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ELECTIVE PAPER 6C: INTERNATIONAL TAXATION

CASE STUDY - 1

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

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

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

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

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

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

- A Ltd. obtained interest-free loan of ₹ 50 crores from A Pty, Singapore. Out of the 25 directors of A Pty., Singapore, 10 are appointed by A Ltd.
- A Ltd. obtained foreign currency loan of \$ 10 million from Wells Fargo Bank of USA, in USA, based on a back to back deposit made by A Inc. USA to the tune of \$ 5 million in the bank. Interest of ₹ 6 crores is paid on such loan.
- A Ltd. obtained foreign currency loan of \$ 20 million from Bank of USA, in USA, based on a back to back deposit made by A Inc., USA to the tune of \$ 20 million in the bank. Interest works out to ₹ 12 crores.
- A Ltd. had to incur a sum of ₹ 1 crore as an interest towards the delayed payment to AA Ltd. China, being its creditor for supply of raw material. 90% of raw materials required by A Ltd. is supplied by AA Ltd., China. The price and other conditions for supply of raw material are influenced by AA Ltd., China.

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

I. OBJECTIVE TYPE QUESTIONS

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

1. Which of the following enterprises are associated enterprises/deemed associated enterprises of A Ltd.?
 - (a) A Inc., USA; A LLC, Cyprus; and AAA Ltd., Taiwan.
 - (b) A Inc., USA; A LLC, Cyprus; and A Pty, Singapore.
 - (c) A Inc., USA; A LLC, Cyprus; and AA Ltd., China.
 - (d) A Inc., USA; AA Ltd., China; and A Pty, Singapore.
2. Which of the following approaches does India follow in relation to secondary adjustments?
 - (a) Deemed equity approach

- (b) Deemed dividend approach
 - (c) Deemed loan approach
 - (d) Either (a) or (c)
3. If A Ltd. does not furnish transfer pricing report for F.Y.2019-20, what would be the quantum of penalty imposable under the Income-tax Act, 1961 for such a failure?
- (a) 1% of the value of international transaction
 - (b) 2% of the value of international transaction
 - (c) ₹ 1 crore – fixed penalty
 - (d) ₹ 1 lakh – fixed penalty
4. In a case where primary adjustment to transfer price is made *suo motu* by A Ltd., the time limit for repatriation of “excess money” is -
- (a) 60 days from 30th September of the Assessment Year
 - (b) 90 days from 30th September of the Assessment Year
 - (c) 60 days from 30th November of the Assessment Year
 - (d) 90 days from 30th November of the Assessment Year
5. The excess money which is available with the AE, if not repatriated to India within the prescribed time, shall be deemed to be an advance made by A Ltd. to such AE, if the primary adjustment to transfer price, made by it *suo motu* in its return of income, is in respect of -
- (a) A.Y.2016-17 and the amount of primary adjustment is ₹ 2 crores.
 - (b) A.Y.2019-20 and the amount of primary adjustment is ₹ 1 crore
 - (c) A.Y.2019-20 and the amount of primary adjustment is ₹ 1.05 crore
 - (d) A.Y.2018-19 and the amount of primary adjustment is ₹ 1 crore.

II. DESCRIPTIVE QUESTIONS

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

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

(ii) A Ltd. is contemplating to stop the current business activity and start a new business vertical. In this regard, it wants to know whether the interest disallowed under the relevant provision of the Income-tax Act, 1961 can be carried forward to next year and whether it could be set-off against the income of the new business. (2 Marks)

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

ELECTIVE PAPER 6C- INTERNATIONAL TAXATION

SUGGESTED SOLUTION – CASE STUDY 1

I. ANSWERS TO OBJECTIVE TYPE QUESTIONS

1. (c) A Inc., USA; A LLC, Cyprus; and AA Ltd., China.
2. (c) Deemed Loan Approach
3. (d) ₹ 1 lakh – fixed penalty
4. (d) 90 days from 30th November of the assessment year
5. (c) A.Y.2019-20 and the amount of primary adjustment is ₹ 1.05 crore

II. ANSWERS TO DESCRIPTIVE QUESTIONS

1. Section 94B is applicable to an Indian company or a permanent establishment of a foreign company in India, being the borrower who pays interest in respect of any form of debt issued by
 - non-resident, being an associated enterprises (AE) of such borrower or
 - by a lender which is not an AE but where the AE provides either implicit or explicit guarantee to such lender or deposits a corresponding and matching amount of funds with the lender, then such debt would be deemed to have been issued by an AE.

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

Particulars	Amount (₹ in crores)
Interest paid to A LLC Cyprus [See Note (i)]	80.00

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

Notes:

- (i) Interest paid to a non-resident AE falls within the scope of section 94B. A LLC is deemed to be an AE of A Ltd., since the loan advanced by it constitutes not less than 51% of the book value of total assets of A Ltd. Hence, interest paid to A LLC is to be considered for the purpose of limitation of interest deduction under section 94B.
- (ii) The proviso to Section 94B(1) states "where the debt is issued by a lender which is not associated but an associated enterprise either **provides an implicit or explicit**

guarantee to such lender or deposits a corresponding and matching amount of funds with the lender, such debt shall be **deemed to have been issued by an associated enterprise.**”

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

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

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

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

- (iv) Since the loan is obtained based on a letter of comfort provided by a resident director of A Ltd., the said interest will not be factored for the purpose of excess interest disallowance under section 94B.
- (v) Since loan was obtained by A Ltd independently from a third-party lender Union City Bank of India, interest paid on such loan shall not be considered for the purposes of Section 94B, as the same is paid to an enterprise which is not a non-resident AE.
- (vi) Since A Ltd.’s voting power in AAA Ltd., Taiwan is less than 26%, AAA Ltd., Taiwan is not an AE of A Ltd. Since loan was obtained by A Ltd from Bank of Taiwan, Indian branch, for which guarantee was given by an enterprise, not being an AE, this interest shall not be considered for the purposes of section 94B. Likewise, guarantee fee paid to AAA Ltd. shall also not be considered for the purposes of section 94B.

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

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

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

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

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

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

Further, since 90% of raw materials required by A Ltd. is supplied by AA Ltd., China and price and other conditions for supply of raw material are also influenced AA Ltd., China, AA Ltd., is deemed to be an AE of A Ltd. Thus, the amount of

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

interest paid towards delayed payment has to be considered for the purpose of limitation of interest deduction under section 94B.

ALTERNATE ANSWER:

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

As per section 94B(2), the excess interest shall mean an amount of **total interest paid or payable** in excess of 30% of earnings before interest, taxes, depreciation and amortization (EBITDA) of the borrower in the previous year or interest paid or payable to associated enterprises for that previous year, whichever is less.

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

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

whichever is less.

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

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

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

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

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

Particulars	Amount (₹ in crores)
Interest paid to A LLC Cyprus	80.00
Interest paid to Bank of Chennai based on guarantee provided by A Inc. USA	8.00
Guarantee Fee paid to A Inc. USA	0.50
Interest paid to TN Mercantile bank based on letter of comfort by director of A Ltd.	4.00
Interest paid to Union City Bank, India	3.00
Interest paid to Bank of Taiwan	3.00
Guarantee fees paid to AAA Ltd., Taiwan	0.25
Interest paid to Wells Fargo Bank based on deposits made by A Inc. USA	6.00
Interest paid to Bank of USA based on deposits made by A Inc. USA	12.00
Interest paid to AA Ltd., China being interest on delayed payment to creditor	<u>1.00</u>
Total interest paid or payable by A Ltd.	117.75
Interest paid or payable to non-resident AE (computed above)	101.50
EBIDTA	200.00
Excess Interest: lower of the following would be disallowed,	57.75
- Total interest paid or payable in excess of 30% of ₹ 57.75 crores EBIDTA [i.e., ₹ 117.75 crores – ₹ 60.00 crores]	
- Interest paid or payable to non-resident AE ₹ 101.50 crores	
Therefore, interest paid or payable allowable as deduction under the head "Profits and gains of business or profession" would be ₹ 60 crores (₹ 117.75 crores – ₹ 57.75 crores)	60.00

2. (i) Multinational groups are often able to structure their financing arrangements to maximize these benefits. To prevent tax erosion on account of such arrangements, country's tax administrations often introduce rules that place a limit on the amount of interest that can be deducted in computing a company's profit for tax purposes. Such rules are designed to counter cross-border shifting of profit through excessive interest payments, and thus aim to protect a country's tax base. Under the initiative of the G-20 countries, the Organization for Economic Co-operation and Development (OECD) in its Base Erosion and Profit Shifting (BEPS) project had taken up the issue of base erosion and profit shifting by way of excess interest deductions by the MNEs in its Action plan 4. The OECD has recommended several measures in its final report to address this issue. In view of the above, section 94B has been inserted in the Income-tax Act, 1961, in line with the recommendations of OECD BEPS Action Plan 4, to provide that interest paid or payable by an entity to its non-resident associated enterprises shall be restricted to 30% of its earnings before interest, taxes, depreciation and amortization (EBITDA) or interest paid or payable to non-resident associated enterprises, whichever is less.
- (ii) Section 94B(4) provides that interest amount disallowed in a particular assessment year shall be carried forward and allowed as deduction against the profits and gains, if any, **of any business** carried on by the assessee. Therefore, based on the same, it can be concluded that A Ltd shall be eligible to carry forward the disallowed interest amount and claim the same as a deduction against the profits and gains from any business or profession carried on by it.
3. Indian Transfer Pricing regulations provide that any income arising from an international transaction shall be computed having regard to arm's length price. However, section 92(3) provides that transfer pricing provisions shall not apply in cases where such application results an increase in the expenditure or decrease in the revenue of the Indian entity. In the given case, as interest payment to the AE would only result in an increase in the expenditure of A Ltd. and subsequent reduction of profits, transfer pricing provisions under the Income-tax Act, 1961 shall not apply.

ELECTIVE PAPER 6C: INTERNATIONAL TAXATION

CASE STUDY - 2

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

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

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

The details of the assignments are as follows -

Assignment 1 [Client – Mr. Harry Smith]

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

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

Assignment 2 [Client – MNO Ltd.]

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

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

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

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

Based on the above facts, answer the following questions –

Multiple Choice Questions

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

1. Assuming that the tax deductible at source, if any, has been fully deducted, does Mr. Harry Smith and Ms. Rita Smith have to file return of income in India for A.Y.2020-21?
 - (a) Yes, because they have earned income in India which is chargeable to tax as per the provisions of the Income-tax Act, 1961.
 - (b) No, because tax deductible at source has been fully deducted from income earned by them in India
 - (c) Harry Smith has to file his return of income but Rita Smith need not file her return of income
 - (d) Rita Smith has to file her return of income but Harry Smith need not file his return of income
2. MNO Ltd. is a company -
 - (a) resident in India, since it has carried on the operation of purchase of goods in India

- (b) non-resident in India, since its registered head office is in Country 'X'
 - (c) non-resident in India, since key management decisions are taken in Country 'X'
 - (d) non-resident in India, due to reasons stated in (b) and (c) above.
3. The effective rate of income-tax applicable on total income of M/s. Pacific Airlines is –
- (a) 42.432%
 - (b) 44.512%
 - (c) 43.68%
 - (d) 46.592%
4. Salary paid by M/s. Hari Om & Co. to its partners falls within the limits prescribed under section 40(b)(v). Does Hari Om & Co. have to deduct tax on salary paid to its partners?
- (a) Yes; tax is deductible at source under section 192 on salary paid to its partners.
 - (b) No; salary paid to partners is not subject to tax deduction at source
 - (c) Yes; tax is deductible at source under section 192 on salary paid to resident partners and under section 195 on salary paid to the non-resident partner
 - (d) Salary paid to resident partners is not subject to tax deduction at source; but tax has to be deducted under section 195 on salary paid to the non-resident partner
5. Mr. Harish and Mr. Austin Smith have been appointed as senior officials of Country L embassy and Country Y embassy, respectively, in India in October, 2019. Mr. Harish and Mr. Austin Smith are subjects of Country L and Country Y, respectively, and are not engaged in any other business or profession in India. The remuneration received by Indian officials working in Indian embassy in Country L is exempt but in Country Y is taxable. The tax treatment of remuneration received by Mr. Harish and Mr. Austin Smith from embassies of Country L and Country Y, respectively, in India for the P.Y.2019-20 is:
- (a) Exempt from income-tax under section 10
 - (b) Taxable under the Income-tax Act, 1961
 - (c) Remuneration received by Mr. Harish is exempt but remuneration received by Mr. Austin Smith is taxable
 - (d) Remuneration received by Mr. Harish is taxable but remuneration received by Mr. Austin Smith is exempt.

DESCRIPTIVE QUESTIONS

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

- (b) Let us suppose that there has been a failure to deduct tax at source on the amount of Rs.2 lakh paid by XYZ Ltd. to Mr. Harry Smith for advertisement of shaving cream. The Assistant Commissioner of Income-tax imposed penalty on the company for failure to deduct tax at source. The company seeks your advice on whether penalty is imposable for such failure and if so, in this case, whether such levy is in order. Examine. **(3 Marks)**
2. (a) Examine whether the income of MNO Ltd. would be subject to tax in India. If so, compute the income chargeable to tax in India. **(2 Marks)**
- (b) Determine the income of M/s. Pacific Airlines chargeable to tax in India **(4 Marks)**

ELECTIVE PAPER 6C: INTERNATIONAL TAXATION

SOLUTION TO CASE STUDY 2

I. ANSWERS TO MULTIPLE CHOICE QUESTIONS

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

II. ANSWERS TO DESCRIPTIVE QUESTIONS

1. (a) Mr. Harry Smith is a non-resident in India for A.Y.2020-21, since he has stayed in India only for 55 days in the P.Y.2019-20. Ms. Rita Smith would also be non-resident in India for A.Y.2020-21, since she has also stayed in India only for 55 days in the P.Y.2019-20.

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

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

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

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

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

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

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

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

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

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

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

income of MNO Ltd. shall be subject to tax for assessment year 2020-21.

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

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

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

- (i) the amount paid or payable, whether in or out of India, to the assessee on account of the carriage of, *inter alia*, passengers from any place in India; and
- (ii) the amount received or deemed to be received in India by or on behalf of the assessee on account of the carriage of, *inter alia*, passengers from any place outside India.

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

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

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

ELECTIVE PAPER 6C: INTERNATIONAL TAXATION

CASE STUDY - 3

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

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

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

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

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

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

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

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

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

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

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

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

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

Other points:

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

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

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

I MULTIPLE CHOICE QUESTIONS

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

1. Delhi Tamil Sangam, as per its rules, pays a fixed honorarium per concert to each musician performing in the concerts organised by it. Shivam, however, refuses to accept this sum. If he requests Delhi Tamil Sangam to pay such sum directly to Help All, an unregistered institution providing relief to the poor and needy in rural India, what would be the tax consequence?
 - (a) No amount would be chargeable to tax in the hands of Mr. Shivam, since this is a case of diversion of income at source by overriding title.
 - (b) The amount payable to Help All would be chargeable to tax only in the hands of Mr. Shivam, since it is a case of application of income.
 - (c) The amount payable to Help All would be chargeable to tax only in the hands of the institution which has received the amount.
 - (d) The amount payable to Help All would be chargeable to tax both in the hands of Mr. Shivam and in the hands of the institution.

2. Mr. Arvind opened a bank account in Country "P" on 1.7.2017. He has made deposits of foreign currency equivalent to INR 5 lakhs on 1.7.2017, INR 7 lakhs on 1.10.2017, INR 12 lakhs on 1.9.2019 and INR 25 lakhs on 1.3.2020, in that bank, out of Indian income which has not been assessed to tax in India. The deposit of INR 12 lakhs on 1.9.2019 is made out of the withdrawal of earlier deposits made on 1.7.2017 and 1.12.2017 with the said bank. Further, out of INR 25 lakhs deposited by him on 1.3.2020, Mr. Arvind withdrew INR 2 lakhs on 31.3.2020. The value of an undisclosed asset in form of bank account under the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 will be taken as:
- (a) INR 49 lakhs
 - (b) INR 47 lakhs
 - (c) INR 37 lakhs
 - (d) INR 35 lakhs
3. If Cure House Inc. opts for advance ruling for the project of providing consultancy in field of medicine, such ruling shall be binding on:
- (a) Cure House Inc., in relation to the abovementioned project
 - (b) Jurisdictional Assessing Officer of Cure House
 - (c) Both (a) and (b)
 - (d) Cure House Inc. and Jurisdictional Assessing Officer in relation to the abovementioned project and for any future transaction of similar nature in India
4. Which of the following would **not** be considered as a permanent home of Mr. Shivam in context of the relevant rule in the DTAA with Country "Q" for dual residency?
- (i) House in Defence Colony, Delhi where his family lives
 - (ii) Own house in Mumbai which has been let out
 - (iii) Rent-free accommodation provided by his employer in Country "Q"
- The correct answer is -
- (a) Only (i) above
 - (b) Only (ii) above
 - (c) Only (iii) above
 - (d) Both (i) and (iii) above
5. Mr. Arvind acquired a flat in Country "P" in the P.Y.2015-16 for INR 50 lakhs. Out of the said sum, INR 20 lakhs was assessed to tax in total income of the P.Y.2015-16 and earlier years. This asset comes to the notice of the Assessing Officer in the year 2019-20. If the value of the flat on 1.4.2019 is INR 90 lakhs, the amount chargeable to tax in the year 2019-20 would be:
- (a) INR 90 lakhs

- (b) INR 70 lakhs
- (c) INR 54 lakhs
- (d) INR 30 lakhs

II DESCRIPTIVE QUESTIONS

1. (i) With reference to the DTAA between India and Country “Q”, examine whether Shivam is a resident in India or Country “Q” in the previous year 2019-20. **(5 Marks)**
 (ii) With reference to the DTAA between India and Country “R”, comment on whether provision of consultancy services through Sudha would lead to creation of PE in India for Cure House Inc., a Country “R” company. **(2 Marks)**
2. Determine the total income and tax liability of Shivam for the previous year 2019-20 as per the provisions of the Income-tax Act, 1961. Advance tax calculations may be ignored. Ignore the perquisite value of rent free accommodation provided to Shivam in Country “Q”. Indicate reasons for treatment of each item. Working Notes should form part of your answer. **(8 Marks)**

EXHIBIT I

Telegraphic Transfer Buying Rate

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

Date	Exchange Rate (INR)	Date	Exchange Rate (INR)
30.09.2019	45.95	31.01.2020	47.83
31.10.2019	46.85	29.02.2020	48.52
30.11.2019	45.10	31.03.2020	48.61
31.12.2019	46.95		

EXHIBIT II

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

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

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

Explanation: For the purposes of this rule

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

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

- (2) "specified date" means—

- (a) in respect of income chargeable under the head "Salaries", the last day of the month immediately preceding the month in which the salary is due, or is paid in advance or in arrears;
- (b) in respect of income[by way of] "interest on securities", the last day of the month immediately preceding the month in which the income is due;
- (c) in respect of income chargeable under the heads "Income from house property", "Profits and gains of business or profession" [not being income referred to in clause (d)] and "Income from other sources" (not being income by way of dividends [and "Interest on securities"]), the last day of the previous year of the assessee;
- (d) in respect of income chargeable under the head "Profits and gains of business or profession" in the case of a non-resident engaged in the business of operation of ships, the last day of the month immediately preceding the month in which such income is deemed to accrue or arise in India ;
- (e) in respect of income by way of dividends, the last day of the month immediately preceding the month in which the dividend is declared, distributed or paid by the company;
- (f) in respect of income chargeable under the head "Capital gains", the last day of the month immediately preceding the month in which the capital asset is transferred :]

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

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

EXHIBIT III

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

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

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

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

- (a) in respect of a country or specified territory outside India with which India has entered into an agreement for the relief or avoidance of double taxation of income in terms of section 90 or section 90A, the tax covered under the said agreement;
- (b) in respect of any other country or specified territory outside India, the tax payable under the law in force in that country or specified territory in the nature of income-tax referred to in clause (iv) of the Explanation to section 91.

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

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

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

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

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

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

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

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

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

- (8) Credit of any foreign tax shall be allowed on furnishing the following documents by the assessee, namely:—
- (i) a statement of income from the country or specified territory outside India offered for tax for the previous year and of foreign tax deducted or paid on such income in Form No.67 and verified in the manner specified therein;
 - (ii) certificate or statement specifying the nature of income and the amount of tax deducted therefrom or paid by the assessee,—
 - (a) from the tax authority of the country or the specified territory outside India; or
 - (b) from the person responsible for deduction of such tax; or
 - (c) signed by the assessee:
- Provided** that the statement furnished by the assessee in clause (c) shall be valid if it is accompanied by,—
- (A) an acknowledgement of online payment or bank counter foil or challan for payment of tax where the payment has been made by the assessee;
 - (B) proof of deduction where the tax has been deducted.
- (9) The statement in Form No.67 referred to in clause (i) of sub-rule (8) and the certificate or the statement referred to in clause (ii) of sub-rule (8) shall be furnished on or before the due date specified for furnishing the return of income under sub-section (1) of section 139, in the manner specified for furnishing such return of income.
- (10) Form No.67 shall also be furnished in a case where the carry backward of loss of the current year results in refund of foreign tax for which credit has been claimed in any earlier previous year or years.

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

EXHIBIT IV

EXTRACTS OF DTAA BETWEEN INDIA AND COUNTRY “Q”

ARTICLE 4

FISCAL DOMICILE

1. *For the purposes of this Agreement, the term "resident of a Contracting State" means any person who is a resident of a Contracting State in accordance with the taxation laws of that State.*
2. *“Where by reason of the provisions of paragraph 1, an individual is a resident of both Contracting States, then his status shall be determined as follows:*
 - (a) *he shall be deemed to be a resident of the State in which he has a permanent home available to him; if he has a permanent home available to him in both States, he shall be deemed to be a resident of the State with which his personal and economic relations are closer (centre of vital interests) ;*

- (b) *if the State in which he has his centre of vital interests cannot be determined, or if he has not a permanent home available to him in either State, he shall be deemed to be a resident of the State in which he has an habitual abode ;*
- (c) *if he has an habitual abode in both States or in neither of them, he shall be deemed to be a resident of the State of which he is a national ;*
- (d) *if he is a national of both States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement*

ARTICLE 23

AVOIDANCE OF DOUBLE TAXATION

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

EXHIBIT V

EXTRACT OF DTAA BETWEEN INDIA AND COUNTRY "R"

ARTICLE 5

PERMANENT ESTABLISHMENT

1. *For the purposes of this Agreement, the term "permanent establishment" means a fixed place of business through which the business of an enterprise is wholly or partly carried on.*
2. *The term "permanent establishment" includes especially:*
 - (a) *a place of management;*
 - (b) *a branch;*
 - (c) *an office;*
 - (d) *a factory;*
 - (e) *a workshop;*

- (f) *a sales outlet;*
 - (g) *a warehouse in relation to a person providing storage facilities for others;*
 - (h) *a farm, plantation or other place where agricultural, forestry, plantation or related activities are carried on; and*
 - (i) *a mine, an oil or gas well, a quarry or any other place of extraction of natural resources.*
3. *The term "permanent establishment" shall also include:*
- (a) *a building site, a construction, installation or assembly project or supervisory activities in connection therewith, where such site, project or activities continue for a period or periods aggregating more than 180 days;*
 - (b) *the furnishing of services including consultancy services by an enterprise through employees or other personnel by the enterprise for such purpose, but only where activities of that nature continue (for the same or a connected project) within the Contracting State for a period or periods aggregating more than 180 days within any twelve-month period.*

ELECTIVE PAPER 6C: INTERNATIONAL TAXATION

SOLUTION TO CASE STUDY 3

I. ANSWERS TO MCQs (Most appropriate answers)

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

II. ANSWERS TO DESCRIPTIVE QUESTIONS

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

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

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

- a) He has been in India during the previous year for a total period of 182 days or more; or
- b) He has been in India during the 4 years immediately preceding the previous year for total period of 365 days or more and has been in India for at least 60 days in the previous year.

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

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

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

- (i) He is a resident in at least 2 out of 10 years preceding the relevant previous year, and
- (ii) His total stay in India in last seven years preceding P.Y. 2019-20 is 730 days or more.

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

As per Country "Q" tax residency rules, Shivam qualifies to be resident for the year 2019-20 in Country "Q", since he stays for 183 days (more than 180 days) in Country "Q" in the Financial Year 2019-20.

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

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

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

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

- (a) the residential property is located and
- (b) social and cultural activities are closer

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

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

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

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

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

<u>Salary from services rendered in Country "Q" (October 2019 - March 2020)</u>		
Basic Salary [See Note (i)]	3,93,680	
Cost of Living Allowance [See Note (i)]	<u>2,81,200</u>	<u>6,74,880</u>
		16,04,880
Less: Standard deduction u/s 16(ia)		<u>50,000</u>
		15,54,880
<u>Income from House Property at Mumbai</u>		
Net Annual Value [See Note (ii)]	6,00,000	
Less: Standard deduction @ 30%	<u>(1,80,000)</u>	
		4,20,000
<u>Income from Other Sources</u>		
Interest earned from investment of security deposit (INR 1,00,000 @10%)	10,000	
Interest earned on saving bank account with Country "Q" [QGD 150 x INR 48.61] [See Rule 115 in Note (i)]	7,292	
Interest on Securities of a Country "Q" company [QGD 5000 x INR 48.52] [See Rule 115 in Note (i)]	2,42,600	
Interest on bonds issued by Country "P" Government	30,000	
Dividend from a Country "Q" Company (QGD 1000 x INR 48.52) [See Rule 115 in Note (i)]	<u>48,520</u>	
(Dividend from foreign company is taxable in India)		
		<u>3,38,412</u>
Gross Total Income		23,13,292
<u>Less: Deductions under Chapter VI-A</u>		
Deduction u/s 80DD	75,000	
(Flat deduction of INR 75,000 is allowed in respect of medical treatment of dependent disabled, irrespective of the expenditure incurred)		
Deduction u/s 80GG [See Note (iii)]	<u>60,000</u>	<u>1,35,000</u>
Total Income		<u>21,78,292</u>
Total Income (rounded off)		21,78,290

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

Particulars	INR	INR
Tax on INR 21,78,290		4,65,987
Add: Health and education cess @4%		<u>18,639</u>
Tax Liability		4,84,626
Less: Foreign Tax Credit [See Note (v)]		

- on salary income	98,078	
- on interest income	<u>36,390</u>	<u>1,34,468</u>
Net tax liability		<u>3,50,158</u>
Net tax liability (rounded off)		3,50,160

Notes:

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

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

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

Overseas salary for the period October 2019 to March 2020:

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

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

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

Deduction shall be lower of the following:

- INR 5,000 per month = INR 60,000
- 25% of the adjusted total income = 25% of INR 22,38,292 = INR 5,59,573

- Actual rent – 10% of adjusted total income = INR 3,00,000 (25,000*12) – INR 2,23,829 (10% of 22,38,292) = INR 76,171

Adjusted total income = Gross total income after providing for deduction under section 80C to 80U but before deduction under section 80GG = INR 23,13,292 – INR 75,000 = INR 22,38,292.

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

- (iv) Deduction under section 80TTA is allowed only on interest earned on saving deposits with Indian bank and not with overseas bank account.
- (v) Since Shivam is a resident and ordinarily resident in India for the A.Y.2020-21 by virtue of section 6 of the Income-tax Act, 1961, his global income is taxable in India. In such case, the income arising in Country “Q” is doubly taxed. In order to avoid double taxation, Shivam can take the benefit of DTAA between India and Country “Q” by way of foreign tax credit in respect of the tax paid in Country “Q” or tax paid on such income in India, whichever is lower.

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

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

Calculation of foreign tax credit

Doubly taxed Salary Income		INR
Basic Salary		3,93,680
Cost of Living Allowance		2,81,200
		6,74,880
Less: Standard deduction (50,000 x 6,74,880/16,04,880)		21,026
Doubly taxed salary income		6,53,854
Computation of foreign tax credit on doubly taxed salary income:		
Lower of:		
Tax withheld in Country “Q” on salary income at 15%	98,078	
Tax payable in India on salary income@22.25% (INR 4,84,626/ INR 21,78,290)	1,45,483	
Foreign tax credit		98,078

Double taxed Interest Income		INR
Interest Income on Securities of Country “Q” company		2,42,600
Computation of foreign tax credit on doubly taxed interest income:		
Lower of:		
Tax withheld in Country “Q” on interest income at 15%, which is also the rate as per the DTAA [750(5000 x 15%) x 48.52]		36,390

Tax payable in India on interest income@22.25%	<u>53,979</u>
Foreign tax credit	36,390

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

ELECTIVE PAPER 6C: INTERNATIONAL TAXATION

CASE STUDY - 4

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

Income earned in foreign nations

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

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

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

Income earned in India

Particulars	(Rs. in lakhs)
Business income	1.5
Long-term capital gains on sale of residential house in Mumbai on 1.3.2020	45
Agricultural income from lands in Bengaluru	3.2

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

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

Income-tax rate structure:

Country E

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

Country F

Flat 27% without any basic exemption limit.

Tax treatment/ concessions in other nations

- (i) No statutory allowance/deduction in respect of house property income in Country E as well as Country F.
- (ii) Loss from firm can be set off against other business income in Country F only.
- (iii) Agricultural income is exempt in Country E only.

A Search is conducted by the Income-tax department in India in the premises of Mr. Arjun Batra on 30.4.2020 and it has come to the notice of the department that Mr. Arjun Batra has earned income to the tune of Rs.5 lakhs in country E during the previous year 2017-18.

Further, Income-tax department noticed the existence of undisclosed gold jewellery which was purchased on 21-4-2017. Neither this income, nor the asset in question, has any bearing to income chargeable under the provisions of the Income-tax Act, 1961.

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

I. MULTIPLE CHOICE QUESTIONS

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

1. Let us say Arjun has earned income from house property in Country X which is taxable under the domestic tax laws of Country X. Such income is also taxable in the hands of Arjun in India, since he is resident in India. Assume that the DTAA between India and Country X provides for taxation of such income in the source state only. In this situation,
 - (a) Such income is exempt in India by virtue of the DTAA between India and Country X
 - (b) Such income will be exempt in India, provided that Arjun obtains a Tax Residency Certificate from the Government of Country X.
 - (c) Such income is taxable in India, since Arjun is resident in India.
 - (d) Such income is taxable in India, since the Income-tax Act, 1961 does not provide for exemption of income from house property outside India.
2. Assume that Arjun has earned an income of Rs.4 lakhs by way of lump sum consideration for copyright of a literary book from a publisher in Country Y, with which India does not have a DTAA. The same has been taxed at a flat rate of 5% in Country Y. In India, his gross total income is Rs.7 lakhs. The double taxation relief available is -
 - (a) Rs.20,000
 - (b) Rs.7,800
 - (c) Rs.1,950
 - (d) Nil
3. Assume that Arjun had acquired a factory building in Country Z for Rs.24 lakhs on 21-3-2017, for which Rs.18 lakhs was invested from explained sources which had suffered tax in India. This asset comes to the knowledge of the Assessing Officer on 20-5-2019. The market value of the asset as on 1-4-2019 is Rs.40 lakhs. The value of undisclosed foreign asset as per Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 (BM Act) is
 - (a) Rs.40 lakhs
 - (b) Rs.22 lakhs
 - (c) Rs.10 lakhs
 - (d) Rs.6 lakhs
4. Continuing the facts of MCQ 3., assume that the Assessing Officer has issued the notice under BM Act on 30-5-2019. The time limit for completion of assessment under the BM Act is
 - (a) 31-3-2022
 - (b) 30-5-2021
 - (c) 31-3-2023

(d) 30-5-2022

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

- (i) Both undisclosed income and undisclosed asset would be taxable in the P.Y.2020-21
- (ii) Both undisclosed income and undisclosed asset would be taxable in the P.Y.2017-18
- (iii) Undisclosed income is taxable in the P.Y.2017-18 and undisclosed asset in the P.Y.2020-21
- (iv) Undisclosed asset is taxable in the P.Y.2017-18 and undisclosed income in the P.Y.2020-21
- (v) The value of undisclosed asset is Rs.4.2 lakhs
- (vi) The value of undisclosed asset is Rs.5.2 lakhs
- (vii) The value of disclosed asset is Rs.5.3 lakhs

The correct answer is –

- (a) (i) and (vi)
- (b) (ii) and (v)
- (c) (iii) and (vi)
- (d) (iv) and (vii)

II. DESCRIPTIVE QUESTIONS

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

ELECTIVE PAPER 6C: INTERNATIONAL TAXATION

SOLUTION TO CASE STUDY 4

I. ANSWERS TO MCQs (Most appropriate answers)

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

II. ANSWERS TO DESCRIPTIVE QUESTION

Answer to Q.1:

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

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

Computation of tax liability of Mr. Arjun Batra for A.Y.2020-21	Rs.
Tax on Rs.35.7 lakhs, being non-agricultural income [Rs.32.5 lakhs] + agricultural income [Rs.3.2 lakhs]	
Tax on LTCG of Rs.8 lakhs@20%	1,60,000
(+) Tax on other income of Rs.27.7 lakhs	6,43,500
	8,03,500

(-) Tax on Rs.5.7 lakhs, being agricultural Income [Rs.3.2 lakhs] + Basic Exemption Limit [Rs.2.5 lakhs]	26,500
	7,77,000
Add: Health and education cess @4%	31,080
	8,08,080
Indian rate of tax = $8,08,080 \times 100/32,50,000 = 24.864\%$	
Less: Rebate u/s 91 on income of Country E + Country F	4,49,179
Tax payable in India	3,58,901
Tax payable (Rounded off)	3,58,900
Computation of average rate of tax in Country E	Rs. in lakhs
Gross rental receipts from commercial property [No deduction is allowed from this in Country E]	2.0
Share income from partnership firm (loss) to be ignored	-
Business income	2.2
STCG from sale of vacant site on 1-11-2019	15.0
Agricultural income [Exempt in Country E]	-
Total income	19.2
Rates of tax in Country E	
Upto 3 lakhs Nil	-
3 to 6 lakhs 15%	0.45
Above 6 lakhs 22%	2.904
	3.354
Average rate of tax in Country E = $3.354 \times 100/19.2 = 17.469\%$	
Doubly Taxed Income (in Country E)	Rs. in lakhs
Gross rental receipts form commercial property (Rs.2 lakhs – Rs.0.6 lakhs, being 30% of Rs.2 lakhs)	1.4
Share of loss from partnership firm	(1.0)
Business income	2.2
STCG from sale of vacant site on 1-11-2019	15.0
	17.6
Double Taxation Relief at India rate of tax or rate of tax in Country E, whichever is lower	17.469%
Double Taxation Relief = 17.469% of Rs.17.6 lakhs = Rs.3,07,454	
Doubly Taxed Income (in Country F)	Rs. in lakhs
Gross rental receipts from commercial property [Rs.3 lakhs (-) 30% of Rs.3 lakhs]	2.1
Business income	3.3
Share of loss from partnership firm	(1.5)
Agricultural income	1.8
Total income	5.7
Rate of Tax in Country F	27%
Double Taxation Relief at Indian rate of tax (24.864%) or rate of tax in Country F	24.864%

(27%), whichever is lower	
Double Taxation Relief = 24.864% of Rs.5.7 lakhs = Rs.1,41,725	
Double Taxation Relief [Country E & Country F] = Rs.3,07,454 + Rs.1,41,725	4,49,179

ELECTIVE PAPER 6C: INTERNATIONAL TAXATION

CASE STUDY - 5

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

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

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

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

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

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

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

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

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

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

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

The first meeting takes up one important matter that is, the grant of a power of attorney to Mrs. Indra to enable the work in Mauritius to go on smoothly. Accordingly, it is decided that all matters of day-to-day

importance can be approved by Mrs. Indra. If the matter involves expenditure of more than Rs. 25,000, the approval of Mr. Rai would be mandatory.

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

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

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

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

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

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

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

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

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

I. MULTIPLE CHOICE QUESTIONS

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

1. During the P.Y. 2017-18 and P.Y. 2018-19, Mr. Rai was in India on business visits from June 15, 2017 to August 31, 2017 and July 1, 2018 to September 28, 2018, respectively. During the previous year 2019-20, Mr. Rai was in India during April-May 2019 and November 2019. What is the residential status of Mr. Rai for previous years 2018-19 and 2019-20, respectively?
 - (a) Non-resident and Resident and Ordinarily Resident, respectively
 - (b) Non-resident for both years
 - (c) Resident and Ordinarily Resident for both years
 - (d) Resident but Not Ordinarily Resident for both years
2. During the Previous Year 2019-20, Mr. Rai received Rs.75,00,000 on account of sale of agricultural land in Mauritius. The money was first received in Mauritius and then remitted to his Indian bank account. Is the sum taxable in India?
 - (a) No, as agricultural income is exempt u/s 10(1).
 - (b) No, as the income has accrued and arisen outside India and is also received outside India.
 - (c) Yes, since it is remitted to India in the same year.
 - (d) Yes, as agricultural income earned outside India is not exempted in India in the hands of a resident.

3. Mr. Bhandari only holds the shares in RB Pvt. Ltd. If he sells the shares held by him in RB Pvt. Ltd. for a gain during the Previous Year 2019-20, which of the following statements is true?
 - (a) The resultant gain is a short-term capital gain taxable under the normal provisions of the Act.
 - (b) The resultant gain is a short-term capital gain taxable@15% u/s 111A.
 - (c) The resultant gain is a long-term capital gain taxable@20% u/s 112.
 - (d) The resultant gain is a long-term capital gain taxable@10% u/s 112A.
4. Mr. Bhandari receives dividend payment from RB Pvt. Ltd. in his Indian bank account during 2019-20 to the tune of Rs.1,50,000. Which of the following statements is true?
 - (a) Mr. Bhandari is liable to pay tax on such dividend as it forms part of his total income
 - (b) RB Pvt. Ltd. will have to pay a dividend distribution tax u/s 115-O on such payments
 - (c) Mr. Bhandari is eligible for an exemption under section 10(34) in respect of such dividend.
 - (d) Both (b) and (c)
5. During the previous year 2019-20, RB Pvt. Ltd. entered into contracts for purchase and sale of barley grains with PB Pvt Ltd. PB Pvt. Ltd. is a company incorporated in New Delhi. On account of which of the following facts, would the companies be considered to be associated enterprises?
 - (a) One of the four directors of PB Pvt. Ltd. is Mr. Bhandari
 - (b) RB Pvt. Ltd. owns 20% of shares in PB Pvt. Ltd.
 - (c) RB Pvt. Ltd. extended a loan of Rs.20 lakhs to PB Pvt. Ltd. when the book value of the latter is Rs.42 lakhs
 - (d) Mr. Bhandari owns 26% of shares in PB Pvt. Ltd.

II. DESCRIPTIVE QUESTIONS

1. The board decides to understand the matter at hand from a tax lawyer. Accordingly, Mr. Bhandari seeks a meeting with a tax lawyer on the question. The lawyer explains the following in an informal conversation:
 RB Pvt. Ltd. would be considered to be a resident of India for tax purposes despite it having been incorporated in Port Louis, Mauritius. The reasons for the same are detailed as follows:
 - Majority of the board of directors reside in India
 - The place of incorporation of the company is irrelevant
 - All the revenue generation activity is linked to India
 In your opinion, can the Indian tax authorities argue that RB Pvt. Ltd. is resident in India for tax purposes, despite the fact that the company has been incorporated in Mauritius? Would their reasoning be the same as cited by the tax lawyer? **(8 Marks)**
2. Assume that Mr. Bhandari has opened an office of RB Pvt. Ltd. in Pune from where he and Mr. Sharma execute the work of the company relating to Indian operations. RB Pvt. Ltd. is further considering advertising the product on internet using Facebook. RB Pvt. Ltd. enters into talks with Facebook for hosting the desired advertisements. It negotiated a sum of INR 10 lakhs, which is paid to Facebook for online advertisement services in March, 2020. Assume that Facebook does not have a permanent establishment in India.
 - (a) Is the fee paid for online advertisement services by RB Pvt. Ltd. to Facebook Inc. taxable in India? Discuss. **(3 Marks)**
 - (b) If the answer to (a) is in the affirmative, is there any requirement to deduct tax at source? If tax is not so deducted, what would be the consequence? **(3 Marks)**

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

ELECTIVE PAPER 6C: INTERNATIONAL TAXATION

SOLUTION TO CASE STUDY 5

I. ANSWERS TO MCQs (Most appropriate answers)

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

II. ANSWERS TO DESCRIPTIVE QUESTIONS

Answer to Q.1:

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

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

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

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

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

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

Percentage of passive income to total income = $4/15 \times 100 = 26.67\%$

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

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

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

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

Answer to Q.2:

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

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

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

- (b) RB Pvt. Ltd. is liable to deduct equalization levy of Rs.60,000 from the amount of Rs.10 lakhs payable to Facebook Inc. In case it fails to so deduct equalization levy, it shall, notwithstanding such failure, be liable to pay the levy to the credit of the Central Government by 7th April, 2020. Further, penalty of an amount equal to Rs. 60,000 would be attracted for failure to deduct equalization levy. Also, disallowance of the expenditure of Rs.10 lakhs would be attracted under section 40(a)(ib) while computing business income of RB Pvt. Ltd.
- (c) Section 10(50) of the Income-tax Act, 1961 exempts income arising from providing specified service of online advertisement, which are subject to equalization levy, from income-tax.

CASE STUDY - 6

M/s. Shiva Vishnu LLP is a leading tax consultant based at New Delhi. The firm has four resident partners, Mr. Shiva, Mr. Vishnu, Mr. Ganesh and Mr. Karthik. As per the partnership deed, the profits and losses are shared equally amongst partners. All partners are working partners and salary is paid to all partners as per the terms of the partnership deed.

One of the partners, Mr. Vishnu sold listed equity shares of B Ltd (STT was paid both at the time of purchase and sale) on 23rd January, 2020 for ₹ 2,70,000. The said shares were purchased by him on 15th January, 2018 for ₹ 2,75,000. The fair market value of such shares on 31st January, 2018 was ₹ 2,50,000. He sold land owned by him in Pune for ₹ 22 lakhs on 24th February, 2020. The said land was purchased by him for ₹ 11 lakhs on 22nd February, 2018.

The LLP provides direct taxes consultancy services. Over the last couple of years, they have taken up few assignments in the area of international taxation. These assignments relate to double taxation avoidance agreements, non-resident taxation, transfer pricing and other international taxation matters.

The details of some of the assignments are as follows -

Assignment 1 [Client – Ganges Ltd.]

Ganges Ltd. is an Indian Company in which Nile Inc., a Country E company holds 40% shareholding and voting power. During the previous year 2017-18, the Indian company supplied computers to the Country E based company @CED 1100 per piece. The price of computer supplied to other unrelated parties in Country E is @CED 1400 per piece. During the course of assessment proceedings relating to A.Y.2018-19, the Assessing Officer carried out primary adjustments and added a sum of ₹ 168 lakhs, being the difference between actual price of computer and arm's length price for 700 pieces and it was duly accepted by the assessee. The Assessing Officer passed the order, in which the primary adjustments were made, on 1.6.2019. On account of this adjustment, the excess money of ₹ 168 lakhs is available with Nile Inc, Country E. In this context, Ganges Ltd. wants to know the effect of this transaction for the assessment year 2020-21 on the basis that it declared an income of ₹ 300 lakhs and the excess money is still lying with Nile Inc. till today. Assume the rate of exchange as 1 CED = ₹ 80. [CED stands for Country E Dollars, which is the currency of Country E]; six month LIBOR as on 30.9.2019 is 9.50%.

Assignment 2 [Client – Godavari Ltd.]

Godavari Ltd., a resident Indian Company, on 01-04-2019 has borrowed ₹ 80 crores from M/s. Mississippi Inc, a Company incorporated in Country F, at an interest rate of 8% p.a. The said loan is repayable over a period of 12 years. Further, loan is guaranteed by M/s Amazon Inc incorporated in Country F. M/s. Colorado Inc, a non-resident, holds shares carrying 40% of voting power both in M/s Godavari Ltd. and M/s Amazon Inc. M/s Colorado Inc has also deposited ₹ 80 crores with M/s Mississippi Inc.

The net profit of M/s. Godavari Ltd. was ₹ 7 crores after debiting the above interest, depreciation of ₹ 4 crores and income-tax of ₹ 2.70 crores. Godavari Ltd. wants to know if interest is allowable as deduction under the head "Profits and gains of business or profession" and if so, to what extent.

Assignment 3 [Client – Ms. Sheetal]

Ms. Sheetal is a resident Individual. She has income from the following sources:

- (i) Taxable income from a sole-proprietary concern in Baroda ₹ 80 lakhs.
- (ii) Share of profit from a partnership firm in Bhopal ₹ 40 lakhs.
- (iii) Agricultural Income (Gross) from coffee estate in Country G which has no DTAA with India, CGD 40000. Withholding Tax on the above income CGD 8000

- (iv) Brought forward business loss of F.Y.2015-16 in Country G was CGD 12000 which is not permitted to be set off against other income as per the laws of that country.

Ms. Sheetal desires to know her total income and tax liability for the A.Y. 2020-21 (Assume 1 CGD = ₹50). [CGD stands for Country G Dollars which is the currency of Country G]

Based on the above facts, answer the following questions –

MULTIPLE CHOICE QUESTIONS

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

1. Would the total income of A.Y.2020-21 of Ganges Ltd. undergo a change if –

- (i) the primary adjustment made was ₹ 90 lakhs;
- (ii) the said adjustment pertained to P.Y.2015-16 instead of P.Y. 2017-18?

The correct answer is -

- (a) No, the total income of A.Y.2020-21 would not undergo any change due to the reasons stated in either (i) or (ii) above.
- (b) Yes, the total income of A.Y.2020-21 would undergo a change due to the reason stated in (i) but not due to the reason stated in (ii) above.
- (c) Yes, the total income of A.Y.2020-21 would undergo a change due to the reason stated in (ii) but not due to the reason stated in (i) above.
- (d) Yes, the total income would undergo a change due to the reasons stated in both (i) and (ii) above.

2. Interest payable by Godavari Ltd. to Mississippi Inc. would be subject to limitation of interest deduction because –

- (i) M/s. Colorado Inc. holds shares carrying 40% voting power in Godavari Ltd.
- (ii) M/s. Colorado Inc. holds shares carrying 40% voting power both in Godavari Ltd. and M/s. Amazon Inc
- (iii) M/s. Amazon Inc. guarantees the loan taken by Godavari Ltd. from M/s. Mississippi Inc.
- (iv) M/s. Colorado Inc. has deposited ₹ 80 crores with M/s. Mississippi Inc.

The most appropriate answer is -

- (a) (i) and (iv) above
- (b) (ii) and (iii) above
- (c) (i) and (iii) above
- (d) Either (a) or (b)

3. While computing total income of Ms. Sheetal under the Income-tax Act, 1961, brought forward business loss in Country G –

- (i) can be set-off against her business income from sole-proprietorship in Baroda
- (ii) cannot be set-off against her business income from sole-proprietorship in Baroda since such set-off is not permitted as per the tax laws of Country G

- (iii) should not be deducted while computing doubly taxed income for the purpose of deduction under section 91
- (iv) has to be deducted while computing doubly taxed income for the purpose of deduction under section 91

Which of the above statements are correct?

- (a) (i) and (iii)
 - (b) (ii) and (iii)
 - (c) (i) and (iv)
 - (d) (ii) and (iv)
4. If Ms. Sheetal derived share income from a partnership firm in Country G which is taxable under the laws of Country G, then, assuming that the shares of the partners are not specified in the instrument evidencing partnership since the same is not a requirement as per the laws of Country G, which of the following statements would be correct?
- (i) Share income of Ms. Sheetal from the partnership firm would be taxable under the Income-tax Act, 1961
 - (ii) Share income of Ms. Sheetal from the partnership firm would be exempt under section 10(2A) of the Income-tax Act, 1961
 - (iii) Share income of Ms. Sheetal from the partnership firm would be included in “doubly taxed income” for the purpose of deduction under section 91
 - (iv) Share income of Ms. Sheetal from the partnership firm would not be included in “doubly taxed income” for the purpose of deduction under section 91

The correct answer is –

- (a) (i) and (iii)
 - (b) (i) and (iv)
 - (c) (ii) and (iii)
 - (d) (ii) and (iv)
5. In relation to the transaction of sale of shares and land by Mr. Vishnu, which of the following statements are correct, in the context of the facts given in the case study and the provisions contained in the Income-tax Act, 1961 –
- (a) Long-term capital loss (computed) on sale of listed equity shares by Mr. Vishnu cannot be set-off against long-term capital gains on sale of land by him, since loss from an exempt source cannot be set-off against gains from a taxable source.
 - (b) Long-term capital loss (computed) on sale of listed equity shares by Mr. Vishnu can be set-off against long-term capital gains on sale of land by him.
 - (c) Long-term capital gains (computed) on sale of listed equity shares by Mr. Vishnu is includible in computation of total income but not taxable.
 - (d) Long-term capital gains (computed) on sale of listed equity shares by Mr. Vishnu is exempt, and hence not includible while computing total income.

DESCRIPTIVE QUESTIONS

1. (a) Ganges Ltd. wants to know the effect of the transaction of supply of computers to Nile Inc., in respect of which the Assessing Officer carried out primary adjustments in computing the total income for A.Y.2020-21, considering that the excess money is still lying with Nile Inc. **(5 Marks)**
(b) Is the interest payable by Godavari Ltd. to M/s. Mississippi Inc. allowable as deduction while computing the total income of Godavari Ltd.? If so, to what extent? **(4 Marks)**
2. Compute the total income and tax liability of Ms. Sheetal for A.Y.2020-21. **(6 Marks)**

ELECTIVE PAPER 6C- INTERNATIONAL TAXATION

SUGGESTED SOLUTION – CASE STUDY 6

I. ANSWERS TO MULTIPLE CHOICE QUESTIONS

1. (a) No, the total income of A.Y.2020-21 would not undergo any change due to the reasons stated in either (i) or (ii) above.
2. (d) Either (a) or (b)
3. (c) (i) and (iv)
4. (a) (i) and (iii)
5. (b) Long-term capital loss (computed) on sale of listed equity shares by Mr. Vishnu can be set-off against long-term capital gains on sale of land by him

II. ANSWERS TO DESCRIPTIVE QUESTIONS

Answer to Q.1

- (a) In this case, Ganges Ltd., the Indian company, and Nile Inc., a Country E company, are deemed to be associated enterprises as per section 92A(2) since Nile Inc. holds more than 26% voting power in Ganges Ltd.

On account of the primary adjustment of ₹ 168 lakhs made by the Assessing Officer, the total income of Ganges Ltd. for A.Y.2018-19 would increase by ₹ 168 lakhs.

I. If Ganges Ltd. opts not to pay additional income-tax on such excess money not repatriated

In this case, secondary adjustment has to be made under section 92CE, since –

- (1) The company has accepted the primary adjustment made by the Assessing Officer;
- (2) The primary adjustment is in respect of A.Y.2018-19; and
- (3) The primary adjustment exceeds ₹ 100 lakhs.

Accordingly, the excess money (i.e., ₹ 168 lakhs) available with the associated enterprise (i.e., Nile Inc., Country E) not repatriated to India within 90 days of the date of the order of the Assessing Officer would be deemed as an advance made by the Ganges Ltd. to its associated enterprise, Nile Inc. Interest would be calculated on such advance at 12.50% [i.e., the rate of six month LIBOR as on 30th September, 2019 (i.e., 9.50%)+ 3%], since the international transaction is denominated in foreign currency. Such interest computed from 1.6.2019 to 31.3.2020 amounting to $10/12 \times 168 \text{ lakhs} \times 12.50\% = ₹ 17,50,000$ would be added to his total income for A.Y.2020-21.

II. If Ganges Ltd. opts to pay additional income-tax on such excess money not repatriated

In such a case, Ganges Ltd. has to pay additional income-tax @20.9664% (tax @18% plus surcharge @12% plus cess@4%) on ₹ 168 lakhs, which amounts to ₹ 35,22,355. Where additional income-tax is so paid by Ganges Ltd., it will not be required to make secondary adjustment and compute interest from the date of payment of such tax. The additional income-tax so paid by Ganges Ltd. would be treated as the final payment of tax in respect of excess money not repatriated and no further credit

would be allowed to Ganges Ltd. or to any other person in respect of the amount of additional income-tax so paid.

- (b) If an Indian company, being the borrower, incurs any expenditure by way of interest in respect of any debt issued by its non-resident associated enterprise (AE) and such interest exceeds ₹ 1 crore, then, the interest paid or payable by such Indian company in excess of 30% of its earnings before interest, taxes, depreciation and amortization (EBITDA) or interest paid or payable to associated enterprise, whichever is lower, shall not be allowed as deduction as per section 94B.

Further, where the debt is issued by a lender which is not associated but an associated enterprise either provides an implicit or explicit guarantee to such lender or deposits a corresponding and matching amount of funds with the lender, such debt shall be deemed to have been issued by an associated enterprise and limitation of interest deduction would be applicable.

In the present case, since M/s Colorado Inc holds 40% of voting power i.e., more than 26% of voting power in both Godavari Ltd and M/s Amazon Inc, Godavari Ltd. and M/s Amazon Inc are deemed to be associated enterprises.

Since loan of ₹ 80 crores taken by Godavari Ltd., an Indian company from M/s Mississippi Inc, is guaranteed by M/s Amazon Inc, an associated enterprise of Godavari Ltd., such debt shall be deemed to have been issued by an associated enterprise and interest payable to M/s Mississippi Inc shall be considered for the purpose of limitation of interest deduction under section 94B.

Computation of interest to be allowed in the computation of income under the head profits and gains of business or profession of M/s. Godavari Ltd.

Particulars	₹
Net profit	7,00,00,000
Add: Interest already debited (₹ 80 crores x 8%)	6,40,00,000
Depreciation	4,00,00,000
Income tax	<u>2,70,00,000</u>
EBITDA	<u>20,10,00,000</u>
Interest paid or payable by Godavari Ltd.	6,40,00,000
Less: Excess interest – Lower of	
Interest paid or payable in excess of 30% of EBITDA	
- ₹ 6,40,00,000 (-) ₹ 6,03,00,000	₹ 37,00,000
Interest paid or payable to non-resident AE	₹ 6,40,00,000
	<u>37,00,000</u>
Interest allowable as deduction	<u>6,03,00,000</u>

Note – Since Colorado Inc., an associated enterprise of Godavari Ltd., has deposited a matching amount of ₹ 80 crores with Mississippi Inc., the interest payable by Godavari Ltd. to Mississippi Inc. on loan of ₹ 80 crores borrowed from Mississippi Inc. would be subject to limitation of interest deduction on the basis of this line of reasoning also.

Answer to Q.2

Computation of taxable income and tax payable by Ms. Sheetal for A.Y. 2020-21

Particulars	₹	₹
Profits and gains from business and profession		
Income from sole proprietary concern in Baroda	80,00,000	

Share of profit, ₹ 40 lakhs, from a partnership firm in Bhopal is exempt	Nil	
Business profit	80,00,000	
Less: Business Loss ¹ in Country G (CGD 12,000 x ₹ 50/CGD)	<u>6,00,000</u>	74,00,000
Income from Other Sources		
Agricultural income from coffee estate in Country G, is taxable in India (CGD 40,000 x ₹ 50/CGD)		<u>20,00,000</u>
Gross Total Income/ Total Income		94,00,000
Tax on total income		
Tax on ₹ 94,00,000 [30% x ₹ 84,00,000 plus ₹ 1,12,500]		26,32,500
Add: Surcharge@10%, since total income exceeds ₹ 50 lakhs		<u>2,63,250</u>
		28,95,750
Add: HEC@4%		<u>1,15,830</u>
		30,11,580
Average rate of tax in India [i.e., ₹ 30,11,580/₹ 94,00,000 x 100]	32.04%	
Average rate of tax in Country G [i.e., CGD 8,000/CGD 40,000]	20%	
Doubly taxed income [₹ 20,00,000 – ₹ 6,00,000]	14,00,000	
Rebate under section 91 on ₹ 14,00,000 @20% (lower of average Indian tax rate and rate of tax in Country G)		<u>2,80,000</u>
Tax payable in India [₹ 30,11,580 – ₹ 2,80,000]		<u>27,31,580</u>

Note: Since Ms. Sheetal is resident in India for the P.Y.2019-20, her global income would be subject to tax in India. She would be allowed deduction under section 91 since all the following conditions are fulfilled:-

- She is a resident in India during the relevant previous year.
- Agricultural income from coffee estate accrues or arises to her outside India in Country G during that previous year.
- Such agricultural income is not deemed to accrue or arise in India during the previous year.
- Such agricultural income has been subjected to income-tax in Country G in her hands and she has paid tax on such income in Country G.
- There is no agreement under section 90 for the relief or avoidance of double taxation between India and Country G, where the income has accrued or arisen.

¹ Since the eight year period from A.Y.2016-17, being the assessment year in which such business loss was incurred, has not expired, the business loss can be set-off against current year business income

ELECTIVE PAPER 6C: INTERNATIONAL TAXATION

CASE STUDY - 7

Mr. Eashwar, an Indian citizen aged 55 years, carries on the business of trading in garments in India. He has also set up a branch office in Country X and Country Y for trading in garments in those countries. He visits Country X and Y frequently for furtherance of his business. During the P.Y.2019-20, he made three visits to Country X from 13th May, 2019 to 13th June, 2019, from 18th August, 2019 to 5th October, 2019 and from 17th January, 2020 to 4th February, 2020. He visited Country Y thrice from 3rd April, 2019 to 24th April, 2019, from 4th July, 2019 to 14th August, 2019 and 5th March, 2020 to 20th March, 2020. The number of days of his stay in Country X and Y during the past ten years is as follows –

Previous Year (P.Y.)	No. of days in Country X	No. of days in Country Y
P.Y. 2018-19	97	78
P.Y.2017-18	95	85
P.Y.2016-17	98	82
P.Y.2015-16	100	80
P.Y.2014-15	103	75
P.Y.2013-14	110	70
P.Y.2012-13	120	60
P.Y.2011-12	118	60
P.Y.2010-11	115	62
P.Y.2009-10	108	72

He has not visited any other country in the last 10 years. He has a passion for writing and has written two literary books, from which he earns royalty income in Country X. He has purchased agricultural land in Country X. In Country Y, he has purchased a house, which he has let out. He has invested in shares of a company incorporated in Country Y. The following are the particulars of income earned by him in India, Country "X" and Country "Y" for the previous year 2019-20.

Particulars	₹
Income from the business of trading in garments	
In India	34,30,000
In Country X	10,45,000
In Country Y	(1,30,000)
Agricultural income in Country "X" (gross) (taxable in Country X)	1,25,000
Dividend received from a company incorporated in Country "Y" (gross) (taxable in Country Y)	40,000
Royalty income from a literary book from Country "X" (gross) (taxable in Country X)	4,00,000
Expenses incurred for earning royalty	40,000
Rent from a house situated in Country "Y" (gross) (taxable in Country Y)	1,80,000
Municipal tax in respect of the above house (not allowed as deduction in country "Y")	10,000

Note: Business loss in Country "Y" not eligible for set off against other incomes as per law of that country. The rates of tax in Country "X" and Country "Y" are 20% and 30%, respectively.

Mr. Eashwar's younger brother, Mr. Karan, aged 48 years, earns income from a business in Country Z.

Mr. Eashwar's elder sister, Mrs. Radha Srinivas, aged 61 years, is married and settled in Calcutta. She is a Hindustani classical singer and composer who gives concerts in India and Country W. She visits Country W every year during the music season in October to participate in the Mega music concert held there. For the rest of the year, she gives concerts in India. She earns ₹ 10 lakhs from concerts held in India and CWD 10145 from concerts held in Country W. Tax deducted in Country W in October, 2019 in respect of income earned by her in that country was 2500 CWD. She earns income of CUD 10000 by way of royalty in respect of copyright of her musical compositions in Country U. The royalty is paid to her every year on 25th March after deduction of tax@10%. In India, she has interest income of ₹ 4 lakhs from bank fixed deposits in her name and ₹ 25,000 from savings bank account. She pays medical insurance premium of ₹ 27,000 to insure her health and ₹ 30,000 to insure the health of her husband, a resident aged 64 years. She deposits ₹ 1.50 lakhs in public provident fund and ₹3 lakhs in five-year fixed deposit in the name of her son, Mr. Ramesh. The conversion rates are as follows -

TT buying rate	30.9.2019	31.10.2019	28.2.2020	31.3.2020
Country U dollar (CUD)	₹ 70	₹ 74	₹ 78	₹ 80
Country W dollar (CWD)	₹ 70	₹ 72	₹ 68	₹ 69

Based on the above facts, answer the following questions, assuming that India has –

- no double taxation avoidance agreement with Countries W, X and Y;
- a double taxation avoidance agreement with Country Z in line with OECD Model Convention, 2017
- a double taxation avoidance agreement with Country U in line with UN Model Convention, 2017
- India follows credit method for providing double taxation relief with respect to taxes paid in Countries Z and U.

MULTIPLE CHOICE QUESTIONS

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

- The total income of Mr. Eashwar for the A.Y.2020-21 is -
 - ₹ 46,89,000
 - ₹ 48,19,000
 - ₹ 49,89,000
 - ₹ 51,19,000
- For the purpose of computing deduction under section 91 for A.Y.2020-21, the “doubly taxed income” of Mr. Eashwar in respect of income earned in Country X and Country Y would be –
 - ₹ 15,30,000 and ₹ 1,59,000, respectively
 - ₹ 12,30,000 and ₹ 1,59,000, respectively
 - ₹ 15,30,000 and ₹ 29,000, respectively
 - ₹ 12,30,000 and ₹ 29,000, respectively

3. The rebate under section 91 available to Mr. Eashwar for A.Y.2020-21 is –
 - (a) ₹ 2,53,842
 - (b) ₹ 3,48,995
 - (c) ₹ 3,13,842
 - (d) ₹ 2,88,995
4. As per the India-Country Z DTAA and India-Country U DTAA, royalty, if any, arising to Mr. Karan and Ms. Radha Srinivas in Country Z and Country U, respectively, would be taxable –
 - (a) Only in India
 - (b) Royalty arising to Mr. Karan may be taxed either in India or in Country Z and royalty arising to Ms. Radha Srinivas may be taxed either in India or in Country U
 - (c) Royalty arising to Mr. Karan would be taxable only in India; Royalty arising to Ms. Radha Srinivas may be taxed either in India or in Country U
 - (d) Royalty arising to Ms. Radha Srinivas would be taxable only in India; Royalty arising to Mr. Karan may be taxed either in India or in Country Z
5. Let us suppose that, as per the DTAA between India and Country U, a particular income earned by Mrs. Radha Srinivas in Country U may be taxed in Country U. While computing her total income under the Income-tax Act, 1961, the said income –
 - (a) should not be taken into account at all
 - (b) should be taken into account; thereafter, deduction is to be allowed from the tax payable in India on her total income.
 - (c) may be taken into account in order to compute the amount of tax on the remaining income.
 - (d) may be taken into account; thereafter, deduction may be allowed from the tax payable in India on her total income.

DESCRIPTIVE QUESTIONS

1. Determine the residential status of Mr. Eashwar for A.Y.2020-21. **(5 Marks)**
2. Compute the total income and tax liability of Ms. Radha Srinivas for A.Y.2020-21, and determine the foreign tax credit available to her. **(10 Marks)**

ELECTIVE PAPER 6C- INTERNATIONAL TAXATION**SUGGESTED SOLUTION – CASE STUDY 7****I. ANSWERS TO MULTIPLE CHOICE QUESTIONS**

1. (a) ₹ 46,89,000
2. (d) ₹ 12,30,000 and ₹ 29,000, respectively
3. (a) ₹ 2,53,842
4. (c) Royalty arising to Mr. Karan would be taxable only in India; Royalty arising to Ms. Radha Srinivas may be taxed either in India or in Country U
5. (b) should be taken into account; thereafter, deduction is to be allowed from the tax payable in India on her total income

II. ANSWERS TO DESCRIPTIVE QUESTIONS**Answer to Q.1****Determination of residential status of Mr. Eashwar for A.Y.2020-21**

No. of days of stay in Country X = 32 days + 49 days + 19 days = 100 days

No. of days of stay in Country Y = 22 days + 42 days + 16 days = 80 days

No. of days of stay in India = 366 days – 100 days – 80 days = 186 days

Since Mr. Eashwar's stay in India is for 186 days (i.e., 182 days or more) in the P.Y.2019-20, he is resident in India for A.Y.2020-21.

For determining whether he is resident and ordinarily resident in the A.Y.2020-21, the number of days of his stay in India in the last seven previous years is relevant -

Previous Year (P.Y.)	No. of days in Country X	No. of days in Country Y	No. of days in India
P.Y. 2018-19	97	78	365-97-78 = 190
P.Y.2017-18	95	85	365-95-85 = 185
P.Y.2016-17	98	82	365-98-82 = 185
P.Y.2015-16	100	80	366-100-80 = 186
P.Y.2014-15	103	75	365-103-75 = 187
P.Y.2013-14	110	70	365-110-70 = 185
P.Y.2012-13	120	60	365-120-60 = 185
Total number of days in the last seven years			1303

Since his stay in India exceeds 730 days in the last seven previous years; and his number of days of stay in India is 182 days or more in all the earlier previous years, he satisfies the condition of being resident in

atleast 2 out of the 10 preceding previous years. Therefore, he is resident and ordinarily resident in India for A.Y.2020-21.

Answer to Q.2

Computation of tax liability of Ms. Radha Srinivas for the A.Y. 2020-21

Particulars	₹	₹
Profits and gains of business or profession		
From concerts held in India	10,00,000	
From royalty received from Country U [CLD 10000 x 80 (being conversion rate as on 31.3.2020 -Rule 115)]	8,00,000	
From concerts held in Country W [CWD 10145 x 69 (being conversion rate as on 31.3.2020 – Rule 115)]	<u>7,00,005</u>	
		25,00,005
Income from Other Sources		
Income from bank fixed deposits in her name	4,00,000	
Income from savings bank account	<u>25,000</u>	<u>4,25,000</u>
Gross Total Income		29,25,005
Less: Deduction under section 80C		
Deposit in PPF	1,50,000	
Five year fixed deposit in the name of her son (does not qualify for deduction under section 80C)	-	
Under section 80D	50,000	
Medical insurance premium to insure her health and health of spouse (₹ 57,000, restricted to ₹ 50,000, being the maximum allowable for senior citizens) (See Note 1)		
Under section 80TTB	<u>50,000</u>	
Interest on bank FD and savings bank account restricted to		<u>2,50,000</u>
Total Income		<u>26,75,005</u>
Total Income (rounded off)		26,75,010
<u>Tax on Total Income</u>		
Income-tax (See Note 2)		6,12,503
Add: Health and Education Cess @4%		<u>24,500</u>
		6,37,003
Average rate of tax in India (i.e., ₹ 6,37,003/ ₹ 26,75,010 × 100)	23.813%	
Foreign Tax Credit		
Lower of tax payable under the Income-tax Act, 1961 on income from profession and foreign tax payable on such income		
Tax covered under India-Country U DTAA under section 90 [Lower of ₹ 1,90,504 (i.e., 23.813% x ₹ 8,00,000) and ₹ 78,000 (₹ 78, being the conversion rate as on 28.2.2020 as per Rule 128 x CUD 1000)]	78,000	
Income-tax referred to in section 91: Country W [Lower of ₹ 1,66,692 (i.e., 23.813% x ₹ 7,00,005) and ₹		

1,75,000 (₹ 70, being the conversion rate as on 30.9.2019 as per Rule 128 x CWD 2500)]	<u>1,66,692</u>	<u>2,44,692</u>
Tax payable in India (₹ 6,37,003 – ₹ 2,44,692)		<u>3,92,311</u>
Tax payable (rounded off)		3,92,310

Notes:

1. Section 80D allows a higher deduction of up to ₹ 50,000 in respect of the medical premium paid to insure the health of a senior citizen. Therefore, in respect of medical insurance premium of ₹ 57,000 paid by Mrs. Radha Srinivas to insure the health of herself and her spouse, she will be allowed deduction of ₹ 50,000 under section 80D, since she and her husband are resident Indians of the age of 60 years or more during the P.Y.2019-20.
2. The basic exemption limit for senior citizens is ₹ 3,00,000 and the age criterion for qualifying as a "senior citizen" for availing the higher basic exemption limit is 60 years. Accordingly, Mrs. Radha Srinivas is eligible for the higher basic exemption limit of ₹ 3,00,000, since she is a resident Indian of the age of 61 years.
3. As per Rule 115, for computing income from profession of Mrs. Radha Srinivas, the TT buying rate as on 31.3.2020 has to be considered. Royalty income from Country U and income from concerts in Country W constitute her income from profession, since she is a singer and a composer. However, as per Rule 128, for computing foreign tax credit, TT buying rate as on the last day of the month immediately preceding the month in which tax was deducted or paid in that country has to be considered. Foreign Tax Credit has been computed accordingly.
4. Since the DTAA with Country U is in line with UN Model Convention, as per article 12(1), royalty income arising in a Contracting State (Country U, in this case) and paid to a resident of another Contracting State (Mrs. Radha Srinivas, a resident of India, in this case) **may** be taxed in that other State (India, in this case). However, such royalties may also be taxed in the Source State according to its laws, but if the beneficial owner is a resident of another State, then the tax so charged shall not exceed a prescribed percentage to be established through bilateral negotiations (assumed to be 10%, as given in the question, in this case). It is presumed that the rate of 10% is as per domestic tax laws and the negotiated rate as per Article 12(2) of the DTAA of India with Country U. Credit for such tax paid by Mrs. Radha Srinivas in Source State, i.e., Country U, in this case, would be available as per Article 23B(1).

ELECTIVE PAPER 6C: INTERNATIONAL TAXATION

CASE STUDY - 8

Mr. Arjun, aged 52 years, carries on in Mumbai, business of trading of spices grown in his own spice gardens in Munnar. He also has spice gardens in Country Z, and he derives income from Country Z from sale of spices grown therein. He stays in India during the entire month of May, July, September, November, January and March. He stays in Country Z during the months of April, June, August, October, December and February. As per the domestic laws of Country Z, he would be resident of that country if his stay in that country is for 180 days or more. Mr. Arjun owns a flat in Juhu, Bombay, where he lives with his wife, two children, and his parents. He also owns a flat in Thane which he has let out. He owns a residential house in Country Z where he stays when he visits Country Z. Mr. Arjun is passionate artist and has showcased his paintings in art exhibitions in Mumbai. He has deposits in SBI from which he earned interest of ₹ 42,300 in the P.Y.2019-20. He deposited ₹ 1,50,000 in public provident fund and paid ₹ 28,000 as mediclaim premium to insure his health and that of his spouse. He also paid ₹ 32,000 to insure the health of his parents.

Mr. Arjun holds 100 equity shares in each of the four Indian companies, namely, ABC Ltd., PQR Ltd., EFG Ltd and HIJ Ltd. The particulars of businesses carried on/services provided by these companies are detailed hereunder –

Company	Particulars
ABC Ltd.	It is engaged in manufacturing spices in India and has a branch in Country Z and Country L. It effects sale of spices to customers, P and Q through its branch in Country Z; and customers, J and K through its branch in Country L. In addition, it also effects sale of spices to bulk customers M and N in Country Z and bulk customers O and Q in Country L, directly.
PQR Ltd.	It is engaged in lending business and it also has a branch in Country L and Country Z. It has given a loan to L & Co., a firm located in Country L at interest of 20% as per the domestic tax laws of Country L. It has also given a loan to Z & Co., a firm located in Country Z, at interest of 8% as per the domestic tax laws of Country Z.
EFG Ltd.	It is engaged in assembly projects in India. It has also set up assembly projects in Country Z and Country L. In Country Z, the project was set up on 28 th March, 2019 and lasted upto 30 th March, 2020. In Country L, the project was set up on 5 th May, 2019 and lasted upto 31 st October, 2019.
HIJ Ltd.	It is engaged in providing technical consultancy services to clients in India and abroad. It provides technical consultancy to clients in Country Z and Country L, respectively, through personnel engaged by it for such purposes. The personnel so engaged for Country Z project stayed in Country Z from 3 rd June, 2019 to 25 th January 2020 in the P.Y.2019-20. The personnel so engaged for Country L project stayed in Country L from 10 th July, 2019 to 31 st December 2019 in the P.Y.2019-20.

Mr. Arjun sold part of the equity shares held by him in each of the above companies. The details of the shares are given below –

Name of Co.	No. of shares	Date of acquisition	Cost of acquisition (per share)	Date of transfer	Sale price (per share)	FMV as on 31.1.2018
ABC Ltd.	40	28.12.2017	₹ 1,000	2.1.2020	₹ 7,500	₹ 2,000
PQR Ltd.	25	30.11.2017	₹ 3,000	28.12.2019	₹ 5,000	₹ 6,500
EFG Ltd.	45	1.1.2018	₹ 2,000	15.1.2020	₹ 3,000	₹ 1,500
HIJ Ltd.	10	15.1.2018	₹ 4,000	2.3.2020	₹ 2,500	₹ 6,000

Based on the above facts, answer the following questions, assuming that India has –

- (i) a double taxation avoidance agreement with Country Z in line with OECD Model Convention, 2017
- (ii) a double taxation avoidance agreement with Country L in line with UN Model Convention, 2017
- (iii) India follows credit method for providing double taxation relief with respect to taxes paid in Countries Z and L.

MULTIPLE CHOICE QUESTIONS

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

1. For ABC Ltd., which of the following is a criterion for residency in India's DTAA with Country L but not in India's DTAA with Country Z –
 - (a) Place of management
 - (b) Place of incorporation
 - (c) Neither (a) nor (b)
 - (d) Both (a) and (b)
2. As per the DTAA entered into by India with Country Z and Country L, the assembly projects set up by EFG Ltd. in those countries would –
 - (a) constitute a PE in both countries
 - (b) not constitute a PE in either country Z or Country L
 - (c) constitute a PE in Country Z but not constitute a PE in Country L
 - (d) constitute a PE in Country L but not constitute a PE in Country Z.
3. As regards provision of technical consultancy services by HIJ Ltd. to its clients in Country Z and Country L through personnel engaged by them for such purposes, which of the following statements is correct, as per the DTAAs entered into by India with those countries?
 - (a) Provision of such services would constitute a PE in both cases
 - (b) Provision of such services would not constitute a PE in either case
 - (c) Provision of such services would constitute a PE in Country Z but not in Country L
 - (d) Provision of such services would constitute a PE in Country L but not in Country Z
4. As regards taxability of profits earned by ABC Ltd. from sale of spices to customers through its branches in Country Z and L and profit from sale of spices to customers in Country Z and L directly,

which of the following statements is correct, considering the DTAA entered into by India with such countries?

- (a) ABC Ltd. will be subject to tax in Country Z and Country L, to the extent of profits earned from sales effected to customers through its branches located therein.
 - (b) ABC Ltd. will be subject to tax in Country Z and Country L on entire profits earned from sales effected to customers located therein, whether through its branches or directly.
 - (c) ABC Ltd. will be subject to tax in Country Z in respect of profits earned from sales effected to customers through its branch located therein and in Country L on entire profits earned from sales effected to customers located therein, whether through its branch or directly.
 - (d) ABC Ltd. will be subject to tax in Country L in respect of profits earned from sales effected to customers through its branch located therein and in Country Z on entire profits earned from sales effected to customers located therein, whether through its branch or directly.
5. As regards taxability of interest received/receivable by PQR Ltd. on loan given to L & Co. and Z & Co., which of the following statements is correct, considering the DTAA entered into by India with such countries?
- (a) Country L and Z can tax such interest in the hands of PQR Ltd. at its domestic tax rates, namely, 20% and 8%, respectively.
 - (b) Country L and Z cannot tax such interest in the hands of PQR Ltd. since interest is taxable only in India, being the country of residence of PQR Ltd.
 - (c) Country L and Z can tax such interest in the hands of PQR Ltd. at a rate, not exceeding the maximum rate to be established through bilateral negotiations
 - (d) Country Z can tax such interest in the hands of PQR Ltd. at a rate of 8%. However, Country L can tax such interest in the hands of PQR Ltd. at a rate, not exceeding the maximum rate to be established through bilateral negotiations.

DESCRIPTIVE QUESTIONS

1. Examine whether Arjun would be treated as a resident of India or Country Z, as per the relevant article of the DTAA between India and Country Z. **(6 Marks)**
2. Compute the capital gains of Arjun, assuming that the equity shares of all four companies are listed, and securities transaction tax has been paid both at the time of purchase and sale of such shares.

Also, compute the tax liability of Mr. Arjun, assuming that income computed under the head "Profits and gains of business and profession" is ₹ 18,50,000 and income from house property (computed) is ₹ 5,25,000. Ignore Foreign Tax Credit, if any, available. **(9 Marks)**

I. ANSWERS TO MULTIPLE CHOICE QUESTIONS

1. (b) Place of incorporation.
2. (b) not constitute a PE in either country Z or Country L
3. (b) Provision of such services would not constitute a PE in either case
4. (c) ABC Ltd. will be subject to tax in Country Z in respect of profits earned from sales effected to customers through its branch located therein and in Country L on entire profits earned from sales effected to customers located therein, whether through its branch or directly
5. (d) Country Z can tax such interest in the hands of PQR Ltd. at a rate of 8%. However, Country L can tax such interest in the hands of PQR Ltd. at a rate, not exceeding the maximum rate to be established through bilateral negotiations

II. ANSWERS TO DESCRIPTIVE QUESTIONS

Answer to Q.1

The India-Country Z DTAA is in line with OECD Model Convention. Hence, the relevant article i.e., Article 4 of the OECD Convention needs to be looked into for determining the residential status of Mr. Arjun.

As per Article 4(1), the term "resident of a Contracting State" means, *inter alia*, any person who is a resident of a Contracting State in accordance with the taxation laws of that State.

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

As per section 6(1) of the Income-tax Act, 1961, an individual is said to be resident in India in any previous year if he has been in India during the previous year for a total period of 182 days or more. Mr. Arjun stays in India for 184 days during the P.Y. 2019-20 (31 days in May + 31 days in July + 30 days in September + 30 days in November + 31 days in January + 31 days in March). Therefore, he is resident in India for P.Y. 2019-20.

For being resident and ordinarily resident, he should fulfil both the following conditions:

- i) He is a resident in atleast 2 out of 10 years preceding the relevant previous year, and
- ii) His total stay in India in last seven years preceding P.Y. 2019-20 is 730 days or more.

In this case, since Arjun stays in India for 184 days every year, he is resident in India in every previous year as per the provisions of the Income-tax Act, 1961. Therefore, he satisfies the condition of being resident in India for atleast 2 years out of 10 preceding previous years. Also, he has stayed in India for 1288 days (184 days x 7) during the last seven previous years, which is more than 730 days. Hence, he is resident and ordinarily resident in India for A.Y. 2020-21 as per the provisions of the Income-tax Act, 1961.

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

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

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

From the facts, it is evident that Arjun has been living in his own flat in Juhu, Bombay, with his family. Hence, it can be considered as permanent home for him in India. In Country "Z" also, he owns a residential house which would be considered as permanent home for him. Since he has a permanent home both in India and Country "Z", the next test needs to be analysed.

Arjun owns spice gardens in Munnar in India and in Country Z, from which he earns income. However, he also owns a house property in Thane in India from which he derives rental income. His family also resides in Mumbai, India. He has showcased his paintings in Art exhibitions in Mumbai. Therefore, his personal and economic relations with India are closer, since India is the place where -

- (a) his residential property is located and
- (b) social and cultural activities are closer

Thus, by applying Article 4 of the India-Country "Z" DTAA, Arjun shall be deemed to be resident in India in the P.Y.2019-20.

Answer to Q.2

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

Particulars	₹	₹
Income from house property		5,25,000
Profits and gains of business and profession		18,50,000
Capital Gains [See Working Note below]		2,50,000
Income from other sources		<u>42,300</u>
Gross Total Income		26,67,300
Less: Deduction under Chapter VI-A		
Under section 80C [Deposit in PPF]	1,50,000	
Under section 80D [₹ 28,000, restricted to ₹ 25,000 + ₹ 32,000 (since parents are senior citizens, and ₹ 32,000 is within the enhanced limit of ₹ 50,000)]	57,000	
Under section 80TTA	<u>10,000</u>	<u>2,17,000</u>
Total Income		<u>24,50,300</u>
Computation of tax liability		
Particulars	₹	₹
Tax@10% u/s 112A on LTCG of ₹ 1,50,000 [LTCG in excess of ₹ 1 lakh]		15,000
Tax on other income of ₹ 22,00,300		
Upto ₹ 2,50,000	Nil	
₹ 2,50,001 – ₹ 5,00,000@5%	12,500	
₹ 5,00,001 – ₹ 10,00,000@20%	1,00,000	

₹ 10,00,001 – ₹ 22,00,300@30%	<u>3,60,090</u>	<u>4,72,590</u>
		4,87,590
Add: Health and education cess@4%		<u>19,504</u>
Total tax liability		<u>5,07,094</u>
Total tax liability (rounded off)		5,07,090

Working Note-

The capital gains arising from sale of shares in all the four companies is long-term since the period of holding in each case is 12 months or more.

Company	Particulars	LTCG
ABC Ltd.	In this case, the lower of sale price (₹ 7,500) and FMV as on 31.1.2018 (₹ 2,000) is ₹ 2,000. As the actual cost of acquisition of equity shares of ABC Ltd. (₹ 1,000) is less than ₹ 2,000, the cost of acquisition of such share would be taken as ₹ 2,000. The long-term capital gain would be ₹ 2,20,000 (₹ 7,500 – ₹ 2,000) x 40 shares.	2,20,000
PQR Ltd.	In this case, the lower of sale price (₹ 5,000) and FMV as on 31.1.2018 (₹ 6,500) is ₹ 5,000. As the actual cost of acquisition of equity shares of PQR Ltd. (i.e., ₹ 3,000) is less than ₹ 5,000, the cost of acquisition would be taken as ₹ 5,000. The long-term capital gains would be Nil (₹ 5,000 – ₹ 5,000) x 25 shares.	Nil
EFG Ltd.	In this case, the lower of sale price (₹ 3,000) and FMV as on 31.1.2018 (₹ 1,500) is ₹ 1,500. As the actual cost of ₹ 2,000 is higher than ₹ 1,500, the cost of acquisition would be taken as ₹ 2,000. Accordingly, the long-term capital gains would be ₹ 45,000 (₹ 3,000 – ₹ 2,000) x 45	45,000
HIJ Ltd.	In this case, the lower of sale price (₹ 2,500) and the FMV as on 31.1.2018 (₹ 6,000) is ₹ 2,500. Since the actual cost of acquisition (i.e., ₹ 4,000) is higher than ₹ 2,500, accordingly, the actual cost of ₹ 4,000 will be taken as the cost of acquisition. The long-term capital loss would be ₹ 15,000 (₹ 2,500 – ₹ 4,000) x 10 shares.	(15,000)
Long-term capital gains		2,50,000

ELECTIVE PAPER 6C: INTERNATIONAL TAXATION

CASE STUDY - 9

Holding Ltd. is the Indian parent company holding group of various multinational companies having diversified business portfolio. Its group companies are spread across Country A, Country B, Country C and Country D:

Holding Ltd undertakes various transactions with its subsidiaries situated in the countries mentioned above at a predetermined profit margin. One of its subsidiaries Beyond Ltd. (Country A) is engaged in the business of manufacturing and trading of Wagons. Holding Ltd purchased a Wagon from Beyond Ltd for \$15,000 which included warranty for 3 months. The identical Wagon was purchased by Holding Ltd by paying \$14,000 from completely unrelated party with 1 year of warranty. Fair value of warranty is \$700 for one year. However Beyond Ltd provided credit of 4 months to Holding Ltd. Arm's length interest rate is 9% p.a. Net profit before tax of Holding Ltd. is ₹ 25,00,000. Assume 1 \$ = ₹ 50.

Mr. Yatish is the employee of the War Ltd. (Country B). War Ltd is the associate enterprise of Holding Ltd. Mr. Yatish, Citizen of Country B came on deputation to Holding company. He first time came to India on 25th April, 2019 and left India on 21th October, 2019. For F.Y. 2019-20, Yatish has earned salary of ₹ 15,00,000 in India and ₹ 23,00,000 on Country B. Out of that ₹ 23,00,000 earned in Country B, ₹ 9,00,000 was received in India and ₹ 14,00,000 was received in Country B.

Elizabeth Ltd (Country C) is one of the subsidiary companies of the Holding Ltd. Elizabeth Ltd. has filed case in Indian Court regarding interpretation of one of the clauses of the India-Country C DTAA and it has made references to the decision given by Supreme Court of Justice Country E regarding the interpretation of the similar matter in Country E – Country F DTAA. However Income-tax department has contended that such reference of Foreign Court decision cannot be made in an Indian Court for interpretation of treaties.

Statue Ltd (Country D) has office in India which maintains stock of goods for storage, display as well as delivery to the Indian customers. This activity is preparatory and all sales orders and contracts are executed by the head office in Singapore.

Ms. Diana, resident and ordinarily resident, and a shareholder of Statue Ltd. did not disclose foreign asset worth ₹ 25 Lakh in income tax return.

Assume that India has a DTAA with Country A, Country B, Country C and Country D in line with OECD Model Tax Convention 2017.

Another Indian company, Signature Ltd. has earned following income in Country Y:

Income	Date of Accrual of Income
Dividend	25 th May, 2019
Profit of Shipping Business	12 th December, 2019
Capital Gain	31 st March, 2020

Based on the above facts, answer the following questions –

MULTIPLE CHOICE QUESTIONS

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

1. India-Country B DTAA was signed on 1st July, 2017. However TDS provisions of Goods and Service Tax Act came in force on 1st October, 2018. Whether such provisions will be covered in the India-Country B DTAA?

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- (a) Yes, it will be covered
 - (b) No, it won't be covered
 - (c) Will be covered if India-Vietnam enters into fresh agreement to that effect
 - (d) Will be covered if fresh DTAA is made.
2. Calculate the amount of penalty leviable on Ms. Diana under the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 -
- (a) ₹ 25 lakhs
 - (b) ₹ 50 lakhs
 - (c) ₹ 10 lakhs
 - (d) ₹ 1 crore
3. In the interpretation of the treaty, the provisions shall be interpreted in such a way that it enables provisions of the treaty to work and to have their appropriate effects. Which of the following basic principle suggest the above:
- (a) Purposive Interpretation
 - (b) The principle of effectiveness
 - (c) Liberal Construction
 - (d) Reasonableness and Consistency
4. Following details are given for Signature Ltd. in respect of Dividend received by it from Country Y:
- TTBR on 30th April, 2019 – ₹ 65/ CYD
- TTSR on 30th April, 2019 – ₹ 66/ CYD
- TTBR on 25th May, 2019 – ₹ 65/ CYD
- TTSR on 25th May, 2019 – ₹ 66/ CYD
- State the specified date and rate of exchange respectively for conversion of dividend.
- (a) 30th April, 65/CYD
 - (b) 30th April, 65.5/CYD
 - (c) 25th May, 65/CYD
 - (d) 30th April, 66/CYD
5. Holding Ltd has advanced loan to non-resident company of ₹ 60 Crores. Is the company required to furnish information in Form 15CA in respect of this transaction and if so, in which part?
- (a) Part B of Form 15CA
 - (b) Part C of Form 15CA
 - (c) Part D of Form 15CA
 - (d) Not required to furnish Form 15CA

DESCRIPTIVE QUESTIONS

1. Calculate Holding Ltd.'s profit chargeable to tax after transfer pricing adjustments. **(5 Marks)**
2. Determine residential status of Mr. Yatish for A.Y. 2020-21 and calculate Mr. Yatish's income which will be chargeable to tax in India. (Double taxation relief may be ignored) **(6 Marks)**
3. Analyse the correctness of contention made by the income-tax department in the case filed by Elizabeth Ltd. **(2 Marks)**
4. State whether Statue Ltd.'s office in India will constitute Permanent Establishment in India. Would your answer change if India's DTAA with Country D was in line with UN Model Convention, 2017? **(2 Marks)**

ELECTIVE PAPER 6C- INTERNATIONAL TAXATION

SUGGESTED SOLUTION – CASE STUDY 9

I. ANSWERS TO MULTIPLE CHOICE QUESTIONS

1. (b) No, it won't be covered
2. (c) ₹ 10 lakhs
3. (b) The principle of effectiveness
4. (a) 30th April, 65/CYD
5. (d) Not required to furnish Form 15CA

II. ANSWERS TO DESCRIPTIVE QUESTIONS

Answer to Q.1

Holding Ltd, the Indian company and Beyond Ltd., Country A are deemed to be associated enterprises as per section 92A, since Beyond Ltd. is the subsidiary of Holding Ltd.

As per *Explanation* to section 92B, the transactions entered into between these two companies for purchase of Wagon is included within the meaning of "international transaction".

As Holding Ltd. purchased similar product from an unrelated entity at \$14,000, the transactions between Holding Ltd. and such unrelated party can be considered as comparable uncontrolled transactions for the purpose of determining the arm's length price of the transactions between Holding Ltd. and Beyond Ltd. Comparable Uncontrolled Price (CUP) method of determination of arm's length price (ALP) would be applicable in this case.

However, such figure needs to be adjusted by the functional adjustments:

	Amount (in \$)
Purchase of Wagon from unrelated party	\$14,000
Less: Difference in Warranty (Note-1)	(\$525)
Add: Adjustment for credit extended (Note-2)	\$420
Arm's length price	\$13,895

Therefore, transfer pricing adjustment would be of ₹ 55,250 [(\$ 15,000 - \$ 13,895) x ₹50]. The profits of Holding Ltd chargeable to tax would be ₹ 25,00,000+ ₹ 55,250 = ₹ 25,55,250.

Note:

- (1) Beyond Ltd offered warranty only for 3 months while unrelated party provided it for 1 year. Therefore 9 months' cost of warranty shall be adjusted. (\$700 x 9/12)
- (2) Beyond Ltd has provided credit for 4 months whereas unrelated party has not provided such credit. Therefore adjustment for the cost of such credit is needed to be carried out to arrive at arm's length price. (\$14000 x 9 x 4/12)

Answer to Q.2

As per section 6(1), an individual is said to be resident in India in any previous year if he satisfies the conditions:-

- (i) He has been in India during the previous year for a total period of 182 days or more, or
- (ii) He has been in India during the 4 years immediately preceding the previous year for a total period of 365 days or more and has been in India for at least 60 days in the previous year.

In this case, Mr. Yatish stay in India during the P.Y. 2019-20 is 180 days (i.e., 6+31+30+31+31+30+21 days). Since, his stay in India is for less than 182 days, he does not satisfy condition (i). As regards, condition (ii), since Mr. Yatish came India for the first time in P.Y. 2019-20, he cannot satisfy basic condition of stay of atleast 365 days in the four immediately preceding previous years. Hence, his residential status for A.Y. 2020-21 is Non-Resident.

Taxability of income

As per section 5(2), in case of a non-resident, only income which accrues or arises or which is deemed to accrue or arise to him in India or which is received or deemed to be received in India in the relevant previous year is taxable in India.

Calculation of income chargeable to tax in the hand of Mr. Yatish

Particulars	Amount (₹)
Salary earned in India	15,00,000
Salary earned outside India but received in India	9,00,000
Salary earned outside India and received outside India (not taxable)	Nil
Amount Taxable in India	24,00,000

Answer to Q.3

In *CIT v. Vishakhapatnam Port Trust's case [1983] 144 ITR 146*, the Andhra Pradesh High Court observed that, "in view of the standard OECD Models which are being used in various countries, a new area of genuine 'international tax law' is now in the process of developing. Any person interpreting a tax treaty must now consider decisions and rulings worldwide relating to similar treaties. The maintenance of uniformity in the interpretation of a rule after its international adoption is just as important as the initial removal of divergences. Therefore, stand taken by the Income-tax Department may not be accepted by the Court.

Answer to Q.4

As per Article 5 of the DTAA between India – Country D, which is in line with OECD Model Tax Convention, 2017, the term "permanent establishment" shall be deemed not to include maintenance of stock of goods solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise, where such activity are preparatory or auxiliary. Therefore Statue Ltd (Country D)'s office in India will not constitute Permanent Establishment, since its preparatory activities are confined only to storage, display and delivery of goods.

However, if India's DTAA with Country D is in line with UN Model Convention, 2017, then, maintenance of stock of goods for the purpose of delivery may constitute a Permanent Establishment.

ELECTIVE PAPER 6C: INTERNATIONAL TAXATION

CASE STUDY - 10

Rio Grande Inc, a notified Foreign Institutional Investor (FII), derived the following incomes for the financial year 2019-20:-

- (1) Interest received on investment in Rupee Denominated Bonds of Cauvery Ltd., an Indian company issued in March, 2019 - ₹ 4,70,000
- (2) Dividend from listed equity shares of Indian companies – ₹ 2,80,000
- (3) Interest on securities – ₹ 15,48,000 (Expenses of ₹ 13,000 has been incurred to earn such income)
- (4) **Income from sale of securities and shares:**

(i) Bonds of Vaigai Ltd.

[Date of purchase 7th July 2016; Date of sale 5th February, 2020]

Sale proceeds ₹ 58,00,000

Cost of purchase ₹ 29,00,000

Cost Inflation Index: F.Y.2016-17:264; F.Y.2019-20:289

(ii) Listed equity shares of Mahanadi Ltd.

[Date of purchase – 5th June, 2019; Date of sale – 4th January, 2020]

Sale Consideration ₹ 14,50,000

Purchase cost ₹ 6,00,000

[STT paid both at the time of purchase and sale]

(iii) Unlisted equity shares of Godavari Ltd.

[Date of purchase – 2nd August, 2019; Date of sale – 29th March, 2020]

Sale Consideration ₹ 7,80,000

Purchase cost ₹ 2,65,000

Rio Grande Inc. wants to know its total income and tax liability for the A.Y. 2020-21. It has no other income during the F.Y.2019-20.

Zara Ltd. is a company resident in Country A. It had set-up a liaison office at Calcutta to receive trade inquiries from customers in India. The work of the liaison office is not only restricted to forwarding of the trade inquiries to Zara Ltd. but the liaison office also negotiates and enters into contracts on behalf of Zara Ltd. with the customers in India. Zara Ltd. wants to know whether setting up of a liaison office would constitute business connection in India.

Based on the above facts, answer the following questions –

MULTIPLE CHOICE QUESTIONS

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

1. In respect of interest payable to Rio Grande Inc. on Rupee Denominated Bonds issued outside India by Cauvery Ltd., –
 - (a) tax is deductible at source at the rates in force under section 195

- (b) tax is deductible at source@5.2%.
 - (c) tax is deductible at source@20.8%
 - (d) no tax is deductible at source.
2. If we assume that Rupee Denominated Bonds were issued outside India by Cauvery Ltd. in March, 2019 and Zara Ltd. has also subscribed to such bonds, then, in respect of interest payable to Zara Ltd. on such rupee denominated bonds,
- (a) tax is deductible at source at the rates in force under section 195
 - (b) tax is deductible at source@5.2%.
 - (c) tax is deductible at source@10.4%
 - (d) no tax is deductible at source.
3. If we assume that Rio Grande Inc. had purchased listed shares of Vaigai Ltd. (STT paid) and not bonds, the date of purchase and sale remaining the same as given in respect of bonds, the entire capital gains arising on sale of such shares would be -
- (a) Exempt from tax
 - (b) taxable@20% with indexation benefit.
 - (c) taxable@10% without indexation benefit.
 - (d) None of the above.
4. If the liaison office set up in India by Zara Ltd. does not conclude contracts in India but habitually plays the principal role leading to conclusion of service contracts, then, the activities of the liaison office -
- (a) would not constitute business connection for attracting deemed accrual provisions under section 9(1)(i), since it does not actually conclude contracts.
 - (b) would not constitute business connection for attracting deemed accrual provisions under section 9(1)(i), since contract is for provision of services by Zara Ltd. and not purchase and sale of goods
 - (c) would not constitute business connection due to reasons states in (a) and (b) above
 - (d) constitutes business connection for attracting deemed accrual provisions under section 9(1)(i).
5. What are the provisions which have been incorporated in Indian tax laws in line with BEPS Action 1 (The same must be relevant for A.Y. 2020-21)?
- (a) Expansion of scope of business connection to include activities of an agent who habitually plays a principal role leading to conclusion of contracts
 - (b) Expansion of scope of business connection to include activities which constitute significant economic presence
 - (c) Introduction of equalization levy
 - (d) All the above

DESCRIPTIVE QUESTIONS

1. Compute the total income and tax liability of Rio Grande Inc. for A.Y.2020-21. **(12 Marks)**
2. Would the activities carried out by the liaison office set up in India by Zara Ltd. constitute business connection to attract deemed accrual provisions under section 9(1)? **(3 Marks)**

ELECTIVE PAPER 6C- INTERNATIONAL TAXATION

SUGGESTED SOLUTION – CASE STUDY 10

I. ANSWERS TO MULTIPLE CHOICE QUESTIONS

1. (b) tax is deductible at source@5.2%.
2. (d) no tax is deductible at source
3. (d) None of the above
4. (d) constitutes business connection for attracting deemed accrual provisions under section 9(1)(i)
5. (c) Introduction of equalization levy

II. ANSWERS TO DESCRIPTIVE QUESTIONS

Answer to Q.1

Computation of total income of Rio Grande Inc., a notified FII, for A.Y.2020-21

Particulars	₹	₹
Interest on Rupee Denominated Bonds	4,70,000	
Dividend income of ₹ 2,80,000 [Exempt under section 10(34)]	Nil	
Interest on securities	<u>15,48,000</u>	20,18,000
[No deduction is allowable in respect of expenses incurred in respect thereof as per section 115AD(2)]		
Long-term capital gains on sale of bonds of Vaigai Ltd.		
Sale consideration	58,00,000	
Less: Cost of acquisition	<u>29,00,000</u>	29,00,000
[Benefit of indexation is not allowable as per section 115AD(3)]		
Short-term capital gains on sale of STT paid equity shares of Mahanadi Ltd.		
Sale consideration	14,50,000	
Less: Cost of acquisition	<u>6,00,000</u>	8,50,000
Short-term capital gains on sale on unlisted equity shares of Godavari Ltd.		
Sale consideration	7,80,000	
Less: Cost of acquisition	<u>2,65,000</u>	5,15,000
Total Income		62,83,000

Computation of tax liability of Rio Grande Inc. for A.Y.2020-21

Particulars	₹
Tax@5% on interest of ₹ 4,70,000 received from an Indian company on investment in rupee denominated bonds = 5% x ₹ 4,70,000	23,500
Tax@20% on interest on securities of ₹ 15,48,000 = 20% x ₹ 15,48,000	3,09,600
Tax@10% on long-term capital gains on sale of bonds of Vaigai Ltd. = 10% x ₹ 29,00,000	2,90,000
Tax@15% on short-term capital gains on sale of listed equity shares of Mahanadi Ltd., in respect of which STT has been paid = 15% of ₹ 8,50,000	1,27,500
Tax@30% on short-term capital gains on sale of unlisted equity shares of Godavari Ltd. = 30% of ₹ 5,15,000	<u>1,54,500</u>
	9,05,100
Add: HEC@4%	<u>36,204</u>
Tax Liability	<u>9,41,304</u>
Tax Liability (rounded off)	9,41,300

Answer to Q.2

If a Liaison Office is maintained solely for the purpose of carrying out activities which are preparatory or auxiliary in character, and such activities are approved by the Reserve Bank of India, then, no business connection is established.

In this case, had the liaison office's activities been restricted to forwarding of trade inquiries to Zara Ltd., a Country A based company, its activities would not have constituted business connection. However, the activities of the liaison office in Calcutta extends to also negotiating and entering into contracts on behalf of Zara Ltd. with the customers in India, on account of which business connection is established. Hence, the deemed accrual provisions under section 9(1)(i) would be attracted.

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