for, provide information to commence and target audit enquiries.

57.34 FURNISHING OF REPORT IN RESPECT OF INTERNATIONAL GROUP in INDIA

Section:- 286

(1) Every constituent entity resident in India, shall, if it is constituent of an international group, the parent entity of which is not resident in India, notify the prescribed income-tax authority (herein referred to as prescribed authority) in the form and manner, on or before such date, as may be prescribed,—

(a) whether it is the alternate reporting entity of the international group; or

(b) the details of the parent entity or the alternate reporting entity, if any, of the international group, and the country or territory of which the said entities are resident.

(2) Every parent entity or the alternate reporting entity, resident in India, shall, for every reporting accounting year, in respect of the international group of which it is a constituent, furnish a report, to the prescribed authority on or before the due date specified under sub-section (1) of section 139, for furnishing the return of income for the relevant accounting year, in the form and manner as may be prescribed.

(3) For the purposes of sub-section (2), the report in respect of an international group shall include,—

(a) the aggregate information in respect of the amount of revenue, profit or loss before income-tax, amount of income-tax paid, amount of income-tax accrued, stated capital, accumulated earnings, number of employees and tangible assets not being cash or cash equivalents, with regard to each country or territory in which the group operates;

(b) the details of each constituent entity of the group including the country or territory in which such constituent entity is incorporated or organised or established and the country or territory where it is resident;

(c) the nature and details of the main business activity or activities of each constituent entity; and

(d) any other information as may be prescribed.

(4) A constituent entity of an international group, resident in India, other than the entity referred to in sub-section (2), shall furnish the report referred to in the said sub-section, in respect of the international group for a reporting accounting year, if the parent entity is resident of a country or territory,—

(a) with which India does not have an agreement providing for exchange of the report of the nature referred to in sub-section (2); or

(b) there has been a systemic failure of the country or territory and the said failure has been intimated by the prescribed authority to such constituent entity:

Provided that where there are more than one such constituent entities of the group, resident in India, the report shall be furnished by any one constituent entity, if,—

(a) the international group has designated such entity to furnish the report in accordance with the provisions of sub-section (2) on behalf of all the constituent entities resident in India; and

(b) the information has been conveyed in writing on behalf of the group to the prescribed authority.

(5) Nothing contained in sub-section (4) shall apply, if, an alternate reporting entity of the international group has furnished a report of the nature referred to in sub-section (2), with the tax authority of the country or territory in which such entity is resident, on or before the date specified in the said sub-section and the following conditions are satisfied, namely:—

(a) the report is required to be furnished under the law for the time being in force in the said country or territory;

(b) the said country or territory has entered into an agreement with India providing for exchange of the said report;

(c) the prescribed authority has not conveyed any systemic failure in respect of the said country or territory to any constituent entity of the group that is resident in India;

(d) the said country or territory has been informed in writing by the constituent entity that it is the alternate reporting entity on behalf of the international group; and

(e) the prescribed authority has been informed by the entities referred to in sub-section (4) in accordance with sub-section (1).

(6) The prescribed authority may, for the purposes of determining the accuracy of the report furnished by any reporting entity, by issue of a notice in writing, require the entity to produce such information and document as may be specified in the notice within thirty days of the date of receipt of the notice:

Provided that the prescribed authority may, on an application made by such entity, extend the period of thirty days by a further period not exceeding thirty days.

(7) The provisions of this section shall not apply in respect of an international group for an accounting year, if the total consolidated group revenue, as reflected in the consolidated financial statement for the accounting year preceding such accounting year does not exceed the amount, as may be prescribed.

(8) The provisions of this section shall be a pplied in accordance with such guidelines and subject to such conditions, as may be prescribed

57.35 PENALTIES FOR NOT COMPLYING CBC REPORTING

Section:- 271 GB

Section	Nature of default	Penalty leviable	Competent IT Authority to levy penalty
271GB(1)	Failure to furnish report u/s 286(2)	Rs. 5,000 per day upto 30 days and Rs. 15,000 per day beyond 30 days	Prescribed Income-tax Authority
271GB(2)	Failure to produce the information and documents within the period allowed u/s 271GB(6)	Rs. 5,000 for every day during which the failure continues.	Prescribed Income-tax Authority
271GB(3)	Failure to furnish report or failure to produce information/documents under section 286 even after serving order u/s 271GB(1) or 271GB(2)	Rs.50,000 for every day for which such failure continues beginning from the date of serving such order.	Prescribed Income-tax Authority
271GB(4)	Failure to inform about inaccuracy in report furnish u/s 286(2) Or furnishing of inaccurate information or document in response to notice issued u/s 286(6).	Rs. 5,00,000	Prescribed Income-tax Authority

UNIT H – PENALTIES

57.36 VARIOUS PENALTIES

Section:- 271AA(1), 271BA and 271G

Section	Nature Of Default	Penalty Leviable
271AA(1)	**(1)** Failure to keep and maintain information and documents required by section 92D(1) or 92D(2) **(2)** Failure to report such transaction **(3)** Maintaining or furnishing incorrect information or document	2% of value of each international transaction / or specified domestic transaction entered into
271BA	Failure to furnish a report from an accountant as required by section 92E	Rs. 1,00,000
271G	Failure to furnish any information or document as required by section 92D(3)	2% of the value of the international transaction / specified domestic transaction for each failure

Practical 35

X Ltd., operating in India, is the dealer for the goods manufactured by Yen Ltd. of Japan. Yen Ltd. owns 55% shares of X Ltd. and out of 7 directors of the company, 4 were appointed by them. The Assessing Officer, after verification of transactions of Rs. 300 lacs of X Ltd. for the relevant year and by noticing that the company had failed to maintain the requisite records and had also not obtained the accountants report, adjusted its income by making an addition of Rs. 30,00,000 to the declared income and also issued a show cause notice to levy various penalties. X Ltd seeks your expert opinion.

Note: It is assumed that X Ltd. has not entered into an APA and has also not opted to be subject to Safe Harbour Rules.

Solution

The facts of the case indicate that X Ltd. and Yen Ltd. of Japan are associated enterprises since Yen Ltd. holds 55% shares of X Ltd. and has appointed more than half of the board of directors of X Ltd. Since Yen Ltd. is a non-resident, any transaction between X Ltd. and Yen Ltd. would fall within the meaning of "international transaction" under section 92B. Therefore, the income arising from such transactions have to be computed having regard to the arm's length price.

The action of the Assessing Officer in making addition to the declared income and issuing show cause notice for levy of various penalties is correct since X Ltd. had committed defaults, as listed hereunder, in respect of which penalty, as briefed hereunder, is imposable -

(i) Failure to report any international transaction or any transaction, deemed to be an international transaction or any specified domestic transaction, to which the provisions of Chapter X applies would attract penalty @ 200% of the amount of tax payable since it is a case of misreporting of income referred under section 270A(9) read with section 270A(8).

(ii) Failure to maintain the requisite records as required under section 92D in relation to international transaction makes it liable for penalty under section 271AA which will be 2% of the value of each international transaction.

(iii) Failure to furnish report from an accountant as required under section 92E makes it liable for penalty under section 271BA i.e., a fixed penalty of Rs. 1 Lac.

The Assessing Officer shall give an opportunity of hearing to the assessee with a notice as to why the arm's length price should not be determined on the basis of material or information or document in the possession of the Assessing Officer.

Readers Note:

UNIT I – NOTIFIED JURISDICTIONAL AREA

57.37 SPECIAL MEASURES IN RESPECT OF TRANSACTIONS WITH PERSONS LOCATED IN NOTIFIED JURISDICTIONAL AREA.

Section:- 94A

Section 94A (1): The Central Government may, having regard to the lack of effective exchange of information with any country or territory outside India, specify by notification in the Official Gazette such country or territory as a notified jurisdictional area in relation to transactions entered into by any assessee.

Section 94A (2): Notwithstanding anything to the contrary contained in this Act, i**f an assessee enters into a transaction where one of the parties to the transaction is a person located in a notified jurisdictional area, then**—

(i) **all the parties** to the transaction **shall be deemed to be associated enterprises** within the meaning of section 92A;

(ii) **any transaction** in the nature of purchase, sale or lease of tangible or intangible property or provision of service or lending or borrowing money or any other transaction having a bearing on the profits, income, losses or assets of the assessee including a mutual agreement or arrangement for allocation or apportionment of, or any contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service or facility provided or to be provided by or to the assessee **shall be deemed to be an international transaction** within the meaning of section 92B,

and the **provisions of sections 92, 92A, 92B, 92C [*except the second proviso to sub-section (2)*], 92CA, 92CB, 92D, 92E and 92F shall apply accordingly**.

Section 94A (3): Notwithstanding anything to the contrary contained in this Act, **no deduction,—**

(a) in respect of any payment made to any financial institution located in a notified jurisdictional area **shall be allowed** under this Act, **unless the assessee furnishes an authorisation in the prescribed form authorising the Board or any other income-tax authority acting on its behalf to seek relevant information from the said financial institution on behalf of such assessee**; and

(b) in respect of any other **expenditure or allowance (including depreciation)** arising from the transaction with a person located in a notified jurisdictional area **shall be allowed** under any other provision of this Act, **unless the assessee maintains such other documents and furnishes such information as may be prescribed**, in this behalf.

Section 94A (4): Notwithstanding anything to the contrary contained in this Act, where, in any previous year, the **assessee** has **received or credited any sum** from any person located in a notified jurisdictional area **and the assessee does not offer any explanation about the source of the said sum** in the hands of such person or in the hands of the beneficial owner (if such person is not the beneficial owner of the said sum) **or the explanation offered by the assessee**, in the opinion of the Assessing Officer, is **not satisfactory, then, such sum shall be deemed to be the income of the assessee** for that previous year.

Section 94A (5): Notwithstanding anything contained in any other provisions of this Act, **where any person located in a notified jurisdictional area is entitled to receive any sum or income or amount** on which tax is deductible under Chapter XVII-B, **the tax shall be deducted at the highest of the following rates, namely:—**

(a) at the rate or rates in force;

(b) at the rate specified in the relevant provisions of this Act;

(c) at the rate of thirty per cent.

Section 94A (6): In this section,—

(i) "person located in a notified jurisdictional area" shall include,—
  (a) a person who is resident of the notified jurisdictional area;
  (b) a person, not being an individual, which is established in the notified jurisdictional area; or
  (c) a permanent establishment of a person not falling in sub-clause (*a*)or sub-clause (*b*), in the notified jurisdictional area;

(ii) "permanent establishment" shall have the same meaning as defined in clause (*iiia*)of section 92F;

(iii) "transaction" shall have the same meaning as defined in clause (*v*)of section 92F.

Practical 36

Mr. Robert, a non-resident has invested Rs. 6 crore in notified infrastructure debt fund and therefore he is in receipt of interest income Rs. 50 lakhs during the concerned previous year. Further, he incurred bank charges Rs. 12,000 for realizing such income. Assuming that Mr. Robert is a resident of a NJA, discuss the tax implications of this transaction under Income Tax Act, 1961.

Solution

As per section 115A of the Income Tax Act, 1961, gross interest income from a notified infrastructure debt fund shall be taxed at 5% (plus 3% EC). Therefore, the tax liability of Mr. Robert in respect of such income would be Rs. 2,57,500.

Generally, as per section 194LB, TDS shall be made @5% on interest paid by infrastructure debt fund. However, since Robert is a resident of a NJA and therefore, considering the overriding effect of section 94 A (5), TDS shall be made at @30%.

Readers Note:

58 – TAXATION OF EQUALISATION LEVY

58.1 EQUALISATION LEVY

Section:- Chapter VIII of Finance Act, 2016, 10(50), 40(a)(ib)

To tackle taxation issues in transaction conducted in cyber space, equalization levy has been imposed. Salient features of levy are given below-

(1) Date on which levy come into force

This levy shall come into force on such date as Central Government may, by notification in the Official Gazette, appoint. Vide Notification No.38/2016 dated 27.5.2016, Equalisation Levy Rules, 2016 were notified, which come into force on **1st June, 2016.**

(2) Charging provision

Equalisation levy shall be charged at the rate of 6 percent of the amount of consideration for specified services received or receivable by a non-resident from

- a person resident in India and carrying on business or profession or
- from a non-resident having a permanent establishment in India.

"Specified service" for this purpose, means online advertisement, any provision for digital advertising space or any other facility service for the purpose of online advertisement and includes any other service as may be notified by the Central Government in this behalf.

(3) Relaxation from equalization levy

In the following cases equalization levy is not applicable-

(a) If the non-resident service provider has a permanent establishment in India and income from such specified services is effectively connected to this permanent establishment;

(b) Where the payment for specified service by the person resident in India (or the permanent establishment in India) is not for the purpose of carrying out business or profession.

(c) If the aggregate amount of consideration for specified services received or receivable by a non-resident from a person resident in India (or from a non-resident having a permanent establishment in India) does not exceed Rs.1 lakh in any previous year.

58.2 COLLECTION AND RECOVERY OF EQUALISATION LEVY

Section:- 166

(1) Person responsible for deduction of Equalisation Levy

Every person, being a resident and carrying on business or profession or a non-resident having a permanent establishment in India shall deduct equalisation levy from the amount paid or payable to a non-resident in respect of the specified service.

(2) Rate of Equalisation Levy

6% of the amount of consideration for specified service received or receivable by a non-resident from a person resident in India and carrying on business or profession or a non-resident having a permanent establishment in India.

The amount of consideration of specified services, equalisation levy, interest and penalty payable and refund shall be rounded off to the nearest multiple of ten rupees. [Rule 3 of Equalisation Levy Rules, 2016]

(3) Threshold Limit

Equalisation levy is deductible if the aggregate amount of consideration for specified service in a previous year **exceeds Rs.1,00,000**.

(4) Time period for remittance of Equalisation Levy

The equalisation levy so deducted during any calendar month shall be paid by every assessee to the credit of the Central Government by the 7th of the month immediately following the said calendar month.

Equalisation levy deducted during any calendar month is to be paid to the credit of the Central Government by remitting it to the Reserve Bank of India or the State Bank of India or any other authorised bank, accompanied by an equalisation levy challan. [Rule 4 of Equalisation Levy Rules, 2016]

(5) Consequence of failure to deduct Equalisation Levy

Any assessee who fails to deduct equalisation levy shall, notwithstanding such failure, be liable to pay the levy to the credit of the Central Government by the 7th of the month immediately following the said calendar month.

58.3 FURNISHING OF STATEMENT

Section:- 167

(1) Statement in prescribed form within time

Every assessee shall, within the prescribed time after the end of each financial year, prepare and deliver or cause to be delivered to the Assessing Officer or to any other authority or agency authorised by the Board in this behalf, a statement in the prescribed form, verified in the prescribed manner and setting forth the prescribed particulars in respect of all specified services during such financial year.

The statement of specified service is required to be furnished electronically in Form No. 1 (verified through either a digital signature or an electronic verification code) on or before 30 June immediately following that financial year [Rule 5 of Equalisation Levy Rules, 2016]

(2) Time limit for filing a revised statement

An assessee who has not furnished the statement on or before 30th June immediately following the financial year or having furnished a statement within that time, notices any omission or wrong particulars therein, may furnish a statement or a revised statement, as the case may be.

Such statement or revised statement has to be filed at any time before the expiry of two years from the end of the financial year in which the specified service was provided.

(3) Time limit for filing a statement in response to notice issued by the Assessing Officer

Where any assessee fails to furnish the statement within the prescribed time, the Assessing Officer may serve a notice upon such assessee requiring him to furnish the statement in the prescribed form, verified in the prescribed manner and setting forth the prescribed particulars, within such time, as may be prescribed.

The Assessing Officer has been empowered to issue notice for furnishing such statement, which then has to be furnished within 30 days from date of serving of such notice [Rule 6 of Equalisation Levy Rules, 2016]

58.4 PROCESSING OF STATEMENT

Section:- 168

(1) Manner of processing of statement

Where a statement has been made under section 167 by the assessee, such statement shall be processed in the following manner, namely:—

(a) the equalisation levy shall be computed after making the adjustment for any arithmetical error in the statement;

(b) the interest, if any shall be computed on the basis of sum deductible as computed in the statement;

(c) the sum payable by, or the amount of refund due to, the assessee shall be determined after adjustment of interest computed against the equalisation levy paid under section 166(2) or section 170 and any amount paid otherwise by way of tax or interest;

(d) an intimation shall be prepared or generated and sent to the assessee specifying the sum determined to be payable by, or the amount of refund due to him; and

(e) the amount of refund due to the assessee in pursuance of such determination shall be granted to him.

However, no such intimation shall be sent after the expiry of one year from the end of the financial year in which the statement is furnished.

(2) Prescribed form for service of notice of demand on the taxpayer

Where any levy, interest or penalty is payable under the equalisation levy provisions, a notice of demand specified in Form No. 2 shall be served upon the taxpayer.

Further, intimation issued upon processing of the statement of specified services shall also be deemed to be a notice of demand. [Rule 7 of Equalisation Levy Rules, 2016]

(3) Scheme for centralised processing of statements

For the purposes of processing of statements, the CBDT may make a scheme for centralised processing of such statements to expeditiously determine the tax payable by, or the refund due to, the assessee as required thereunder.

58.5 RECTIFICATION OF MISTAKES

Section:- 169

(1) Time limit for amending an intimation

With a view to rectifying any mistake apparent from the record, the Assessing Officer may amend any intimation issued under section 168.

Such intimation can be amended within one year from the end of the financial year in which the intimation sought to be amended was issued.

(2) Amendment can be made suo motu or brought to notice by the assessee

The Assessing Officer may make an amendment to any intimation under sub-section (1), either suo motu or on any mistake brought to his notice by the assessee.

(3) Opportunity of being heard to be given to the assessee by the Assessing Officer before amending an intimation

An amendment to any intimation, which has the effect of increasing the liability of the assessee or reducing a refund, shall not be made unless the Assessing Officer has given notice to the assessee of his intention so to do and has given the assessee a reasonable opportunity of being heard.

Where any such amendment to any intimation has the effect of enhancing the sum payable or reducing the refund already made, the Assessing Officer shall make an order specifying the sum payable by the assessee and the provisions of this Chapter shall apply accordingly.

58.6 INTEREST ON DELAYED PAYMENT OF EQUAILISATION LEVY

Section:- 170

Every assessee, who fails to credit the equalisation levy or any part thereof within 7th of the month following the calendar month in which it is deducted to the account of the Central Government, shall pay simple interest at the rate of 1% of such levy for every month or part of a month by which such crediting of the tax or any part thereof is delayed.

58.7 PENALTY FOR FAILURE TO DEDUCT OR PAY EQUAILISATION LEVY

Section:- 171

Nature of default	Penalty
Failure to deduct equalisation levy	In addition to payment of equalisation levy and interest, penalty equal to the amount of equalisation levy that he failed to deduct would be leviable
Failure to remit equalisation levy to the Central Government on or before 7th of the following month, after deduction	In addition to paying the equalisation levy and interest, a penalty of Rs. 1,000 for every day during which the failure continues is leviable. However, such penalty shall not exceed the amount of equalisation levy that he failed to pay.

58.8 PENALTY FOR FAILURE TO FURNISH STATEMENT

Section:- 172

For failure to furnish the statement within 30th June of the immediately following year or within 30 days from the date of service of notice by the Assessing Officer, penalty of Rs.100 for each day during which the failure continues is leviable

58.9 CIRCUMSTANCES WHEN PENALTY CANNOT BE IMPOSDED UNDER SECTION 171 AND 172

Section:- 173

No penalty for failure to deduct or pay equalisation levy or failure to furnish statement shall be imposable, if the assessee proves to the satisfaction of the Assessing Officer that there was reasonable cause for the said failure.

No order imposing a penalty under this Chapter shall be made unless the assessee has been given a reasonable opportunity of being heard.

58.10 APPEAL TO COMMISSIONERN OF INCOME-TAX (APPEALS)

Section:- 174

(1) Time limit for filing of appeal against an order imposing penalty

An assessee aggrieved by an order imposing penalty under this Chapter, may appeal to the Commissioner of Income-tax (Appeals) within a period of 30 days from the date of receipt of the order of the Assessing Officer

(2) Fee for filing appeal

An appeal shall be in the prescribed form [Form 3] and verified in the prescribed manner. It shall be accompanied by a fee of Rs.1,000.

It may be filed electronically under digital signature or electronically through EVC. Any document accompanying Form No.3 shall be furnished in the manner in which Form No.3 is furnished.[Rule 8 of Equalisation Levy Rules, 2016]

(3) Provisions of the Income-tax Act, 1961 applicable in case of such appeals

Where an appeal has been filed, the provisions of sections 249 to 251 of the Income-tax Act shall, as far as may be, apply to such appeal.

58.11 APPEAL TO APPELLATE TRIBUNAL

Section:- 175

(1) Assessee/CIT may file appeal to Appellate Tribunal against an order passed by Commissioner (Appeals) under section 174

An assessee aggrieved by an order made by the Commissioner of Income-tax (Appeals) under section 174 may appeal to the Appellate Tribunal against such order.

The Commissioner of Income-tax may, if he objects to any order passed by the Commissioner of Income-tax (Appeals) under section 174, direct the Assessing Officer to appeal to the Appellate Tribunal against such order.

(2) Time limit for filing appeal

An appeal shall be filed within 60 days from the date on which the order sought to be appealed against is received by the assessee or by the Commissioner of Income-tax

(3) Fee for filing appeal

The appeal shall be in the prescribed form [Form No.4] and verified in the prescribed manner.

In the case of an appeal filed by an assessee, it shall be accompanied by a fee of Rs.1,000. Also, the form of appeal, the grounds of appeal and the form of verification appended thereto shall be signed by the person specified in Form No.4 [Rule 9 of Equalisation Levy Rules, 2016]

(4) Provisions of the Income-tax Act, 1961 applicable in case of such appeals

Where an appeal has been filed before the Appellate Tribunal under sub-section (1) or sub-section (2), the provisions of sections 253 to 255 of the Income-tax Act shall, as far as may be, apply to such appeal.

58.12 PUNISHMENT FOR FALSE STATEMENT

Section:- 176

If a person -

(a) makes a false statement in any verification under this Chapter or any rule made thereunder; or

(b) delivers an account or statement, which is false, and which he either knows or believes to be false, or does not believe to be true,

he shall be punishable with imprisonment for a term which may extend to three years and with fine.

(i) An offence so punishable shall be deemed to be non-cognizable within the meaning of the Code of Criminal Procedure.

(ii) This is irrespective of anything contained in the Code of Criminal Procedure, 1973.

58.13 INSTITUTION OF PROSECUTION

Section:- 177

Prior sanction of the Chief Commissioner of Income-tax is required for instituting prosecution against any person for any offence under section 176.

58.14 APPLICATION OF CERTAIN PROVISIONS OF INCOME-TAX ACT, 1961

Section:- 178

The following provisions of the Income-tax Act, 1961 shall so far as may be, apply in relation to equalisation levy, as they apply in relation to income-tax.

Section	
120	Jurisdiction of income-tax authorities
131	Power regarding discovery, production of evidence, etc.
133A	Power of survey
138	Disclosure of information respecting assessees
156	Notice of demand
220 to 227	- When tax payable and when assessee deemed in default, - Penalty payable when tax in default, - Certificate to Tax Recovery Officer, - Tax Recovery Officer by whom recovery is to be effected, - Validity of certificate and cancellation or amendment thereof, - Stay of proceedings in pursuance of certificate and amendment or cancellation thereof, - Other modes of recovery, - Recovery through State Government.
229	Recovery of penalties, fine, interest and other sums

232	Recovery by suit or under other law not affected.
260A	Appeal to High Court
261	Appeal to Supreme Court
262	Hearing before Supreme Court
265 to 269	- Tax to be paid notwithstanding reference etc., - Execution for costs awarded by Supreme Court, - Amendment of assessment, - Exclusion of time taken for copy, - Filing of appeal or application for reference by income-tax authority, - Definition of "High Court"
278B	Offences by companies
280A	Special Courts
280B	Offences triable by Special Court
280C	Trial of offences as summons case
280D	Application of Code of Criminal Procedure, 1973 to proceedings before Special Court
282	Service of notice generally
288 to 293	- Appearance by authroised representative, - Rounding off of income, - Rounding off of amount payable and refund due, - Receipt to be given, - Indemnity, - Power to tender immunity from prosecution, - Cognizance of offences, - Section 360 of the Code of Criminal Procedure, 1973 and the Probation of Offenders Act, 1958, not to apply, - Return of income, etc., not to be invalid on certain grounds, - Notice deemed to be valid in certain circumstances, - Presumption as to assets, books of account etc., - Authorisation and assessment in case of search or requisition, - Bar of suits in civil courts

58.15 POWER TO MAKE RULES

Section:- 179

The Central Government is empowered to make rules for the purposes of carrying out the provisions of this Chapter. Also, every Rule made under this Chapter shall be laid before each House of Parliament.

In particular, such rules may also provide for all or any of the following matters, namely:—

(a) the time within which and the form and the manner in which the statement shall be delivered or caused to be delivered or furnished under section 167;

(b) the form in which an appeal may be filed and the manner in which it may be verified u/s 174 & 175;

(c) any other matter which is to be, or may be, prescribed.

Every rule made under this Chapter shall be laid, as soon as may be after it is made, before each House of Parliament, while it is in session, for a total period of 30 days.

This period of 30 days may be comprised in one session or in two or more successive sessions, and if, before the expiry of the session immediately following the session or the successive sessions aforesaid, both Houses agree:

(i) in making any modification in the rule, then, the rule shall thereafter have effect only in such modified form;

(ii) that the rule should not be made, then, the rule would be of no effect.

However, any such modification or annulment shall be without prejudice to the validity of anything previously done under that rule.

58.16 POWER TO REMOVE DIFFICULTIES

Section:- 180

The Central Government is empowered to remove any difficulty which arises in giving effect to the provisions of this Chapter. It may, by order published in the Official Gazette, not inconsistent with the provisions of this Chapter, remove the difficulty.

However, no such order shall be made after the expiry of a period of two years from the date on which the provisions of this Chapter come into force.

Every order made under this section shall be laid, as soon as may be after it is made, before each House of Parliament.

58.17 CONSEQUENTIAL PROVISIONS IN THE INCOME-TAX ACT, 1961

Section:- 10(50) and 40(a)(ib)

Section	Provision
10(50)	Any income arising from any specified service provided on or after 1st June, 2016 and chargeable to equalization levy shall be exempt from tax.
40(a)(ib)	Any consideration paid or payable to a non-resident for a specified service on which equalisation levy is deductible, shall be disallowed, if such levy has not been deducted or after deduction, has not been paid on or before the due date under section 139(1) . However such sum shall be allowed as a deduction in the previous year in which such levy has been paid.