CHAPTER 22 - LIABILITY IN SPECIAL CASES

EXERCISE

Question 1
“NEPTUNE” is a shipliner, used in carrying passengers and cargo, owned by M/s Thomas & Thomas of U.K. The ship carried the passengers and cargo in June, 2018 from Singapore to Chennai and vice versa and collected charges thereof amounting to Rs. 200 lacs. It left Chennai port on 15.6.2018 for its journey to Korea. No other journey to India was undertaken by any of the vessels of the company during the year ended on 31.3.2019. The non-resident company had authorized its Indian agent to comply with the income tax provisions.
You are consulted by the company to explain about the procedure as to return of income to be filed and the period within which the assessment thereof will be completed by the Assessing Officer.

Answer
M/s. Thomas & Thomas of U.K shall be required to file the return of income in India for the journey of its ship before it leaves for onward journey to Korea.
However, as per the proviso to section 172(3), where the Assessing Officer is satisfied that it is not possible for the master of the ship to furnish the return before the departure of the ship from the port, and if satisfactory arrangements have been made for filing of return and payment of tax by the authorised agent in India, he may permit filing of return within 30 days of departure of the ship.
Section 172(4A) provides a time limit of 9 months for completion of assessment in such cases. The period of 9 months is reckoned from the end of the financial year in which the return under section 172(3) is furnished.

Question 2
The directors of a private company are personally liable to pay the income tax due from the company but their liability does not extend towards interest and penalty payable by the company. Discuss.

Answer
Section 179 contains the provisions relating to the liability of directors of a private company in liquidation in respect of tax due from the company. Where any tax due from a private company in respect of income of any previous year or from any other company in respect of any income of any previous year during which such other company was a private company cannot be recovered, then, every person who was a director of such company at any time during the relevant previous year shall be jointly and severally liable for the payment of such tax. However, the director shall not be so liable if he proves that the non-recovery cannot be attributed to any gross neglect, misfeasance or breach of duty on his part in relation to the affairs of the company.
Explanation to section 179 clarifies that the expression “tax due” includes penalty, interest or any other sum payable under the Act. Therefore, the directors liability is not confined to tax alone but extends to penalty, interest or any other sum payable by the company.
Question 3

In respect of the taxes due from a private limited company, which could not be recovered from it, the Tax Recovery Officer attached the properties of an erstwhile director for recovery thereof. It was contended by the director that a notice under section 156 had not been served on him and therefore, the proceedings for recovery were not valid. What is the correct legal position?

Answer

The liability of a director of a private limited company for arrears due from the company is provided in section 179. There is no necessity to issue a notice to a director, because the position of a person on whom liability is fastened is equated to that of an ‘assessee’ in default. For the purpose of section 220(4), the person held liable under section 179 would be deemed to be an assessee-in-default. This may be contrasted with the arrears of a partnership firm which may be recovered from the erstwhile partners only after issue of a notice under section 156 and a default is committed by them.

Under section 179, every person who was a director of a private limited company at any time during the relevant previous year shall be jointly and severally liable for the payment of taxes which cannot be recovered from the company, unless he proves that the non-recovery cannot be attributed to any gross negligence, misfeasance or breach of duty on his part in relation to the affairs of the company.
CHAPTER 23 - MISCELLANEOUS

EXERCISE

Question 1
How does the income of a person who is trying to alienate his assets with a view to avoid tax be dealt with under the Act?

Answer
The income of a person who is trying to alienate his assets with a view to avoid tax will be dealt with as per the provisions of section 175. Accordingly, if it appears to the Assessing Officer during any current assessment year that any person is likely to charge, sell, transfer, dispose of or otherwise part with any of his assets with a view to avoiding payment of any liability under the Income-tax Act, 1961, the total income of such person for the period from the expiry of the previous year to the date when the Assessing Officer commences proceedings under this section is chargeable to tax in that assessment year.

The total income of each completed year or part of any previous year included in such period shall be chargeable to tax at the rates in force in that assessment year and separate assessments will be made for each completed previous year or part of any previous year. The Assessing Officer may estimate the income of such individual for such period or any part thereof, where it cannot be readily determined in the manner provided in the Act.

The tax chargeable under this section shall be in addition to tax, if any, chargeable under any other provision of the Act.

Question 2
Fearless General Finance & Investment Limited, a residuary non-banking company, accepts public deposits, issues deposit certificate and repays the same after some period of time along with interest, under different schemes run by it. Following transactions were noted from their books of account:

(i) Mr. A, an individual, has deposited Rs. 15,000 on 1st May, 2015 for 48 months by bearer cheque and another Rs. 15,000 on 30th June, 2018 in cash to purchase a new certificate of 48 months tenure.

(ii) Mr. A has applied for premature withdrawal against both the certificates and the company has paid him Rs. 16,500, by a bearer cheque, against principal and interest on 23rd March, 2019, due against his first certificate (purchased in 2015) and Rs. 15,500 in cash on 25th March, 2019, against the second certificate.

Discuss the violation of income tax provision, if any, and consequential penalty for each transaction. Will it make any difference if the certificates were held by Mr. A with his wife Mrs. A, jointly, while repaying back in cash or bearer cheque?

Answer
(i) There is no violation of section 269SS at the time of acceptance of the first deposit of Rs. 15,000 by bearer cheque on 1.5.2015, since it is not in excess of the threshold limit of Rs. 20,000. However, violation under section 269SS is attracted at the time of acceptance of the second deposit in cash on 30th June, 2018, since as on that date, there is already an outstanding deposit of Rs. 15,000 and another cash deposit of Rs. 15,000 would take the aggregate to Rs. 30,000, which exceeds...
the threshold limit of Rs. 20,000. Therefore, penalty under section 271D of a sum equal to the amount of deposit taken from Mr. A is attracted for failure to comply with the provisions of section 269SS.

(ii) In this case, there is a violation of the provisions of section 269T at the time of first repayment by bearer cheque on 23rd March, 2019, since on that date, the aggregate amount of deposits held by Mr. A with the non-banking company (together with interest payable on such deposits) is more than Rs. 20,000. Therefore, penalty under section 271E equal to the amount of deposit so repaid will be attracted for failure to comply with the provisions of section 269T.

However, the second repayment of Rs. 15,500 on 25th March, 2019 in cash cannot be considered as a violation of section 269T, since neither the amount of deposit with interest thereon nor the aggregate amount of deposits held by Mr. A on that date together with interest exceeds the threshold limit of Rs. 20,000.

The provisions of section 269T will be attracted at the time of first repayment of bearer cheque even if the certificate is being held by Mr. A in joint name with his wife.

Question 3
The proceedings before the Income-tax Authorities either can be attended by the assessee in person or through an authorized representative. Who can be treated as an authorized representative of the assessee?

Answer
As per section 288, the proceedings before the income-tax authorities can be attended by an assessee in person or through an authorised representative, i.e., a person authorized by the assessee in writing to appear on his behalf, being:

(i) a person who is a relative or a regular employee of the assessee; or

(ii) any officer of a Scheduled Bank in which the assessee maintains a current account or has other regular dealings; or

(iii) a legal practitioner who is entitled to practise in any civil court in India; or

(iv) a chartered accountant within the meaning of the Chartered Accountants Act, 1949 who hold a valid certificate of practice

(v) any person who has passed any accountancy examination recognized in this behalf by the CBDT for this purpose; or

(vi) any person who has acquired such educational qualifications as prescribed by the CBDT; or

(vii) any person who, before the coming into force of this Act in the Union territory of Dadra and Nagar Haveli, Goa, Daman and Diu, or Pondicherry, attended any proceedings before an income-tax authority in the said territory on behalf of any assessee otherwise than in the capacity of an employee or relative of that assessee

(viii) any person who was actually practising as an income-tax practitioner, immediately before commencement of the Income-tax Act, 1961.
Question 4
An order for A.Y. 2017-18 was passed by the Assessing Officer as per section 143(3), but the typist wrongly typed in the order, the assessment year as A.Y.2016-17 and the relevant previous year as ending on 31.3.2016. The assessee claimed in appeal that the same is an invalid order which was not accepted by the CIT (Appeals) on the ground of the error being of clerical nature. Discuss the correctness of the order of the CIT(Appeals).

Answer
Section 292B provides that no return of income, assessment, notice or summons furnished or made or issued or taken in pursuance of any of the provisions of the Income-tax Act, 1961 shall be invalid or deemed to be invalid merely by reason of any mistake, defect or omission in such return of income, assessment or notice etc., if such return of income, assessment, notice, summons etc. is in substance and effect in conformity with or according to the intent and purpose of the Act. Therefore, a clerical mistake cannot invalidate an otherwise valid assessment. Thus, the typographical error in the assessment order as to assessment year and previous year does not make the same invalid unless established otherwise. Accordingly, the action of the CIT(Appeals) in not accepting the claim of the assessee is valid.

Question 5
“Proceedings cannot be initiated under the Act, unless a proper notice to this effect has been served upon.” In this context answer:
(i) What are the prescribed modes of service of such notice?
(ii) On whom should the notice be addressed and served upon in the cases where the assessee is a dissolved firm, a deceased person and a partitioned HUF.

Answer
(i) As per section 282(1), the service of notice or summon or requisition or order or any other communication under this Act may be made by delivering or transmitting a copy thereof to the person named therein -
   (1) by post or such courier services as approved by the CBDT; or
   (2) in such manner as provided in the Code of Civil Procedure, 1908 for the purposes of service of summons; or
   (3) in the form of any electronic record as provided in Chapter IV of the Information Technology Act, 2000; or
   (4) by any other means of transmission of documents as may be provided by rules made by the CBDT in this behalf.

The CBDT is empowered to make rules providing for the addresses (including the address for electronic mail or electronic mail message) to which such communication may be delivered or transmitted to the person named therein.

(ii) The service of notice in the given cases should be on the persons mentioned hereunder:

<table>
<thead>
<tr>
<th>Person</th>
<th>Notice to be addressed and served on</th>
</tr>
</thead>
<tbody>
<tr>
<td>A dissolved firm</td>
<td>Any person who was a partner (not being a minor) immediately before dissolution.</td>
</tr>
<tr>
<td>A deceased person</td>
<td>The legal heirs of the deceased.</td>
</tr>
<tr>
<td>A partitioned HUF</td>
<td>Last Manager of the HUF, or, if he is dead, then, all adult members of the erstwhile HUF.</td>
</tr>
</tbody>
</table>
Question 6

"Tax Recovery Officer, can recover the arrear demands from the assessee in default out of sale proceeds of the property attached after making a proclamation". How can such proclamation be made under the Act?

Answer

Movable Property [Rules 38 & 39 of Schedule II to the Income-tax Act, 1961]

Where the Tax Recovery Officer orders sale of movable property, he should issue a proclamation in the language of the district, of the intended sale, specifying the time and place of sale and whether the sale is subject to confirmation or not. The proclamation should be made by beat of drum or other customary mode, -

(a) in the case of property attached by actual seizure –
   (i) in the village in which the property was seized, or, if the property was seized in a town or city, then, in the locality in which it was seized; and
   (ii) at such other places as the Tax Recovery Officer may direct;

(b) in the case of property attached otherwise than by actual seizure, in such places, if any, as the Tax Recovery Officer may direct.

A copy of the proclamation should also be affixed in a conspicuous part of the office of the Tax Recovery Officer.

Immovable Property [Rule 54 of Schedule II to the Income-tax Act, 1961]

The Tax Recovery Officer shall make a proclamation for sale of immovable property at some place on or near such property by beat of drum or other customary mode. A copy of the proclamation shall be affixed on a conspicuous part of the property and also upon a conspicuous part of the office of the Tax Recovery Officer.

Where the Tax Recovery Officer directs, such proclamation shall also be published in the Official Gazette or in a local newspaper or in both, and the cost of such publication shall be deemed to be cost of the sale.

Where the property to be sold is divided into lots for the purpose of being sold separately, then it is not necessary to make a separate proclamation for each lot of property, unless in the opinion of the Tax Recovery Officer, proper notice of sale cannot otherwise be given.

Question 7

Explain the circumstances under which the Assessing Officer can resort to provisional attachment of the property of the assessee. Also, state the period of time for which such attachment can take place.

When can the Assessing Officer revoke provisional assessment of property? Discuss.

Answer

As per the provisions of section 281B, there can be provisional attachment to protect the interest of Revenue in certain cases i.e. -

(i) The proceeding for the assessment of any income or for the assessment or reassessment of any income which has escaped assessment should be pending.

(ii) Such attachment should be necessary for the purpose of protecting the interest of Revenue in the opinion of the Assessing Officer.

(iii) The previous approval of the Principal Chief Commissioner or Chief Commissioner, Principal Commissioner or Commissioner, Principal Director General or Director
General or Principal Director or Director has been obtained by the Assessing Officer.

(iv) The Assessing Officer, may, by an order in writing attach provisionally any property belonging to the assessee in the manner provided in the Second Schedule.

(v) Such provisional attachment shall cease to have effect after the expiry of a period of six months from the date of order made under section 281B(1). However, the period can be extended by the Principal Chief Commissioner or Chief Commissioner, Principal Commissioner or Commissioner, Principal Director General or Director General or Principal Director or Director, as the case may be, for the reasons to be recorded in writing for a further period or periods as he thinks fit. The total period of extension in any case cannot exceed 2 years or 60 days after the date of order of assessment or reassessment, whichever is later.

The Assessing Officer shall, by order in writing, revoke provisional attachment of a property made under section 281B(1) in a case where the assessee furnishes a guarantee from a scheduled bank, for an amount not less than the fair market value of such provisionally attached property or for an amount which is sufficient to protect the interests of the revenue.

**Question 8**

Mr. Biswas, a stock broker, has defaulted with regard to his income-tax payments and the Assessing Officer has attached his membership card of Stock Exchange under section 281B of the Income-tax Act, 1961. Mr. Biswas contends that the membership card is not transferable and is not his personal asset. Discuss the validity of attachment of the card by the Assessing Officer in the context of Section 281B.

**Answer**

The right of membership is not a private asset and it is merely a personal privilege granted to the member. It is non-transferable and incapable of alienation by the member or his legal representative except to the limited extent provided in the rules and regulations of the stock exchange and subject to the fulfillment of conditions prescribed by the stock exchange. The nomination, even if permitted, is subject to the rules and is not automatic. The right of nomination is vested in the stock exchange absolutely in the case of death of or default of a member. Thus, the membership card is not the property of the assessee and therefore cannot be attached under section 281B. It has been so held by the Apex Court in the case of Stock Exchange Ahmedabad vs. ACIT (2001) 248 ITR 209.
CHAPTER 24 - NON RESIDENT TAXATION

EXERCISE

Question 1
Peeyush, returned to India on 12th June, 2018 for permanently residing in India after a stay of about 20 years in U.K., provides the sources of his various income and seeks your opinion to know about his liability to income tax thereon in India in assessment year 2019-20:

(i) Income of rent of the flat in London which was deposited in a bank there. The flat was given on rent by him after his return to India since July, 2018.

(ii) Dividends on the shares of three German Companies which are being collected in a bank account in London. He proposes to keep the dividend on shares in London with the permission of the Reserve Bank of India.

(iii) He has got two sons, one of whom is of 12 years and other 19 years. Both his sons are staying in London and not returning to India with him. Each of his sons is having income of Rs. 75,000 in U.K. in foreign currency (not received in India) and of Rs. 20,000 in India.

(iv) During the preceding accounting year when he was a non-resident, he had sold 1000 shares which were acquired by him in British Pound Sterling and the sale proceeds were repatriated. The profit in terms of British Pound Sterling on sale of these 1000 shares was 175% of the cost at Rs. 37,500 while in terms of Indian Rupee it was Rs. 50,000.

Answer
Peeyush returned to India on 12th June 2018 for permanently residing in India after staying in UK for 20 years. During the P.Y.2018-19, he stays in India for 293 days. Since he has stayed in India for a period of 182 days or more during the previous year 2018-19, he would be a resident in India for the A.Y.2019-20. However, he would be a resident but not ordinarily resident, assuming that he was a non-resident in nine out of ten previous years preceding P.Y.2018-19 and his stay in India during the seven previous years is less than 730 days. The residential status of Peeyush for A.Y.2019-20 is, therefore, Resident but Not Ordinarily Resident.

As per section 5(1), only income which is received/ deemed to be received/ accrued or arisen/ deemed to accrue or arise in India is taxable in case of a Resident but not Ordinarily Resident. Income which accrues or arises outside India shall not be included in his total income, unless it is derived from a business controlled in, or a profession set up in, India.

(i) Rental income from a flat in London which was deposited in a bank there shall not be taxable in the case of a resident but not ordinarily resident, since both the accrual and receipt of income are outside India.

(ii) Dividends from shares of three German Companies, collected in a bank account in London, would also not be taxable in the case of a resident but not ordinarily resident since both the accrual and receipt of income are outside India.

(iii) As per section 64(1A), all income accruing or arising to a minor child is includible in the hands of the parent, after providing for deduction of Rs. 1,500 per child under section 10(32).

Accordingly, income of Rs. 20,000 accruing to his minor son, aged 12 years, in India is includible in the income of Peeyush, after providing deduction of Rs. 1,500. Therefore,
Rs.18,500 is includible in the income of Peeyush. Income accruing to the minor child outside India (which is also received outside India) is not includible in the income of Peeyush.

Since the other son is major, his income is not includible in the income of Peeyush.

(iv) Repatriation of sale proceeds of 1000 shares sold in the preceding accounting year, when Peeyush was a non-resident, is not taxable in the A.Y.2019-20 since it is not the income of the P.Y.2018-19.

Consequently, only the income includible under section 64(1A) would form part of the total income of Mr. Peeyush for A.Y.2019-20. Since his total income (i.e., Rs. 18,500) is less than the basic exemption limit, there would be no liability to income-tax for A.Y.2019-20.

Question 2

Mr. David, a citizen of India, serving in the Ministry of External Affairs in India, was transferred to Indian Embassy in Canada on 31.03.2018. He did not visit India any time during the previous year 2018-19. He has received the following income for the Financial Year 2018-19:

<table>
<thead>
<tr>
<th>S. No.</th>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i)</td>
<td>Salary</td>
<td>5,00,000</td>
</tr>
<tr>
<td>(ii)</td>
<td>Foreign Allowance</td>
<td>4,00,000</td>
</tr>
<tr>
<td>(iii)</td>
<td>Interest on fixed deposit from bank in India</td>
<td>1,00,000</td>
</tr>
<tr>
<td>(iv)</td>
<td>Income from agriculture in Pakistan</td>
<td>2,00,000</td>
</tr>
<tr>
<td>(v)</td>
<td>Income from house property in Pakistan</td>
<td>2,50,000</td>
</tr>
</tbody>
</table>

Compute his gross total income for Assessment Year 2019-20.

Answer

As per section 6(1), Mr. David is a non-resident for the A.Y. 2019-20, since he was not present in India at any time during the previous year 2018-19.

As per section 5(2), a non-resident is chargeable to tax in India only in respect of following incomes:

(i) Income received or deemed to be received in India; and
(ii) Income accruing or arising or deemed to accrue or arise in India.

In view of the above provisions, income from agriculture in Pakistan and income from house property in Pakistan would not be chargeable to tax in the hands of David, assuming that the same were received in Pakistan.

Income from ‘Salaries’ payable by the Government to a citizen of India for services rendered outside India is deemed to accrue or arise in India as per section 9(1)(iii). Hence, such income is taxable in the hands of Mr. David, even though he is a non-resident.

However, allowances or perquisites paid or allowed as such outside India by the Government to a citizen of India for rendering service outside India is exempt under section 10(7). Hence, foreign allowance of Rs. 4,00,000 is exempt under section 10(7).

**Gross Total Income of Mr. David for A.Y. 2019-20**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Salaries</td>
<td>5,00,000</td>
</tr>
<tr>
<td>Income from other sources (Interest on fixed deposit in India)</td>
<td>1,00,000</td>
</tr>
<tr>
<td><strong>Gross Total Income</strong></td>
<td><strong>6,00,000</strong></td>
</tr>
</tbody>
</table>
Question 3

Mr. A, a citizen of India, left for USA for the purposes of employment on 1.5.2018. He has not visited India thereafter. Mr. A borrows money from his friend Mr. B, who also left India for employment purpose one week before Mr. A’s departure, to the extent of Rs. 10 lakhs and buys shares in X Ltd., an Indian company. Discuss the taxability of the interest charged @10% in B’s hands where the same has been received in New York.

Answer

An individual is said to be resident in India in any previous year, if he-
(i) has been in India during that year for a total period of 182 days or more, or
(ii) has been in India during the four years immediately preceding that year for a total period of 365 days or more and has been in India for at least 60 days in that year.

In the case of an Indian citizen leaving India for the purposes of employment outside India during the previous year, the period of stay during the previous year in condition (ii) above, to qualify as a resident, would be 182 days instead of 60 days.

In this case, Mr. A is an Indian citizen who left India for employment outside India on 01.05.2018. Mr. A has been in India only from 1.4.2018 to 01.05.2018 i.e. for 31 days. Since his stay in India during the previous year 2018-19 is only 31 days, he does not satisfy the minimum criterion of 182 days stay in India for being a resident. Hence, his residential status for A.Y. 2019-20 is Non-Resident. Mr. B, who left India one week before A’s departure, is also a non-resident for the same reasons.

Section 9(1)(v) provides that income by way of interest payable by a non-resident in respect of any debt incurred, or moneys borrowed and used, for the purposes of a business or profession carried on by such person in India shall be deemed to accrue or arise in India. Therefore, interest payable by a non-resident in respect of any debt incurred, or moneys borrowed and used, for the purpose of making or earning any income from any source other than a business or profession carried on by him in India, shall not be deemed to accrue or arise in India. Therefore, interest payable by Mr. A on money borrowed from Mr. B to invest in shares of an Indian company shall not be deemed to accrue or arise in India and hence, is not taxable in India in the hands of Mr. B.

Question 4

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

Answer

The Explanation below section 9(2) clarifies that income by way of, inter alia, fees for technical services from services utilized in India would be deemed to accrue or arise in India under section 9(1)(vii) in case of a non-resident and be included in his total income, whether or not such services were rendered in India.

In this case, the technical services rendered by the foreign company, JJ Ltd., were for setting up a fertilizer plant in Orissa. Therefore, the services were utilized in India. Consequently, as per the Explanation below section 9(2), the fee of Rs. 2.5 crore for
technical services rendered by JJ Ltd. (both off-shore and on-shore services) to KK Ltd. is
decom to accrue or arise in India and includible in the total income of JJ Ltd.
Therefore, the view of JJ Ltd. that it is not liable to tax in India in respect of fee of Rs. 1
crore (as it is for rendering services outside India) is not correct.

Question 5
Examine with reasons whether the following transactions attract income-tax in India, in the
hands of recipients under section 9 of Income-tax Act, 1961:

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

(ii) A firm of solicitors in Mumbai engaged a barrister in UK for arguing a case before
Supreme Court of India. A payment of 5000 pounds was made as per terms of
professional engagement.

(iii) Amount paid by Government of India for use of a patent developed by Mr. A, who is a
non-resident.

(iv) Sai Engineering, a non-resident foreign company entered into a collaboration
agreement on 25/6/2018, with an Indian Company and was in receipt of interest on
8% debentures for Rs. 20 lakhs, issued by Indian Company, in consideration of
providing technical know-how utilised in its business in Mumbai during previous
year 2018-19.

Answer

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

As per Explanation to section 9, where income is deemed to accrue or arise in
India under section 9(1)(vii), such income shall be included in the total income of
the non-resident German company, regardless of whether it has a residence or
place of business or business connection in India.

(ii) As per section 9(1)(i), all income accruing or arising, whether directly or
indirectly, through or from any business connection in India is deemed to accrue or
arise in India.

In this case, there was a professional connection between the firm of solicitors in
Mumbai and the barrister in UK. The expression “business” includes not only trade
and manufacture; it includes, within its scope, “profession” as well. Therefore,
the existence of professional connection amounts to existence of “business
connection” under section 9(1)(i). It was so held by the Supreme Court in Barendra

Hence, the amount of 5,000 pounds paid to the barrister in UK as per the terms
of the professional engagement constitutes income which is deemed to accrue or
arise in India under section 9(1)(i). Hence, it is taxable in India.
(iii) As per section 9(1)(vi), income by way of royalty payable by the Government of India is deemed to accrue or arise in India. “Royalty” means consideration for, inter alia, use of patent. Therefore, the amount paid by Government of India for use of patent developed by Mr. A, a non-resident, is deemed to accrue or arise in India. Hence, it is taxable in India in the hands of Mr. A.

(iv) Rs. 20 lakhs, being the value of debentures issued by an Indian company in consideration of providing technical know-how for use in its business in India, is in the nature of fee for technical services, deemed to accrue or arise in India to Sai Engineering, a non-resident foreign company, under section 9(1)(vii). Hence, it is taxable in India.

Further, as per section 9(1)(v), income by way of interest payable by a person who is a resident of India is deemed to accrue or arise in India. Therefore, interest income from debentures of an Indian company is deemed to accrue or arise in India in the hands of Sai Engineering by virtue of section 9(1)(v). Hence, it is taxable in India.

**Note** – Since the question specifically requires the candidates to examine the taxability of the above transactions under section 9, the provisions of double taxation avoidance agreement, if any, applicable in the above cases, have not been taken into consideration.

**Question 6**

Z, an American tourist, comes to India for the first time on June 17, 2018. He leaves India on September 29, 2018. Determine his residential status for the assessment year 2019-20. Does it make any difference if he comes to India on a business trip or if he is an Indian citizen?

**Answer**

Previous year 2018-19: 105 [14+31+31+29]

Previous year 2017-18: Nil

Previous year 2016-17: Nil

and so on ……

He is non-resident for the assessment year 2019-20 as he does not satisfy any of the basic conditions. It does not make any difference if he comes on a business trip to India.

Further, in this case, it does not make any difference if he is an Indian citizen as far as the answer of non-resident is concerned. However, there is a difference in application of basic conditions as an Indian citizen who comes on a visit to India during the previous has the option of only one basic condition of 182 days to become a resident.

**Question 7**

M/s. Global Airlines incorporated as a company in USA operated its flights to India and vice versa during the year 2018-19 (April, 2018 to March, 2019) and collected charges of Rs. 125 lakhs for carriage of passengers and cargo out of which Rs. 65 lakhs were received in New York in U.S Dollars for the passenger fare booked from New York to Mumbai. The total expenses for the year on operation of such flights were Rs. 195 lakhs. Compute the income chargeable to tax of the foreign airlines.

**Answer**

As per section 44BBA, in case of a non-resident engaged in the business of operation of aircraft, 5% of the following amounts would be deemed to be the profits and gains from such business:

---

24.5
(a) paid or payable, whether in or out of India, to the assessee or to any person on his behalf on account of the carriage of passengers, livestock, mail or goods from any place in India; and
(b) received or deemed to be received in India by or on behalf of the assessee on account of the carriage of passengers, livestock, mail or goods from any place outside India.

In the present case, the income chargeable to tax of M/s Global Airlines applying the provisions of section 44BBA are as follows:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Fare booked from India to outside India whether received in India or not (Rs.)</th>
<th>Fare booked from New York to Mumbai (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fare</td>
<td>60,00,000 (1,25,00,000 – 65,00,000)</td>
<td>65,00,000</td>
</tr>
<tr>
<td>Deemed income @5% u/s 44BBA</td>
<td>3,00,000 (60,00,000 × 5%)</td>
<td>Nil (since the amount not received in India)</td>
</tr>
</tbody>
</table>

Question 8

Asiatel Italy, a company incorporated in France, was engaged in manufacture, trade and supply equipment and services for GSM Cellular Radio Telephones Systems. It supplied hardware and software to various entities in India. Software licensed by assessee embodied the process which is required to control and manage the specific set of activities involved in the business use of its customers, and also made available to its customers, who used it to carry out their business activities. The Assessing Officer contended that the consideration for supply of software embedded in hardware is 'royalty' under section 9(1)(vi)

Examine the correctness of the action of the Assessing Officer assuming that the software that was loaded on the hardware and embedded in the system does not have any independent existence.

Answer

The issue under consideration in this case is whether consideration for supply of software embedded in hardware would tantamount to 'royalty' for attracting deemed accrual of income under section 9(1)(vi).

As per section 9(1)(vi), income by way of royalty payable by a person who is a non-resident would be deemed to accrue or arise in India, where the royalty is payable in respect of any right, property or information used or services utilized for the purposes of a business or profession carried on by such person in India or for the purposes of making or earning any income from any source in India.

For this purpose, 'royalty' includes transfer of all or any right for use or right to use a computer software irrespective of the medium through which such right is transferred.

The facts of the case are similar to the facts in CIT v. Alcatel Lucent Canada (2015) 372 ITR 476, wherein the above issue came up before the Delhi High Court. The Court observed that the software supply is an integral part of GSM mobile telephone system and is used by the cellular operators for providing cellular services to its customers. Where payment is made for hardware in which the software is embedded and the software does not have independent functional existence, no amount could be attributed as 'royalty' for software in terms of section 9(1)(vi).
In this case, since the software that was loaded on the hardware and embedded in the system does not have any independent existence, there could not be any independent use of such software. Therefore, the rationale of the Delhi High Court ruling can be applied to the case on hand. Accordingly, the action of the Assessing Officer in treating the consideration for supply of software embedded in hardware as royalty under section 9(1)(vi) is not correct.
EXTRA QUESTIONS FOR PRACTICE

ILLUSTRATION 1
J, a citizen of India, employed in the Indian Embassy at Tokyo, Japan. He received salary and allowances at Tokyo from the Government of India for the year ended 31.3.2019 for services rendered by him in Tokyo. Besides, he was allowed perquisites by the Government. He is a non-resident for the assessment year 2019-20. Examine the taxability of salary, allowances and perquisites in the hands of J for the assessment year 2019-20.

SOLUTION
As per section 9(1)(iii), salaries payable by the Government to a citizen of India for services rendered outside India shall be deemed to accrue or arise in India. As such, salary received by J is chargeable to tax, even though he was a non-resident for A.Y. 2019-20.
As per section 10(7), all allowances or perquisites paid or allowed as such outside India by the Government to a citizen of India for rendering services outside India is exempt from tax. Therefore, the allowances and perquisites received by J are exempt as per section 10(7).

ILLUSTRATION 2
Mr. Soham, an Indian Citizen, left India on 20-04-2016 for the first time to setup a software firm in Singapore. On 10-04-2018, he entered into an agreement with LK Limited, an Indian Company, for the transfer of technical documents and designs to setup an automobile factory in Faridabad. He reached India along with his team to render the requisite services on 15-05-2018 and was able to complete his assignment on 20-08-2018. He left for Singapore on 21-08-2018. He charged Rs. 50 lakhs for his services from LK Limited.
Determine the residential status of Mr. Soham for the Assessment Year 2019-20 and examine whether the fees charged from LK Limited would be chargeable to tax as per the Income-tax Act, 1961.

SOLUTION
Determination of residential status of Mr. Soham
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 the case of an Indian citizen leaving India for the purposes of employment outside India during the previous year or an Indian citizen, who being outside India, comes on a visit to India in any previous year, the period of stay during the previous year in condition (ii) above, to qualify as a resident, would be 182 days instead of 60 days.
In this case, Mr. Soham is an Indian citizen who left India to set up a software firm in Singapore on 20.04.2016. Therefore, he is an Indian citizen living in Singapore, who comes on a visit to India during the P.Y. 2018-19. His stay in India during the period of his visit is only 99 days (i.e., 17+30+31+21 days). Since his stay in India during the previous year 2018-19 is only 99 days, he does not satisfy the minimum criterion of 182 days.
182 days stay in India for being a resident. Hence, his residential status for A.Y.2019-20 is Non-Resident.

ILLUSTRATION 3
Miss Vivitha paid a sum of 5000 USD to Mr. Kulasekhara, a management consultant practising in Colombo, specializing in project financing. The payment was made in Colombo. Mr. Kulasekhara is a non-resident. The consultancy is related to a project in India with possible Ceylonese collaboration. Is this payment chargeable to tax in India in the hands of Mr. Kulasekhara?

SOLUTION
A non-resident is chargeable to tax in respect of income received outside India only if such income accrues or arises or is deemed to accrue or arise to him in India. The income deemed to accrue or arise in India under section 9 comprises, *inter alia*, income by way of fees for technical services, which includes any consideration for rendering of any managerial, technical or consultancy services. Therefore, payment to a management consultant relating to project financing is covered within the scope of “fees for technical services”.

The *Explanation* below section 9(2) clarifies that income by way of, *inter alia*, fees for technical services, from services utilized in India would be deemed to accrue or arise in India in case of a non-resident and be included in his total income, whether or not such services were rendered in India or whether or not the non-resident has a residence or place of business or business connection in India.

In the instant case, since the services were utilized in India, the payment received by Mr. Kulasekhara, a non-resident, in Colombo is chargeable to tax in his hands in India, as it is deemed to accrue or arise in India.

ILLUSTRATION 4
Compute the total income in the hands of an individual, aged 55 years, being a resident and ordinarily resident, resident but not ordinarily resident, and non-resident for the A.Y. 2019-20:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest on UK Development Bonds, 50% of interest received in India</td>
<td>10,000</td>
</tr>
<tr>
<td>Income from a business in Chennai (50% is received in India)</td>
<td>20,000</td>
</tr>
<tr>
<td>Short term capital gains on sale of shares of an Indian company received in London</td>
<td>20,000</td>
</tr>
<tr>
<td>Dividend from British company received in London</td>
<td>5,000</td>
</tr>
<tr>
<td>Long term capital gains on sale of plant at Germany, 50% of profits are received in India</td>
<td>40,000</td>
</tr>
<tr>
<td>Income earned from business in Germany which is controlled from Delhi (Rs. 40,000 is received in India)</td>
<td>70,000</td>
</tr>
<tr>
<td>Profits from a business in Delhi but managed entirely from London</td>
<td>15,000</td>
</tr>
<tr>
<td>Income from house property in London deposited in an Indian Bank at London, brought to India (Computed)</td>
<td>50,000</td>
</tr>
<tr>
<td>Interest on debentures in an Indian company received in London</td>
<td>12,000</td>
</tr>
<tr>
<td>Fees for technical services rendered in India but received in London</td>
<td>8,000</td>
</tr>
</tbody>
</table>
Profits from a business in Bombay managed from London 26,000
Pension for services rendered in India but received in Burma 4,000
Income from property situated in Pakistan received there 16,000
Past foreign untaxed income brought to India during the previous year 5,000
Income from agricultural land in Nepal received there and then brought to India 18,000
Income from profession in Kenya which was set up in India, received there but spent in India 5,000
Gift received on the occasion of his wedding 20,000
Interest on savings bank deposit in State Bank of India 12,000
Income from a business in Russia, controlled from Russia 20,000
Dividend from Reliance Petroleum Limited, an Indian Company 5,000
Agricultural income from a land in Rajasthan 15,000

**SOLUTION**

**Computation of total income for the A.Y. 2019-20**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Resident and ordinarily resident Rs.</th>
<th>Resident but not ordinarily resident Rs.</th>
<th>Non-resident Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest on UK Development Bonds, 50% of interest received in India</td>
<td>10,000</td>
<td>5,000</td>
<td>5,000</td>
</tr>
<tr>
<td>Income from a business in Chennai (50% is received in India)</td>
<td>20,000</td>
<td>20,000</td>
<td>20,000</td>
</tr>
<tr>
<td>Short term capital gains on sale of shares of an Indian company received in London</td>
<td>20,000</td>
<td>20,000</td>
<td>20,000</td>
</tr>
<tr>
<td>Dividend from British company received in London</td>
<td>5,000</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Long term capital gain on sale of plant at Germany, 50% of profits are received in India</td>
<td>40,000</td>
<td>20,000</td>
<td>20,000</td>
</tr>
<tr>
<td>Income earned from business in Germany which is controlled from Delhi, out of which Rs. 40,000 is received in India</td>
<td>70,000</td>
<td>70,000</td>
<td>40,000</td>
</tr>
<tr>
<td>Profits from a business in Delhi but managed entirely from London</td>
<td>15,000</td>
<td>15,000</td>
<td>15,000</td>
</tr>
<tr>
<td>Income from property in London deposited in a Bank at London, later on remitted to India</td>
<td>50,000</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Interest on debentures in an Indian company received in London</td>
<td>12,000</td>
<td>12,000</td>
<td>12,000</td>
</tr>
<tr>
<td>Fees for technical services rendered in India but received in London</td>
<td>8,000</td>
<td>8,000</td>
<td>8,000</td>
</tr>
<tr>
<td>Profits from a business in Bombay managed from London</td>
<td>26,000</td>
<td>26,000</td>
<td>26,000</td>
</tr>
<tr>
<td>Pension for services rendered in India but received in Burma</td>
<td>4,000</td>
<td>4,000</td>
<td>4,000</td>
</tr>
</tbody>
</table>
Income from property situated in Pakistan received there | 16,000 | - | -
Past foreign untaxed income brought to India during the previous year | - | - | -
Income from agricultural land in Nepal received there and then brought to India | 18,000 | - | -
Income from profession in Kenya which was set up in India, received there but spent in India | 5,000 | 5,000 | -
Gift received on the occasion of his wedding [not taxable] | - | - | -
Interest on savings bank deposit in State Bank of India | 12,000 | 12,000 | 12,000
Income from a business in Russia, controlled from Russia | 20,000 | - | -
Dividend from Reliance Petroleum Limited, an Indian Company [Exempt under section 10(34)] | - | - | -
Agricultural income from a land in Rajasthan [Exempt under section 10(1)] | - | - | -

<table>
<thead>
<tr>
<th>Gross Total Income</th>
<th>3,51,000</th>
<th>2,17,000</th>
<th>1,82,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less: Deduction under section 80TTA</td>
<td>10,000</td>
<td>10,000</td>
<td>10,000</td>
</tr>
<tr>
<td>[Interest on savings bank account subject to a maximum of Rs.10,000]</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Total Income</td>
<td>3,41,000</td>
<td>2,07,000</td>
<td>1,72,000</td>
</tr>
</tbody>
</table>

Illustration 5
Sea Port Shipping Line, a non-resident foreign company operating its ships on the Indian Ports during the previous year ended on 31.3.2019, had collected freight of Rs. 100 lakhs, demurrages of Rs. 20 lakhs and handling charges of Rs. 10 lakhs. The expenses of operating its fleet during the year for the Indian Ports were Rs. 110 lakhs. The company denies its liability to tax in India. Examine.

SOLUTION
The provisions of section 44B would be beneficial in this case. This section provides that in the case of an assessee, being a non-resident, engaged in the business of operation of ships, a sum equal to 7.5% of the aggregate of the following amounts would be deemed to be the profits and gains of such business chargeable to tax under the head “Profits and gains of business or profession”.
(i) The amount paid or payable, whether within India or outside, to the assessee or to any person on his behalf on account of the carriage of passengers, livestock, mail or goods shipped at any port in India; and
(ii) The amount received or deemed to be received in India by the assessee himself or by any other person on behalf of or on account of the carriage of passengers, livestock, mail or goods shipped at any port outside India.
The above amounts will include demurrage charges and handling charges.
These provisions for computation of the income from the shipping business in case of non-residents would apply notwithstanding anything to the contrary contained in the provisions of sections 28 to 43A of the Income-tax Act, 1961.

Therefore, in this case, M/s. Sea Port Shipping Line is required to pay tax in India on the basis of presumptive scheme as per the provisions of section 44B. The assessee shall not be entitled to set off any of the expenses incurred for earning of such income. Therefore, the Shipping Line is required to pay tax on deemed profit of Rs. 9.75 lacs (7.50% on the total receipts of Rs. 130 lacs).

ILLUSTRATION 6

Mr. Q, a non-resident, operates an aircraft between Singapore and Chennai. He received the following amounts while carrying on the business of operation of aircrafts for the year ended 31.3.2019:

(i) Rs. 2 crores in India on account of carriage of passengers from Chennai.
(ii) Rs. 1 crore in India on account of carriage of goods from Chennai.
(iii) Rs. 3 crores in India on account of carriage of passengers from Singapore.
(iv) Rs. 1 crore in Singapore on account of carriage of passengers from Chennai.

The total expenditure incurred by Mr. Q for the purposes of the business during the year ending 31.3.2019 was Rs. 6.75 Crores.

Compute the income of Mr. Q chargeable to tax in India under the head “Profits and gains of business or profession” for the assessment year 2019-20.

What would be your answer in case the business was carried on by a foreign company, Q Airlines (P) Ltd?

SOLUTION

Section 44BBA says for computing profits and gains of the business of operation of aircraft in the case of non-residents a sum equal to 5% of the aggregate of the following amounts -

(a) paid or payable, whether in or out of India, to the assessee or to any person on his behalf on account of the carriage of passengers, livestock, mail or goods from any place in India; and

(b) received or deemed to be received in India by or on behalf of the assessee on account of the carriage of passengers, livestock, mail or goods from any place outside India.

Keeping in view the provisions of section 44BBA, the income of Mr. Q chargeable to tax in India under the head "Profits and gains of business or profession" is worked out hereunder-

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amount received in India on account of carriage of passengers from Chennai</td>
<td>2,00,00,000</td>
</tr>
<tr>
<td>Amount received in India on account of carriage of goods from Chennai</td>
<td>1,00,00,000</td>
</tr>
<tr>
<td>Amount received in India on account of carriage of passengers from Singapore</td>
<td>3,00,00,000</td>
</tr>
<tr>
<td>Amount received in Singapore on account of carriage of passengers from Chennai</td>
<td>1,00,00,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>7,00,00,000</strong></td>
</tr>
</tbody>
</table>
Income from business under section 44BBA at 5% of Rs. 7,00,00,000 is Rs. 35,00,000, which is the income of Mr. Q chargeable to tax in India under the head “Profits and gains of business or profession” for the A.Y. 2019-20.

In case the assessee is a foreign company, say, Q Airlines (P) Ltd, the answer would be the same since section 44BBA does not distinguish corporate and non-corporate taxpayers who operate aircraft provided their residential status is that of non-resident.

**ILLUSTRATION 7**

The net result of the business carried on by a branch of foreign company in India for the year ended 31.03.2019 was a loss of Rs. 100 lakhs after charge of head office expenses of Rs. 200 lakhs allocated to the branch. Explain with reasons the income to be declared by the branch in its return for the assessment year 2019-20.

**SOLUTION**

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

For the purpose of computing the adjusted total income, the head office expenses of Rs. 200 Lakhs charged to the profit and loss account have to be added back.

The amount of income to be declared by the assessee for A.Y. 2019-20 will be as under:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net loss for the year ended 31.03.2019</td>
<td>(100 lakhs)</td>
</tr>
<tr>
<td>Add: Amount of head office expenses to be considered separately as per section 44C</td>
<td>200 lakhs</td>
</tr>
<tr>
<td>Adjusted total income</td>
<td>100 lakhs</td>
</tr>
<tr>
<td>Less: Head Office expenses allowable under section 44C is the lower of</td>
<td></td>
</tr>
<tr>
<td>(i) Rs. 5 lakhs, being 5% of Rs. 100 lakhs, or</td>
<td>5 lakhs</td>
</tr>
<tr>
<td>(ii) Rs. 200 lakhs.</td>
<td></td>
</tr>
<tr>
<td><strong>Income to be declared in return</strong></td>
<td>95 lakhs</td>
</tr>
</tbody>
</table>

**ILLUSTRATION 8**

Mr. A, a non-resident Indian remits US $ 40,000 to India on 16.09.2005. The amount is partly utilised on 3.10.2005 for purchasing 10,000 equity shares in A Ltd, an Indian Company, at the rate of Rs. 12 per share. These shares are sold for Rs. 48 per share on 30.03.2019. Fair Market value of these shares on 31.01.2018 was Rs. 35 per share. The telegraphic transfer buying and selling rate of US dollars adopted by the State Bank of India is as follows:-

<table>
<thead>
<tr>
<th>Date</th>
<th>Buying Rate (1 US$)</th>
<th>Selling Rate (1 US $)</th>
</tr>
</thead>
<tbody>
<tr>
<td>16.09.2005</td>
<td>18</td>
<td>20</td>
</tr>
<tr>
<td>3.10.2005</td>
<td>19</td>
<td>21</td>
</tr>
<tr>
<td>30.3.2019</td>
<td>59</td>
<td>61</td>
</tr>
</tbody>
</table>

Compute Capital gain chargeable to tax for the A.Y. 2019-20 on the assumption that –

(a) These shares have not been sold through a recognised stock exchange

(b) These shares have been purchased and sold through a recognised stock exchange.
SOLUTION
(a) Where the shares are not sold through recognised stock exchange

<table>
<thead>
<tr>
<th>Particulars</th>
<th>US $</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sale consideration (Rs. 4,80,000/60)</td>
<td>8000</td>
</tr>
<tr>
<td>Less: Cost of Acquisition (1,20,000/20)</td>
<td>6000</td>
</tr>
<tr>
<td><strong>Long term capital gain</strong></td>
<td>2000</td>
</tr>
</tbody>
</table>

Long-term capital gain converted into $ 2000 x Rs. 59 = Rs. 1,18,000

(b) Where the shares are purchased and sold through a recognised stock exchange

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sale consideration</td>
<td>4,80,000</td>
</tr>
<tr>
<td>Less: Cost of Acquisition</td>
<td></td>
</tr>
<tr>
<td>Higher of the following</td>
<td></td>
</tr>
<tr>
<td>Cost of acquisition of assets</td>
<td>1,20,000</td>
</tr>
<tr>
<td>Lower of Fair market value as on 31.1.2018 and Full value of consideration (i.e., lower of Rs. 3,50,000 and Rs. 4,80,000)</td>
<td>3,50,000</td>
</tr>
<tr>
<td><strong>Long term capital gain</strong></td>
<td>1,30,000</td>
</tr>
</tbody>
</table>

Long term capital gains up to Rs. 1,00,000 would be exempt. Long term capital gains exceeding Rs. 1,00,000, i.e., Rs. 30,000 is taxable @10% under section 112A.

ILLUSTRATION 9

A non-resident Indian acquired shares in an Indian company, A Ltd., on 1.1.2009 for Rs. 1,00,000 in foreign currency. These shares are sold by him on 1.1.2018 for Rs. 3,00,000. He invests Rs. 3,00,000 in shares on 31.03.2018 and these shares are sold by him on 30.06.2018 for Rs. 3,50,000. Discuss the tax implications. Ignore the effect of first proviso to section 48.

SOLUTION

Computation of Long term Capital Gain for Assessment Year 2018-19

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sale consideration</td>
<td>3,00,000</td>
</tr>
<tr>
<td>Less: Cost of Acquisition</td>
<td>1,00,000</td>
</tr>
<tr>
<td>Long term capital gain</td>
<td>2,00,000</td>
</tr>
<tr>
<td>Less: Exemption under section 115F</td>
<td>2,00,000</td>
</tr>
<tr>
<td>Exempt long-term capital gain</td>
<td>NIL</td>
</tr>
</tbody>
</table>

Capital Gain for Assessment Year 2019-20:
1. LTCG of Rs. 2,00,000 which was exempt in A.Y.2018-19 becomes taxable this year.
2. STCG of Rs. 50,000 is also taxable this year.

ILLUSTRATION 10

Mr. John, a non-resident Indian, purchased unlisted shares of an Indian Company at a cost of Rs. 70,000 on 01.07.2010 in foreign currency. Mr. John sold the said shares for a consideration of Rs. 2,50,000 on 01.08.2018 and the expenditure incurred wholly or exclusively in connection with the transfer is Rs. 10,000. Compute the taxable capital gain if he deposited in specified assets Rs. 1,50,000 out of sale consideration. Ignore the effect of first proviso to section 48.
SOLUTION

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sale Consideration</td>
<td>2,50,000</td>
</tr>
<tr>
<td>Less: Transfer Expenses</td>
<td>10,000</td>
</tr>
<tr>
<td>Net Consideration</td>
<td>2,40,000</td>
</tr>
<tr>
<td>Less: Cost of Acquisition</td>
<td>70,000</td>
</tr>
<tr>
<td>Long-term capital gain</td>
<td>1,70,000</td>
</tr>
<tr>
<td>Less: Exemption u/s 115F</td>
<td>1,06,250*</td>
</tr>
<tr>
<td><strong>Taxable long-term capital gain</strong></td>
<td><strong>63,750</strong></td>
</tr>
</tbody>
</table>

\[
*1,70,000 \times 1.50,000 \\
2,40,000 = \text{Rs. 1,06,250}
\]

ILLUSTRATION 11

During the financial year 2018-19, Nadal, a tennis professional and a non-Indian citizen participated in India in a Tennis Tournament and won prize money of Rs. 15 lacs. He contributed articles on the tournament in a local newspaper for which he was paid Rs. 1 lac. He was also paid Rs. 5,00,000 by a Soft Drink company for appearance in a T.V. advertisement. Although his expenses in India were met by the sponsors, he had to incur Rs. 3,00,000 towards his travel costs to India. He was a non-resident for tax purposes in India.

What would be his tax liability in India for A.Y. 2019-20? Is he required to file his return of income?

SOLUTION

Under section 115BBA, all the three items of receipts in India viz. prize money of Rs. 15 lakhs, amount received from newspaper of Rs. 1 lakh and amount received towards TV advertisement of Rs. 5 lakhs - are chargeable to tax. No expenditure is allowable against such receipts. The rate of tax chargeable under section 115BBA is 20%, plus health and education cess @4%. The total tax liability works out to Rs. 4,36,800 being 20.8% of Rs. 21 lakhs. Thus, Nadal will be liable to tax on the income earned in India.

He is not required to file his return of income if -

(a) his total income during the previous year consists only of income arising under section 115BBA; and

(b) the tax deductible at source under the provisions of Chapter XVII-B have been deducted from such incomes.

ILLUSTRATION 12

Smith, a foreign national and a cricketer came to India as a member of Australian cricket team in the year ended 31st March, 2019. He received Rs. 5 lakhs for participation in matches in India. He also received Rs. 1 lakh for an advertisement of a product on TV. He contributed articles in a newspaper for which he received Rs. 10,000. When he stayed in India, he also won a prize of Rs. 20,000 from horse racing in Mumbai. He has no other income in India during the year.

(i) Compute tax liability of Smith for Assessment Year 2019-20.
(ii) Are the income specified above subject to deduction of tax at source?
(iii) Is he liable to file his return of income for Assessment Year 2019-20?
(iv) What would have been his tax liability, had he been a match referee instead of a cricketer?

**SOLUTION**

(i) Computation of tax liability of Smith for the A.Y.2019-20

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Income taxable under section 115BBA</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income from participation in matches in India</td>
<td>5,00,000</td>
<td></td>
</tr>
<tr>
<td>Advertisement of product on TV</td>
<td>1,00,000</td>
<td></td>
</tr>
<tr>
<td>Contribution of articles in newspaper</td>
<td>10,000</td>
<td></td>
</tr>
<tr>
<td><strong>Income taxable under section 115BB</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income from horse races</td>
<td>20,000</td>
<td></td>
</tr>
<tr>
<td><strong>Total income</strong></td>
<td>6,30,000</td>
<td>1,22,000</td>
</tr>
<tr>
<td>Tax@ 20% under section 115BBA on Rs. 6,10,000</td>
<td></td>
<td>1,22,000</td>
</tr>
<tr>
<td>Tax@ 30% under section 115BB on income of Rs. 20,000 from horse races</td>
<td>6,000</td>
<td></td>
</tr>
<tr>
<td><strong>Add: Health and Education cess@4%</strong></td>
<td></td>
<td>1,28,000</td>
</tr>
<tr>
<td><strong>Total tax liability of Smith for the A.Y.2019-20</strong></td>
<td>1,33,120</td>
<td>5,120</td>
</tr>
</tbody>
</table>

(ii) Yes, the above income is subject to tax deduction at source. Income referred to in section 115BBA (i.e., Rs. 6,10,000, in this case) is subject to tax deduction at source@20% under section 194E. Income referred to in section 115BB (i.e., Rs. 20,000, in this case) is subject to tax deduction at source@30% under section 194BB. Since Smith is a non-resident, the amount of tax to be deducted calculated at the prescribed rates mentioned above, would be increased by health and education cess@4%.

(iii) Section 115BBA provides that if the total income of the non-resident sportsman comprises of only income referred to in that section and tax deductible at source has been fully deducted, it shall not be necessary for him to file his return of income. However, in this case, Mr. Smith has income from horse races as well. Therefore, he cannot avail the benefit of exemption from filing of return of income as contained in section 115BBA. Hence, he would be liable to file his return of income for A.Y.2019-20.

(iv) The Calcutta High Court in *Indcom v. CIT (TDS)(2011) 335 ITR 485* has held that ‘match referee’ would not fall within the meaning of “sportsmen” to attract the provisions of section 115BBA. Therefore, although the payments made to non-resident ‘match referee’ are “income” which has accrued and arisen in India, the same are not taxable under the provisions of section 115BBA. They are subject to the normal rates of tax.

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax@30% under section 115BB on winnings of Rs. 20,000 from horse races</td>
<td>6,000</td>
</tr>
<tr>
<td><strong>Tax on Rs. 6,10,000 at the rates in force</strong></td>
<td></td>
</tr>
<tr>
<td>Upto Rs. 2,50,000</td>
<td>Nil</td>
</tr>
<tr>
<td>2,50,000 – 5,00,000 @5%</td>
<td>12,500</td>
</tr>
<tr>
<td>5,00,000 – 6,10,000 @ 20%</td>
<td>22,000</td>
</tr>
<tr>
<td></td>
<td>34,500</td>
</tr>
<tr>
<td></td>
<td>40,500</td>
</tr>
<tr>
<td><strong>Add: Health and Education cess@4%</strong></td>
<td>1,620</td>
</tr>
<tr>
<td></td>
<td>42,120</td>
</tr>
</tbody>
</table>

**************************************************************************
CHAPTER 25 DOUBLE TAXATION

EXERCISE

Question 1
Cosmos Limited, a company incorporated in Mauritius, has a branch office in Hyderabad opened in April, 2018. The Indian branch has filed return of income for assessment year 2019-20 disclosing income of Rs. 50 lacs. It paid tax at the rate applicable to domestic company i.e. 30% plus education cess on the basis of paragraph 2 of Article 24 (Non-Discrimination) of the Double Taxation Avoidance Agreement between India and Mauritius, which reads as follows:

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

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

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

SOLUTION

Under section 90(2), where the Central Government has entered into an agreement for avoidance of double taxation with the Government of any country outside India or specified territory outside India, as the case may be, then, in relation to the assessee to whom such agreement applies, the provisions of the Income-tax Act, 1961 shall apply to the extent they are more beneficial to the assessee. Thus, in view of paragraph 2 of the Article 24 (Non-discrimination of the Double Taxation Avoidance Agreement (DTAA), it appears that the Indian branch of Cosmos Limited, incorporated in Mauritius, is liable to tax in India at the rate applicable to domestic company (30%), which is lower than the rate of tax applicable to a foreign company (40%).

However, Explanation 1 to section 90 clarifies that the charge of tax in respect of a foreign company at a rate higher than the rate at which a domestic company is chargeable, shall not be regarded as less favourable charge or levy of tax in respect of such foreign company. Therefore, in view of this Explanation, the action of the Assessing Officer in levying tax@40% on the Indian branch of Cosmos Ltd. is in accordance with law.

Question 2
Kalpesh Kumar, a resident individual, is a musician deriving income of Rs. 7,50,000 from concerts performed outside India. Tax of Rs. 1,00,000 was deducted at source in the country where the concerts were performed. India does not have any double tax avoidance agreement with that country. His income in India amounted to Rs. 30,00,000.

Compute tax liability of Kalpesh Kumar for the assessment year 2019-20 assuming he has deposited Rs. 1,50,000 in Public Provident Fund and paid medical insurance premium in respect of his father, resident in India, aged 65 years, Rs. 52,000.
Answer

Computation of tax liability of Mr. Kalpesh for A.Y.2019-20

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Indian Income</td>
<td>30,00,000</td>
<td></td>
</tr>
<tr>
<td>Foreign Income</td>
<td>7,50,000</td>
<td></td>
</tr>
<tr>
<td><strong>Gross Total Income</strong></td>
<td>37,50,000</td>
<td></td>
</tr>
<tr>
<td>Less: Deduction under section 80C</td>
<td></td>
<td></td>
</tr>
<tr>
<td>PPF Contribution</td>
<td>1,50,000</td>
<td></td>
</tr>
<tr>
<td>Deduction under section 80D</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Medical insurance premium of father, being a resident senior citizen, restricted to</td>
<td>50,000</td>
<td>2,00,000</td>
</tr>
<tr>
<td><strong>Total Income</strong></td>
<td>35,50,000</td>
<td></td>
</tr>
<tr>
<td>Tax on total income</td>
<td>8,77,500</td>
<td></td>
</tr>
<tr>
<td><strong>Add: Health and Education cess @4%</strong></td>
<td>35,100</td>
<td>9,12,600</td>
</tr>
<tr>
<td>Average rate of tax in India [i.e., Rs. 9,12,600 /Rs. 35,50,000 x 100]</td>
<td>25.71%</td>
<td></td>
</tr>
<tr>
<td>Average rate of tax in foreign country [i.e. Rs. 1,00,000/ Rs. 7,50,000 x 100]</td>
<td>13.333%</td>
<td></td>
</tr>
<tr>
<td>Doubly taxed income</td>
<td>7,50,000</td>
<td></td>
</tr>
<tr>
<td>Deduction under section 91 on Rs. 7,50,000 @13.33%</td>
<td>1,00,000</td>
<td></td>
</tr>
<tr>
<td>(lower of average Indian tax rate and foreign tax rate)</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Tax payable in India [Rs. 9,12,600 – Rs. 1,00,000]</strong></td>
<td>8,12,600</td>
<td></td>
</tr>
</tbody>
</table>

**Note:** An assessee shall be allowed deduction under section 91 provided all the following conditions are fulfilled:

(a) The assessee is a resident in India during the relevant previous year.
(b) The income accrues or arises to him outside India during that previous year.
(c) Such income is not deemed to accrue or arise in India during the previous year.
(d) The income in question has been subjected to income-tax in the foreign country in the hands of the assessee and the assessee has paid tax on such income in the foreign country.
(e) There is no agreement under section 90 for the relief or avoidance of double taxation between India and the other country where the income has accrued or arisen.

In this case, Kalpesh Kumar is eligible for deduction under section 91 since all the above conditions are fulfilled.

**Question 3**

The following are the particulars of income earned by Miss Vivitha, a resident Indian aged 25, for the assessment year 2019-20:

<table>
<thead>
<tr>
<th>(Rs. In lacs)</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Income from playing snooker matches in country L</td>
<td>12.00</td>
</tr>
<tr>
<td>Tax paid in country L</td>
<td>1.80</td>
</tr>
<tr>
<td>Income from playing snooker tournaments in India</td>
<td>19.20</td>
</tr>
<tr>
<td>Life Insurance Premium paid</td>
<td>1.10</td>
</tr>
</tbody>
</table>

25.2
Compute her total income and tax liability for the assessment year 2019-20. There is no Double Taxation Avoidance Agreement between India and country L.

***Answer***

Computation of total income and tax liability of Miss Vivitha for the A.Y. 2019-20

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Indian Income [Income from playing snooker tournaments in India]</td>
<td>19,20,000</td>
<td></td>
</tr>
<tr>
<td>Foreign Income [Income from playing snooker matches in country L]</td>
<td>12,00,000</td>
<td>31,20,000</td>
</tr>
<tr>
<td><strong>Gross Total Income</strong></td>
<td></td>
<td>31,20,000</td>
</tr>
</tbody>
</table>

Less: Deduction under Chapter VIA

**Deduction under section 80C**

Life insurance premium of Rs. 1,10,000 paid during the previous year deduction, is within the overall limit of Rs. 1.5 lakh. Hence, fully allowable as deduction

**Deduction under section 80D**

Medical insurance premium of Rs. 54,000 paid for her father aged 62 years. Since her father is a senior citizen, the deduction is allowable to a maximum of Rs. 50,000 (assuming that her father is also a resident in India). Further, deduction is allowable where payment is made by any mode other than cash. Here payment is made by credit card hence, eligible for deduction.

<table>
<thead>
<tr>
<th>Deduction under section 80D</th>
<th>50,000</th>
<th>1,60,000</th>
</tr>
</thead>
</table>

**Total Income**

<table>
<thead>
<tr>
<th>Tax on Total Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income-tax</td>
</tr>
<tr>
<td><em>Add</em>: Health and education cess @4%</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Average rate of tax in India (i.e. Rs. 7,28,520/Rs. 29,60,000 × 100)</td>
</tr>
<tr>
<td>Average rate of tax in foreign country (i.e. Rs. 1,80,000/Rs. 12,00,000 × 100)</td>
</tr>
<tr>
<td>Deduction under section 91 on Rs. 12 lakh @ 15% (lower of average Indian-tax rate or average foreign tax rate)</td>
</tr>
<tr>
<td>Tax payable in India (Rs. 7,28,520 – Rs. 1,80,000)</td>
</tr>
</tbody>
</table>

**Note**: Miss Vivitha shall be allowed deduction under section 91, since the following conditions are fulfilled:

(a) She is a resident in India during the relevant previous year.

(b) The income accrues or arises to her outside India during that previous year and such income is not deemed to accrue or arise in India during the previous year.

(c) The income in question has been subjected to income-tax in the foreign country L in her hands and she has paid tax on such income in the foreign country L.
(d) There is no agreement under section 90 for the relief or avoidance of double taxation between India and country L where the income has accrued or arisen.

Question 4
The concept of Permanent Establishment is one of the most important concepts in determining the tax implications of cross border transactions. Examine the significance thereof, when such transactions are governed by Double Taxation Avoidance Agreements (DTAA).

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

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

As per this definition, to constitute a permanent establishment, there must be a place of business which is fixed and the business of the enterprise must be carried out wholly or partly through this place.

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

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

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

Question 5
An individual resident in India, having income earned outside India in a country with which no agreement under section 90 exists, asks you to examine whether the credit for the tax paid on the foreign income will be allowed against his income-tax liability in India.

SOLUTION
The assessee is a resident in India and accordingly, the income accruing or arising to him globally is chargeable to tax in India. However, section 91 specifies that if a person resident in India has paid tax in any country with which no agreement under section 90 exists, then, for the purpose of relief or avoidance of double taxation, a deduction is allowed from the Indian income-tax payable by him, of a sum calculated on such doubly taxed income at Indian rate of tax or the rate of tax of such foreign country, whichever is lower, or at the Indian rate of tax, if both the rates are equal.

Accordingly, the assessee shall not be given any credit of the tax paid on the income in other country, but shall be allowed a deduction from the Indian income-tax payable by him as per the scheme of section 91.

Question 6
The Income-tax Act, 1961 provides for taxation of a certain income earned in India by Mr. X, a non-resident. The Double Taxation Avoidance Agreement, which applies to Mr. X
provides for taxation of such income in the country of residence. Is Mr. X liable to pay tax on such income earned by him in India? Examine.

SOLUTION
Section 90(2) makes it clear that where the Central Government has entered into a Double Taxation Avoidance Agreement with a country outside India, then in respect of an assessee to whom such agreement applies, the provisions of the Act shall apply to the extent they are more beneficial to the assessee. This means that where tax liability is imposed by the Act, the Double Taxation Avoidance Agreement may be resorted to for reducing or avoiding the tax liability.

However, as per section 90(4), the assessee, in order to claim relief under the agreement, has to obtain a certificate [Tax Residence Certificate (TRC)] from the Government of that country, declaring the residence of the country outside India. Further, he also has to provide the following information in Form No. 10F:

(i) Status (individual, company, firm etc.) of the assessee;
(ii) PAN of the assessee, if allotted;
(iii) Nationality (in case of an individual) or country or specified territory of incorporation or registration (in case of others);
(iv) Assessee's tax identification number in the country or specified territory of residence and in case there is no such number, then, a unique number on the basis of which the person is identified by the Government of the country or the specified territory of which the assessee claims to be a resident;
(v) Period for which the residential status, as mentioned in the certificate referred to in section 90(4) or section 90A(4), is applicable; and
(vi) Address of the assessee in the country or specified territory outside India, during the period for which the certificate, as mentioned in (v) above, is applicable.

However, the assessee may not be required to provide the information or any part thereof, if the information or the part thereof, as the case may be, is already contained in the TRC referred to in section 90(4) or section 90A(4).

The Supreme Court has held, in CIT v. P.V.A.L. Kalandagan Chettiar (2004) 267 ITR 654, that in case of any conflict between the provisions of the Double Taxation Avoidance Agreement and the Income-tax Act, 1961, the provisions of the Double Taxation Avoidance Agreement would prevail over those of the Income-tax Act, 1961. Mr. X is, therefore, not liable to pay tax on the income earned by him in India provided he submits the Tax Residence Certificate obtained from the government of the other country, and provides such other documents and information as may be prescribed.

Question 7
Arif is a resident of both India and another foreign country in the previous year 2018-19. He owns immovable properties (including residential house) in both the countries. He earned income of Rs. 50 lacs from rubber estates in the foreign country during the financial year 2018-19. He also sold some house property situated in foreign country resulting in short-term capital gain of Rs. 10 lacs during the year. Arif has no permanent establishment of business in India. However, he has derived rental income of Rs. 6 lacs from property let out in India and he has a house in Lucknow where he stays during his visit to India.

Article 4 of the Double Taxation Avoidance Agreement between India and the foreign country where Arif is a resident, provides that “where an individual is a resident of both the Contracting States, then he shall be deemed to be resident of the Contracting State in
which he has permanent home available to him. If he has permanent home in both the Contracting States, he shall be deemed to be a resident of the Contracting State with which his personal and economic relations are closer (centre of vital interests)”. You are required to examine with reasons whether the business income of Arif arising in foreign country and the capital gains in respect of sale of the property situated in foreign country can be taxed in India.

SOLUTION
Section 90(1) of the Income-tax Act, 1961 empowers the Central Government to enter into an agreement with the Government of any country outside India for avoidance of double taxation of income under the Indian law and the corresponding law of that country. Section 90(2) provides that where the Central Government has entered into an agreement with the Government of any other country for granting relief of tax or for avoidance of double taxation, then, in relation to the assessee to whom such agreement applies, the provisions of the Income-tax Act, 1961 shall apply to the extent they are more beneficial to that assessee.

Arif has residential houses both in India and foreign country. Thus, he has a permanent home in both the countries. However, he has no permanent establishment of business in India. The Double Taxation Avoidance Agreement (DTAA) with foreign country provides that where an individual is a resident of both the countries, he shall be deemed to be resident of that country in which he has a permanent home and if he has a permanent home in both the countries, he shall be deemed to be resident of that country, which is the centre of his vital interests i.e. the country with which he has closer personal and economic relations.

Arif owns rubber estates in a foreign country from which he derives business income. However, Arif has no permanent establishment of his business in India. Therefore his personal and economic relations with foreign country are closer, since foreign country is the place where –
(a) the property is located and
(b) the permanent establishment (PE) has been set-up

Therefore, he shall be deemed to be resident of the foreign country for A.Y. 2019-20.

The fact of the case and issues arising therefrom are similar to that of CIT vs. P.V.A.L. Kulantagan Chettiar (2004) 267 ITR 654, where the Supreme Court held that if an assessee is deemed to be a resident of a contracting State where his personal and economic relations are closer, then in such a case, the fact that he is a resident in India to be taxed in terms of sections 4 and 5 would become irrelevant, since the DTAA prevails over sections 4 and 5.

However, as per section 90(4), in order to claim relief under the agreement, Arif has to obtain a certificate [Tax Residency Certificate (TRC)] declaring his residence of the country outside India from the Government of that country. Further, he also has to provide such other documents and information, as may be prescribed.

Therefore, in this case, Arif is not liable to income tax in India for assessment year 2019-20 in respect of business income and capital gains arising in the foreign country provided he furnishes the Tax Residency Certificate and provides such other documents and information as may be prescribed.
Question 8
Mr. Kamesh, an individual resident in India furnishes you the following particulars of income earned in India, Country "X" and Country "Y" for the previous year 2018-19. India has not entered into double taxation avoidance agreement with these two countries.

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income from profession carried on in India</td>
<td>7,50,000</td>
</tr>
<tr>
<td>Agricultural income in Country &quot;X&quot; (gross)</td>
<td>50,000</td>
</tr>
<tr>
<td>Dividend received from a company incorporated in Country &quot;Y&quot; (gross)</td>
<td>1,50,000</td>
</tr>
<tr>
<td>Royalty income from a literary book from Country &quot;X&quot; (gross)</td>
<td>6,00,000</td>
</tr>
<tr>
<td>Expenses incurred for earning royalty</td>
<td>50,000</td>
</tr>
<tr>
<td>Business loss in Country &quot;Y&quot; (Proprietary business)</td>
<td>65,000</td>
</tr>
<tr>
<td>Rent from a house situated in Country &quot;Y&quot; (gross)</td>
<td>2,40,000</td>
</tr>
<tr>
<td>Municipal tax in respect of the above house (not allowed as deduction in country &quot;Y&quot;)</td>
<td>10,000</td>
</tr>
</tbody>
</table>

**Note:** Business loss in Country "Y" not eligible for set off against other incomes as per law of that country. The rates of tax in Country "X" and Country "Y" are 10% and 25%, respectively.

Compute total income and tax payable by Mr. Kamesh in India for Assessment Year 2019-20.

**Answer**

**Computation of total income of Mr. Kamesh for A.Y.2019-20**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income from House Property [House situated in country Y]</td>
<td></td>
</tr>
<tr>
<td>Gross Annual Value</td>
<td>2,40,000</td>
</tr>
<tr>
<td>Less: Municipal taxes (assumed as paid in that country)</td>
<td>10,000</td>
</tr>
<tr>
<td>Net Annual Value</td>
<td>2,30,000</td>
</tr>
<tr>
<td>Less: Deduction under section 24 – 30% of NAV</td>
<td>69,000</td>
</tr>
<tr>
<td></td>
<td>1,61,000</td>
</tr>
<tr>
<td>Profits and Gains of Business or Profession</td>
<td></td>
</tr>
<tr>
<td>Income from profession carried on in India</td>
<td>7,50,000</td>
</tr>
<tr>
<td>Royalty income from a literary book from Country X (after deducting expenses of Rs. 50,000)</td>
<td>5,50,000</td>
</tr>
<tr>
<td>Less: Business loss in country Y set-off</td>
<td>65,000</td>
</tr>
<tr>
<td></td>
<td>12,35,000</td>
</tr>
<tr>
<td>Income from Other Sources</td>
<td></td>
</tr>
<tr>
<td>Agricultural income in country X</td>
<td>50,000</td>
</tr>
<tr>
<td>Dividend received from a company in country Y</td>
<td>1,50,000</td>
</tr>
<tr>
<td></td>
<td>2,00,000</td>
</tr>
<tr>
<td>Gross Total Income</td>
<td>15,96,000</td>
</tr>
<tr>
<td>Less: Deduction under Chapter VIA</td>
<td></td>
</tr>
<tr>
<td>Under section 80QQB – Royalty income of a resident from literary work</td>
<td>3,00,000</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Income</td>
<td>12,96,000</td>
</tr>
</tbody>
</table>
## Computation of tax liability of Mr. Kamesh for A.Y.2019-20

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax on total income [30% of Rs. 2,96,000 + Rs. 1,12,500]</td>
<td>2,01,300</td>
</tr>
<tr>
<td>Add: Health and Education cess@4%</td>
<td>8,052</td>
</tr>
<tr>
<td><strong>Less: Deduction under section 91 (See Working Note below)</strong></td>
<td>69,739</td>
</tr>
<tr>
<td>Tax Payable</td>
<td>1,39,613</td>
</tr>
<tr>
<td>Tax payable (rounded off)</td>
<td>1,39,610</td>
</tr>
</tbody>
</table>

### Working Note: Calculation of Rebate under section 91

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Average rate of tax in India [i.e., Rs. 2,09,352 / Rs. 12,96,000 x 100]</td>
<td>16.154%</td>
<td></td>
</tr>
<tr>
<td><strong>Average rate of tax in country X</strong></td>
<td>10%</td>
<td></td>
</tr>
<tr>
<td><strong>Doubly taxed income pertaining to country X</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Agricultural Income</td>
<td>50,000</td>
<td></td>
</tr>
<tr>
<td>Royalty Income [Rs. 6,00,000 – Rs. 50,000 (Expenses) – Rs. 3,00,000 (deduction under section 80QQB)]</td>
<td>2,50,000</td>
<td></td>
</tr>
<tr>
<td>Deduction under section 91 on Rs. 3,00,000 @10% [being the lower of average Indian tax rate (16.154%) and foreign tax rate (10%)]</td>
<td>30,000</td>
<td>30,000</td>
</tr>
<tr>
<td><strong>Average rate of tax in country Y</strong></td>
<td>25%</td>
<td></td>
</tr>
<tr>
<td><strong>Doubly taxed income pertaining to country Y</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income from house property</td>
<td>1,61,000</td>
<td></td>
</tr>
<tr>
<td>Dividend</td>
<td>1,50,000</td>
<td></td>
</tr>
<tr>
<td><strong>Less: Business loss set-off</strong></td>
<td>3,11,000</td>
<td>65,000</td>
</tr>
<tr>
<td>Deduction under section 91 on Rs. 2,46,000 @16.154% (being the lower of average Indian tax rate (16.154%) and foreign tax rate (25%)]</td>
<td>2,46,000</td>
<td>39,739</td>
</tr>
<tr>
<td><strong>Total rebate under section 91 (Country X + Country Y)</strong></td>
<td>69,739</td>
<td></td>
</tr>
</tbody>
</table>

**Note:** Mr. Kamesh shall be allowed deduction under section 91, since the following conditions are fulfilled:

(a) He is a resident in India during the relevant previous year (i.e., P.Y.2018-19).
(b) The income in question accrues or arises to him outside India in foreign countries X and Y during that previous year and such income is not deemed to accrue or arise in India during the previous year.
(c) The income in question has been subjected to income-tax in the foreign countries X and Y in his hands and it is presumed that he has paid tax on such income in those countries.
(d) There is no agreement under section 90 for the relief or avoidance of double taxation between India and Countries X and Y where the income has accrued or arisen.
EXTRA QUESTIONS FOR PRACTICE

ILLUSTRATION 1
Examine the correctness or otherwise of the following statement with reference to the provisions of Income-tax Act, 1961.
The double taxation avoidance treaties entered into by the Government of India override the domestic law.

SOLUTION
The statement is correct.
Section 90(2) provides that where a double taxation avoidance treaty is entered into by the Government, the provisions of the Income-tax Act, 1961 would apply to the extent they are more beneficial to the assessee.
In case of any conflict between the provisions of the double taxation avoidance agreement and the Income-tax Act, 1961, the provisions of the DTAA would prevail over the Act in view of the provisions of section 90(2), to the extent they are more beneficial to the assessee [CIT v. P.V.A.L. Kulandagan Chettiari (2004) 267 ITR 654 (SC)].

ILLUSTRATION 2
Nandita, an individual resident retired employee of the Prasar Bharati aged 60 years, is a well-known dramatist deriving income of Rs. 1,10,000 from theatrical works played abroad. Tax of Rs. 11,000 was deducted in the country where the plays were performed. India does not have any Double Tax Avoidance Agreement under section 90 of the Income-tax Act, 1961, with that country. Her income in India amounted to Rs. 5,10,000. In view of tax planning, she has deposited Rs. 1,50,000 in Public Provident Fund and paid contribution to approved Pension Fund of LIC Rs. 32,000. She also contributed Rs. 28,000 to Central Government Health Scheme during the previous year and gave payment of medical insurance premium of Rs. 26,000 to insure the health of her father, a non-resident aged 84 years, who is not dependent on her. Compute the tax liability of Nandita for the Assessment year 2019-20.

SOLUTION
Computation of tax liability of Nandita for the A.Y. 2019-20

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Indian Income</td>
<td>5,10,000</td>
</tr>
<tr>
<td>Foreign Income</td>
<td>1,10,000</td>
</tr>
<tr>
<td><strong>Gross Total Income</strong></td>
<td><strong>6,20,000</strong></td>
</tr>
<tr>
<td>Less: Deduction under section 80C</td>
<td></td>
</tr>
<tr>
<td>Deposit in PPF</td>
<td>1,50,000</td>
</tr>
<tr>
<td>Under section 80CCC</td>
<td></td>
</tr>
<tr>
<td>Contribution to approved Pension Fund of LIC</td>
<td>32,000</td>
</tr>
<tr>
<td></td>
<td>1,82,000</td>
</tr>
<tr>
<td>Under section 80CCE</td>
<td></td>
</tr>
<tr>
<td>The aggregate deduction under section 80C, 80CCC and 80CCD(1) has to be restricted to Rs. 1,50,000</td>
<td>1,50,000</td>
</tr>
<tr>
<td>Under section 80D</td>
<td></td>
</tr>
<tr>
<td>Contribution to Central Government Health Scheme</td>
<td>28,000</td>
</tr>
</tbody>
</table>
28,000 is also allowable as deduction under section 80D. Since she is a resident senior citizen, the deduction is allowable to a maximum of Rs. 50,000 (See Note 1)

Medical insurance premium of Rs. 26,000 paid for father aged 84 years. Since the father is a non-resident in India, he will not be entitled for the higher deduction of Rs. 50,000 eligible for a senior citizen, who is resident in India. Hence, the deduction will be restricted to maximum of Rs. 25,000.

<table>
<thead>
<tr>
<th>Total Income</th>
<th>4,17,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax on Total Income</td>
<td></td>
</tr>
<tr>
<td>Income-tax (See Note below)</td>
<td>5,850</td>
</tr>
<tr>
<td>Add: Health and Education Cess @4%</td>
<td>234</td>
</tr>
<tr>
<td>Average rate of tax in India</td>
<td></td>
</tr>
<tr>
<td>(i.e. Rs.6,084/Rs.4,17,000 × 100)</td>
<td>1.459%</td>
</tr>
<tr>
<td>Average rate of tax in foreign country</td>
<td></td>
</tr>
<tr>
<td>(i.e. Rs.11,000/Rs.1,10,000 × 100)</td>
<td>10%</td>
</tr>
<tr>
<td>Deduction under section 91 on Rs. 1,10,000 @ 1.459% (lower of average Indian-tax rate or average foreign tax rate)</td>
<td>1,605</td>
</tr>
<tr>
<td>Tax payable in India (Rs. 6,084 – Rs. 1,605)</td>
<td>4,479</td>
</tr>
</tbody>
</table>

Notes:
1. Section 80D allows a higher deduction of up to Rs. 50,000 in respect of the medical premium paid to insure the health of a senior citizen. Therefore, Nandita will be allowed deduction of Rs. 28,000 under section 80D, since she is a resident Indian of the age of 60 years.
2. The basic exemption limit for senior citizens is Rs. 3,00,000 and the age criterion for qualifying as a “senior citizen” for availing the higher basic exemption limit is 60 years. Accordingly, Nandita is eligible for the higher basic exemption limit of Rs. 3,00,000, since she is 60 years old.
3. An assessee shall be allowed deduction under section 91 provided all the following conditions are fulfilled:
   (a) The assessee is a resident in India during the relevant previous year.
   (b) The income accrues or arises to him outside India during that previous year.
   (c) Such income is not deemed to accrue or arise in India during the previous year.
   (d) The income in question has been subjected to income-tax in the foreign country in the hands of the assessee and the assessee has paid tax on such income in the foreign country.
   (e) There is no agreement under section 90 for the relief or avoidance of double taxation between India and the other country where the income has accrued or arisen.

In this case, since all the above conditions are satisfied, Nandita is eligible for deduction under section 91.
CHAPTER 26 - TRANSFER PRICING

EXERCISE

Question 1
Examine the consequences that would follow if the Assessing Officer makes adjustment to arm’s length price in international transactions of the assessee resulting in increase in taxable income. What are the remedies available to the assessee to dispute such adjustment?

Answer
In case the Assessing Officer makes adjustment to arm’s length price in an international transaction which results in increase in taxable income of the assessee, the following consequences shall follow:

1. No deduction under section 10AA or Chapter VI-A shall be allowed from the income so increased.
2. No corresponding adjustment would be made to the total income of the other associated enterprise (in respect of payment made by the assessee from which tax has been deducted or is deductible at source) on account of increase in the total income of the assessee on the basis of the arm’s length price so recomputed.

The remedies available to the assessee to dispute such an adjustment are:

1. In case the assessee is an eligible assessee under section 144C, he can file his objections to the variation made in the income within 30 days [of the receipt of draft order by him] to the Dispute Resolution Panel and Assessing Officer. Appeal against the order of the Assessing Officer in pursuance of the directions of the Dispute Resolution Panel can be made to the Income-tax Appellate Tribunal.
2. In any other case, he can file an appeal under section 246A to the Commissioner (Appeals) against the order of the Assessing Officer within 30 days of the date of service of notice of demand.
3. The assessee can opt to file an application for revision of order of the Assessing Officer under section 264 within one year from the date on which the order sought to be revised is communicated, provided the time limit for appeal to the Commissioner (Appeals) or the Income-tax Appellate Tribunal has expired or the assessee has waived the right of such an appeal. The eligibility conditions stipulated in section 264 should be fulfilled.

Question 2
I. Limited, an Indian Company supplied billets to its holding company, U. Limited, UK during the previous year 2018-19. I. Limited also supplied the same product to another UK based company, V. Limited, an unrelated entity. The transactions with U. Limited are priced at Euro 500 per MT (FOB), whereas the transactions with V. Limited are priced at Euro 700 per MT (CIF). Insurance and Freight amounts to Euro 200 per MT. Compute the arm’s length price for the transaction with U. Limited.

Answer
In this case, I. Limited, the Indian company, supplied billets to its foreign holding company, U. Limited. Since the foreign company, U. Limited, is the holding company of I. Limited, I. Limited and
Transfer Pricing
CA AARISH KHAN
AJ Education NeXt

U. Limited are the associated enterprises within the meaning of section 92A. As I. Limited supplies similar product to an unrelated entity, V. Limited, UK, the transactions between I. Limited and V. Limited can be considered as comparable uncontrolled transactions for the purpose of determining the arm’s length price of the transactions between I. Limited and U. Limited. Comparable Uncontrolled Price (CUP) method of determination of arm’s length price (ALP) would be applicable in this case. Transactions with U. Limited are on FOB basis, whereas transactions with V. Limited are on CIF basis. This difference has to be adjusted before comparing the prices.

<table>
<thead>
<tr>
<th>Price per MT of billets to V. Limited</th>
<th>Amount (in Euro)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less: Cost of insurance and freight per M.T.</td>
<td>700</td>
</tr>
<tr>
<td>Adjusted Price per M.T.</td>
<td>200</td>
</tr>
</tbody>
</table>

Since the adjusted price for V. Limited, UK and the price fixed for U. Limited are the same, the arm’s length price is Euro 500 per MT. Since the sale price to related party (i.e., U. Limited) and unrelated party (i.e., V. Limited) is the same, the transaction with related party U. Limited has also been carried out at arm’s length price.

**Question 3**

*X Ltd., operating in India, is the dealer for the goods manufactured by Yen Ltd. of Japan. Yen Ltd. owns 55% shares of X Ltd. and out of 7 directors of the company, 4 were appointed by them. The Assessing Officer, after verification of transactions of Rs. 300 lacs of X Ltd. for the relevant year and by noticing that the company had failed to maintain the requisite records and had also not obtained the accountants report, adjusted its income by making an addition of Rs. 30,00,000 to the declared income and also issued a show cause notice to levy various penalties. X Ltd seeks your expert opinion.*

**Answer**

The facts of the case indicate that X Ltd. and Yen Ltd. of Japan are associated enterprises since Yen Ltd. holds 55% shares of X Ltd. and has appointed more than half of the board of directors of X Ltd. Since Yen Ltd. is a non-resident, any transaction between X Ltd. and Yen Ltd. would fall within the meaning of “international transaction” under section 92B. Therefore, the income arising from such transactions have to be computed having regard to the arm’s length price. The action of the Assessing Officer in making addition to the declared income and issuing show cause notice for levy of various penalties is correct since X Ltd. had committed defaults, as listed hereunder, in respect of which penalty, as briefed hereunder, is imposable:

(i) Failure to report any international transaction or any transaction, deemed to be an international transaction or any specified domestic transaction, to which the provisions of Chapter X applies, would attract penalty @ 200% of the amount of tax payable since it is a case of misreporting of income referred under section 270A(9) read with section 270A(8).

(ii) Failure to maintain the requisite records as required under section 92D in relation to international transaction makes it liable for penalty under section 271AA which will be 2% of the value of each international transaction.

(iii) Failure to furnish report from an accountant as required under section 92E makes it liable for penalty under section 271BA i.e., a fixed penalty of Rs. 1 Lac.

26.2
The Assessing Officer shall give an opportunity of hearing to the assessee with a notice as to why the arm’s length price should not be determined on the basis of material or information or document in the possession of the Assessing Officer.

**Note:** It is assumed that X Ltd. has not entered into an APA and has also not opted to be subject to Safe Harbour Rules.

**Question 4**

Anush Motors Ltd., an Indian company declared income of Rs. 300 crores computed in accordance with Chapter IV-D but before making any adjustments in respect of the following transactions for the year ended on 31.3.2019:

(i) 10,000 cars sold to Rida Ltd. which holds 30% shares in Anush Motors Ltd. at a price which is less by $ 200 each car than the price charged from Shingto Ltd.

(ii) Royalty of $ 1,20,00,000 was paid to Kyoto Ltd. for use of technical know-how in the manufacturing of car. However, Kyoto Ltd. had provided the same know-how to another Indian company for $ 90,00,000.

(iii) Loan of Euro 1000 crores carrying interest @ 10% p.a. advanced by Dorf Ltd., a German company, was outstanding on 31.3.2018. The total book value of assets of Anush Motors Ltd. on the date was Rs. 90,000 crores. The said German company had also advanced a loan of similar amount to another Indian company @ 9% p.a. Total interest paid for the year was EURO 100 crores.

**Explain in brief the provisions of the Act affecting all these transactions and compute the income of the company chargeable to tax for A.Y. 2019-20 keeping in mind that the value of 1$ and of 1 EURO was Rs. 63 and Rs. 84, respectively, throughout the year.**

**Answer**

Any income arising from an international transaction, where two or more “associated enterprises” enter into a mutual agreement or arrangement, shall be computed having regard to arm’s length price as per the provisions of Chapter X of the Act.

Section 92A defines an “associated enterprise” and sub-section (2) of this section speaks of the situations when the two enterprises shall be deemed to associated enterprises. Applying the provisions of section 92A(2)(a) to (m) to the given facts, it is clear that “Anush Motors Ltd.” is associated with :-

(i) Rida Ltd. as per section 92A(2)(a), because this company holds shares carrying more than 26% of the voting power in Anush Motors Ltd.;

(ii) Kyoto Ltd. as per section 92A(2)(g), since this company is the sole owner of the technology used by Anush Motors Ltd. in its manufacturing process;

(iii) Dorf Ltd. as per section 92A(2)(c), since this company has financed an amount which is more than 51% of the book value of total assets of Anush Motors Ltd.

The transactions entered into by Anush Motors Ltd. with different companies are, therefore, to be adjusted accordingly to work out the income chargeable to tax for the A.Y. 2019-20.

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs. (in crores)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income of Anush Motors Ltd. as computed under Chapter IV-D, prior to adjustments as per Chapter X</td>
<td>300.00</td>
</tr>
<tr>
<td>Add: Difference on account of adjustment in the value of international transactions:</td>
<td></td>
</tr>
<tr>
<td>(i) Difference in price of car @ $ 200 each for 10,000 cars ($ 200 ⋅ 10,000)</td>
<td>12.6</td>
</tr>
</tbody>
</table>
The difference for excess payment of royalty has been added back presuming that the manufacture of cars by Anush Motors Ltd is wholly dependent on the use of know-how owned by Kyoto Ltd.

**Note:** It is presumed that Anush Motors Ltd. has not entered into an Advance Pricing Agreement or opted to be subject to Safe Harbour Rules.

**Question 5**

*What is the legislative objective of bringing into existence the provisions relating to transfer pricing in relation to international transactions? Examine.*

**Answer**

The presence of multinational enterprises in India and their ability to allocate profits in different jurisdictions by controlling prices in intra-group transactions prompted the Government to set up an Expert Group to examine the issues relating to transfer pricing. There is a possibility that two or more entities belonging to the same multinational group can fix up their prices for goods and services and allocate profits among the enterprises within the group in such a way that there may be either no profit or negligible profit in the jurisdiction which taxes such profits and substantial profit in the jurisdiction which is tax haven or where the tax liability is minimum. This may adversely affect a country's share of due revenue. The increasing participation of multinational groups in economic activities in India has given rise to new and complex issues emerging from transactions entered into between two or more enterprises belonging to the same multinational group. The profits derived by such enterprises carrying on business in India can be controlled by the multinational group, by manipulating the prices charged and paid in such intra-group transactions, which may lead to erosion of tax revenue. Therefore, transfer pricing provisions have been brought in by the Finance Act, 2001 with a view to provide a statutory framework which can lead to computation of reasonable, fair and equitable profits and tax in India, in the case of such multinational enterprises.

**Question 6**

*R, an individual resident in India, bought 1,000 equity shares of Rs. 10 each of A Ltd. at Rs. 50 per share on 30.5.2018. He sold 700 equity shares at Rs. 35 per share on 30.9.2018 and the remaining 300 shares at Rs. 25 per share on 20.12.2018. A Ltd. declared a dividend of 50%, the record date being 10.8.2018. R sold on 1.2.2019, a house from which he derived a long-term capital gain of Rs. 75,000. Compute the amount of capital gain arising to R for the assessment year 2019-20.*

**Answer**

The amount of capital gains arising to R has to be computed applying the provisions of sub-section (7) of section 94, which provides that “where:
(a) any person buys or acquires any securities or unit within a period of three months prior to the record date; and
(b) such person sells or transfers -
   (i) such securities within a period of three months after such date; or
   (ii) such unit within a period of nine months after such date; and
(c) the dividend or income on such securities or unit received or receivable by such person is exempted,
then the loss, if any, arising to him on account of such purchase and sale of securities or unit, to the extent such loss does not exceed the amount of dividend or income received or receivable on such securities or unit, shall be ignored for the purpose of computing his income chargeable to tax”.
For this purpose, “record date” means such date as may be fixed by a company for the purpose of entitlement of the holder of the securities to receive dividend; “securities” includes stocks and shares.

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Long-term capital gain on sale of building</td>
<td></td>
<td>75,000</td>
</tr>
<tr>
<td>Less: Short-term capital loss on sale of shares</td>
<td></td>
<td></td>
</tr>
<tr>
<td>700 shares</td>
<td>7,000</td>
<td></td>
</tr>
<tr>
<td>300 shares</td>
<td>7,500</td>
<td>14,500</td>
</tr>
<tr>
<td>Taxable long-term capital gains</td>
<td></td>
<td>60,500</td>
</tr>
</tbody>
</table>

Computation of capital gain on sale of shares of A Ltd. by Mr. R

| Date of purchase of shares | 30.5.2018 |
| Record date                | 10.8.2018 |
| Date of sale of shares     | 30.9.2018 20.12.2018 |
| Number of shares sold      | 700 300 |
| Sale price per share       | Rs. 35 Rs. 25 |

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sale consideration</td>
<td>24,500</td>
<td>7,500</td>
</tr>
<tr>
<td>Less: Cost of acquisition</td>
<td>35,000</td>
<td>15,000</td>
</tr>
<tr>
<td>[See Note below]</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Less: Dividend income as per section 94(7)[700×Rs. 10×50%]</td>
<td>3,500</td>
<td></td>
</tr>
<tr>
<td>Short-term capital loss on sale of shares</td>
<td>7,000</td>
<td>7,500</td>
</tr>
</tbody>
</table>

Note:
(1) 700 shares are sold within 3 months after the record date. Hence, as per section 94(7), the related dividend income should be deducted from the loss.
(2) 300 shares having been sold after 3 months of record date, section 94(7) is not attracted. Therefore, the dividend income of Rs. 1,500 [300×Rs. 10×50%] should not be deducted. Such dividend is exempt under section 10(34).
(3) Short-term capital loss can be set-off against long-term capital gains as per the provisions of section 74(1)(a). Therefore, short-term capital loss on sale of shares can be set-off against long-term capital gains on sale of building.
Question 7
XE Ltd. is an Indian Company in which Zilla Inc., a US company, has 28% shareholding and voting power. Following transactions were effected between these two companies during the financial year 2018-19.
(i) XE Ltd. sold 1,00,000 pieces of T-shirts at $ 2 per T-Shirt to Zilla Inc. The identical T-Shirts were sold to unrelated party namely Kennedy Inc., at $ 3 per T-Shirt.
(ii) XE Ltd. borrowed $ 2,00,000 from a foreign lender based on the guarantee of Zilla Inc. For this, XE Ltd. paid $ 10,000 as guarantee fee to Zilla Inc. To an unrelated party for the same amount of loan, Zilla Inc. collected $ 7000 as guarantee fee.
(iii) XE Ltd. paid $15,000 to Zilla Inc. for getting various potential customers details to improve its business. Zilla Inc. provided the same service to unrelated parties for $ 10,000.

Assume the rate of exchange as 1 $ = Rs. 64
XE Ltd. is located in a Special Economic (SEZ) and its income before transfer pricing adjustments for the year ended 31st March, 2018 was Rs. 1,200 lakhs.
Compute the adjustments to be made to the total income of XE Ltd. State whether it can claim deduction under section 10AA for the income enhanced by applying transfer pricing provisions.

Answer
XE Ltd, the Indian company and Zilla Inc., the US company are deemed to be associated enterprises as per section 92A(2)(a), since Zilla Inc. holds shares carrying not less than 26% of the voting power in XE Ltd.
As per Explanation to section 92B, the transactions entered into between these two companies for sale of product, lending or guarantee and provision of services relating to market research are included within the meaning of “international transaction”.
Accordingly, transfer pricing provisions would be attracted and the income arising from such international transactions have to be computed having regard to the arm’s length price. In this case, from the information given, the arm’s length price has to be determined taking the comparable uncontrolled price method to be the most appropriate method.

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs. in lakhs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amount by which total income of XE Ltd. is enhanced on account of adjustment in the value of international transactions:</td>
<td></td>
</tr>
<tr>
<td>(i) Difference in price of T-Shirt @ $ 1 each for 1,00,000 pieces sold to Zilla Inc. ($ 1 x 1,00,000 ⋅ Rs. 64)</td>
<td>64.00</td>
</tr>
<tr>
<td>(ii) Difference for excess payment of guarantee fee to Zilla Inc. for loan borrowed from foreign lender ($ 3,000 ⋅ Rs. 64)</td>
<td>1.92</td>
</tr>
<tr>
<td>(iii) Difference for excess payment for services to Zilla Inc. ($ 5,000 x Rs. 64)</td>
<td>3.20</td>
</tr>
<tr>
<td></td>
<td><strong>69.12</strong></td>
</tr>
</tbody>
</table>

XE Ltd. cannot claim deduction under section 10AA in respect of Rs. 69.12 lakhs, being the amount of income by which the total income is enhanced by virtue of the first proviso to section 92C(4)
Question 8
Examine the correctness or otherwise of the following with reference to the provisions of the Income-tax Act, 1961

(i) Transfer pricing rules shall have no implication where income is computed on the basis of book profits.

(ii) Assessing Officer can complete the assessment of income from international transaction in disregard of the order passed by the Transfer Pricing Officer by accepting the contention of assessee.

Answer

(i) The statement is correct.

For the purpose of computing book profit for levy of minimum alternate tax, the net profit shown in the profit and loss account prepared in accordance with the Companies Act can be increased/decreased only by the additions and deductions specified in Explanation 1 to section 115JB.

No other adjustments can be made to arrive at the book profit for levy of MAT, except where:

(a) it is discovered that the profit and loss account is not drawn up in accordance with the relevant Schedule of the Companies Act;
(b) incorrect accounting policies and/or accounting standards have been adopted for preparing such accounts; and
(c) the method and rate of depreciation adopted is not correct.

Therefore, transfer pricing adjustments cannot be made while computing book profit for levy of MAT.

(ii) The statement is not correct.

Section 92CA(4) provides that on receipt of the order of the Transfer Pricing Officer determining the arm’s length price of an international transaction, the Assessing Officer shall proceed to compute the total income in conformity with the arm’s length price determined by the Transfer Pricing Officer.

The order of the Transfer Pricing Officer is binding on the Assessing Officer. Therefore, the Assessing Officer cannot complete the assessment of income from international transactions in disregard of the order of Transfer Pricing Officer by accepting the contention raised by the assessee.
EXTRA QUESTIONS FOR PRACTICE

Illustration 1
Examine the following transactions and discuss whether the transfer price declared by the following assessees, who have exercised a valid option for application of safe harbour rules, can be accepted by the Income-tax Authorities –

<table>
<thead>
<tr>
<th>Assessee</th>
<th>International transaction</th>
<th>Aggregate value of transactions entered into in the P.Y.2018-19</th>
<th>Declared Operating Profit Margin</th>
<th>Operating Expense</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) A Ltd., an Indian company</td>
<td>Provision of system support services to X Inc., which is a “specified foreign company” in relation to A Ltd.</td>
<td>Rs. 95 crore</td>
<td>Rs. 12 crore</td>
<td>Rs. 75 crore</td>
</tr>
<tr>
<td>(2) B Ltd., an Indian company</td>
<td>Provision of data processing services with the use of information technology to Y Inc., its foreign subsidiary.</td>
<td>Rs. 180 crore</td>
<td>Rs. 30 crore</td>
<td>Rs. 150 crore</td>
</tr>
<tr>
<td>(3) C &amp; Co., a partnership firm registered under the Partnership Act, 1932</td>
<td>Provision of contract R &amp; D services relating to development of internet technology, to XYZ &amp; Co., a foreign firm, which holds 12% interest in C &amp; Co.</td>
<td>Rs. 175 crore</td>
<td>Rs. 30 crore</td>
<td>Rs. 150 crore</td>
</tr>
<tr>
<td>(4) D Ltd., an Indian company</td>
<td>Provision of contract R &amp; D services relating to generic pharmaceutical drug, to ABC Inc., a foreign company which guarantees 15% of the total borrowings of D Ltd.</td>
<td>Rs. 50 crore</td>
<td>Rs. 9 crore</td>
<td>Rs. 30 crore</td>
</tr>
<tr>
<td>(5) Sole proprietary concern of Mr. E, solely engaged in the original manufacture and export of automobile transmission and steering parts.</td>
<td>100% export of automobile transmission and steering parts to LMN LLP, a foreign LLP, controlled by Mr. E jointly with his relatives.</td>
<td>Rs. 12 crore</td>
<td>Rs. 1 crore</td>
<td>Rs. 10 crore</td>
</tr>
<tr>
<td>(6) F Ltd., an Indian company, solely engaged in the original manufacture and</td>
<td>100% export of non-core auto components to GKG Inc., a foreign company. F Ltd. appoints two-thirds of the Board of Directors of GKG Inc.</td>
<td>Rs. 12 crore</td>
<td>Rs. 1 crore</td>
<td>Rs. 10 crore</td>
</tr>
</tbody>
</table>
In all the above cases, it may be assumed that the Indian entity which provides the services assumes insignificant risk. It may also be assumed that the foreign entities referred to above are non-resident in India.

Would your answer change, if in any of the cases mentioned above, the foreign entity is located in a notified jurisdictional area?

Solution

Section 92CB(1) provides that the determination of arm’s length price under section 92C or section 92CA shall be subject to safe harbour rules. Safe harbour means circumstances in which the income tax authorities shall accept the transfer price declared by the assessee. Section 92CB(2) empowers the CBDT to prescribe such safe harbour rules or circumstances under which the transfer price declared by the assessee shall be accepted by the Income-tax Authorities.

Accordingly, in exercise of the powers conferred by section 92CB read with section 295 of the Income-tax Act, 1961, the CBDT has, vide Notification No.46/2017 dated 7.6.2017, prescribed safe harbour rules. Rule 10TD provides that where an eligible assessee has entered into an eligible international transaction and the option exercised by the said assessee is not held to be invalid under Rule 10TE, the transfer price declared by the assessee in respect of such transaction shall be accepted by the income-tax authorities, if it is in accordance with the circumstances set out thereunder.

An eligible assessee is a person who has exercised a valid option for application of safe harbour rules and is engaged in, inter alia, providing the following services, with insignificant risk, to a non-resident associated enterprise –

(i) software development services; or
(ii) information technology enabled services; or
(iii) contract R & D services wholly or partly relating to software development; or
(iv) contract R & D services wholly or partly relating to generic pharmaceutical drugs; or
(v) manufacture and export of core auto components; or
(vi) manufacture and export of non-core auto components

A person who is engaged in the manufacture and export of core or non-core auto components and where 90% or more of total turnover during the relevant previous year is in the nature of original equipment manufacturer sales also falls within the definition of eligible assessee if he has exercised a valid option for application of safe harbour rules.

(1) X Inc. is a specified foreign company in relation to A Ltd. Therefore, the condition of A Ltd. holding shares carrying not less than 26% of the voting power in X Inc is satisfied. Hence, X Inc. and A Ltd. are deemed to be associated enterprises. Therefore, provision of systems support services by A Ltd., an Indian company, to X Inc., a foreign company, is an international transaction between associated enterprises, and consequently, the provisions of transfer pricing are attracted in this case.

Systems support services falls within the definition of “software development services”, and hence, is an eligible international transaction. Since A Ltd. is providing software development services to a non-resident associated enterprise and has exercised a valid option for safe harbour rules, it is an eligible assessee.
Since the value of international transactions entered does not exceed Rs. 100 crore, A Ltd. should have declared an operating profit margin of not less than 17% in relation to operating expense, to be covered within the safe harbour rules. However, since A Ltd. has declared an operating profit margin of only 16% \(\left(\frac{12}{75} \cdot 100\right)\), the same is not in accordance with the circumstance mentioned in Rule 10TD. Hence, it is not binding on the income-tax authorities to accept the transfer price declared by A Ltd.

(2) Y Inc., a foreign company, is a subsidiary of B Ltd., an Indian company. Hence, Y Inc. and B Ltd. are associated enterprises. Therefore, provision of data processing services by B Ltd., an Indian company, to Y Inc., a foreign company, is an international transaction between associated enterprises, and consequently, the provisions of transfer pricing are attracted in this case.

Data processing services with the use of information technology falls within the definition of “information technology enabled services”, and hence, an eligible international transaction. Since B Ltd. is providing data processing services to a non-resident associated enterprise and has exercised a valid option for safe harbour rules, it is an eligible assessee.

Since the aggregate value of transactions entered into in the P.Y.2017-18 exceeds Rs. 100 crore but does not exceed Rs. 200 crore, B Ltd. should have declared an operating profit margin of not less than 18% in relation to operating expense, to be covered within the scope of safe harbour rules. In this case, since B Ltd. has declared an operating profit margin of 20% \(\left(\frac{30}{150} \cdot 100\right)\), the same is in accordance with the circumstance mentioned in Rule 10TD. Hence, the income-tax authorities shall accept the transfer price declared by B Ltd in respect of such international transaction.

(3) XYZ & Co., a foreign firm holds 12% interest in C & Co., an Indian firm. Therefore, the condition of one enterprise, being a foreign firm, holding not less than 10% interest in another enterprise, being an Indian firm, is satisfied. Hence, XYZ & Co. and C & Co. are deemed to be associated enterprises. Therefore, provision of contract R & D services relating to software development by C & Co., an Indian firm, to XYZ & Co., a foreign firm, is an international transaction between associated enterprises, and consequently, the provisions of transfer pricing are attracted in this case.

Development of internet technology falls within the meaning of “contract R&D services wholly or partly relating to software development”, and hence, is an eligible international transaction. Since C & Co., an Indian firm, is providing contract R & D services to a non-resident associated enterprise and has exercised a valid option for safe harbour rules, it is an eligible assessee.

Since the value of the international transaction does not exceed Rs. 200 crore, C & Co. should have declared an operating profit margin of not less than 24% in relation to operating expense, to be covered within the safe harbour rules. However, since C & Co. has declared an operating profit margin of only 20% \(\left(\frac{30}{150} \cdot 100\right)\), the same is not in accordance with the circumstance mentioned in Rule 10TD. Hence, it is not binding on the income-tax authorities to accept the transfer price declared by C & Co.
(4) ABC Inc., a foreign company, guarantees 15% of the total borrowings of D Ltd., an Indian company. Since ABC Inc. guarantees not less than 10% of the total borrowings of D Ltd., ABC Inc. and D Ltd. are deemed to be associated enterprises. Therefore, provision of contract R & D services relating to generic pharmaceutical drug by D Ltd., an Indian company, to ABC Inc., a foreign company, is an international transaction between associated enterprises, and consequently, the provisions of transfer pricing are attracted in this case.

Provision of contract R & D services in relation to generic pharmaceutical drug is an eligible international transaction. Since D Ltd. is providing such services to a non-resident associated enterprise and has exercised a valid option for safe harbour rules, it is an eligible assessee.

Since the value of the international transaction does not exceed Rs. 200 crore, D Ltd. should have declared an operating profit margin of not less than 24% in relation to operating expense, to be covered within the scope of safe harbour rules. In this case, since D Ltd. has declared an operating profit margin of 30% \( \left( \frac{9}{30} \cdot 100 \right) \), the same is in accordance with the circumstance mentioned in Rule 10TD. Hence, the income-tax authorities shall accept the transfer price declared by D Ltd in respect of such international transaction.

(5) LMN LLP, a foreign LLP, is controlled by Mr. E jointly with his relatives. Mr. E also has control over his own sole proprietorship concern. Therefore, the sole proprietorship concern of Mr. E in India and LMN LLP are deemed to be associated enterprises.

Automobile transmission and steering parts fall within the meaning of “core auto components”, and hence, 100% export of all such parts originally manufactured by the sole proprietorship concern of Mr. E is an eligible international transaction. Since the sole proprietorship concern of Mr. E is solely engaged in the original manufacture and 100% export of such parts and has exercised a valid option for safe harbour rules, it is an eligible assessee.

The sole-proprietorship concern of Mr. E should have declared an operating profit margin of not less than 12% in relation to operating expense, to be covered within the safe harbour rules. However, since A Ltd. has declared an operating profit margin of only 10% \( \left( \frac{1}{10} \cdot 100 \right) \), the same is not in accordance with the circumstance mentioned in Rule 10TD. Hence, it is not binding on the income-tax authorities to accept the transfer price declared by Mr. E.

(6) F Ltd. and GKG Inc. are deemed to be associated enterprises since F Ltd. appoints more than half of the Board of Directors of GKG Inc. Manufacture and export of non-core auto components is an eligible international transaction. Since F Ltd. is engaged in original manufacture of non-core auto components and 100% export of the same, it is an eligible assessee.

F Ltd. should have declared an operating profit margin of not less than 8.5% in relation to operating expense, to be covered within the scope of safe harbour rules. In this case, since F Ltd. has declared an operating profit margin of 10% \( \left( \frac{1}{10} \cdot 100 \right) \), the same is in accordance with the circumstance mentioned in Rule 10TD. Hence,
the income-tax authorities shall accept the transfer price declared by F Ltd in respect of such international transaction. The safe harbour rules shall not apply in respect of eligible international transactions entered into with an associated enterprise located in a notified jurisdictional area. Therefore, if in any of the cases mentioned above, the foreign entity is located in a NJA, the safe harbour rules shall not be applicable, irrespective of the operating profit margin declared by the assessee.

Illustration 2
A Ltd., an Indian company, provides technical services to a company, XYZ Inc., located in a NJA for a consideration of Rs. 40 lakhs in October, 2018. It charges Rs. 42 lakhs for similar services rendered to PQR Inc., which is not located in a NJA. PQR Inc. is not an associated enterprise of A Ltd.

Discuss the tax implications under section 94A read with section 92C in respect of the above transaction of provision of technical services by A Ltd. to XYZ Inc.

Solution
Since XYZ Inc. is located in a NJA, the transaction of provision of technical services by the Indian company, A Ltd., would be deemed to be an international transaction and XYZ Inc. and A Ltd. would be deemed to be associated enterprises. Therefore, the provisions of transfer pricing would be attracted in this case.

The price of Rs. 42 lakhs charged for similar services from PQR Inc, being an independent entity located in a non-NJA country, can be taken into consideration for determining the arm’s length price (ALP) under Comparable Uncontrolled Price (CUP) Method.

Since the ALP is more than the transfer price, the ALP of Rs. 42 lakhs would be considered as the income arising from the international transaction between A Ltd. and XYZ Inc.

Illustration 3
Mr. X, a non-resident individual, is due to receive interest of Rs. 5 lakhs during March 2019 from a notified infrastructure debt fund eligible for exemption under section 10(47). He incurred expenditure amounting to Rs. 10,000 for earning such income. Assuming that Mr. X is a resident of a NJA, discuss the tax implications under section 94A, read with sections 115A and 194LB.

Solution
The interest income received by Mr. X, a non-resident, from a notified infrastructure debt fund would be subject to a concessional tax rate of 5% under section 115A on the gross amount of such interest income. Therefore, the tax liability of Mr. X in respect of such income would be Rs. 25,750 (being 5% of Rs. 5 lakhs plus education cess@2% and SHEC@1%).

Under section 194LB, tax is deductible @5% on interest paid by such fund to a non-resident. However, since X is a resident of a NJA, tax would be deductible@30% as per section 94A, and not @ 5% specified under section 194LB. This is on account of the provisions of section 94A(5), which provides that “Notwithstanding anything contained in any other provision of this Act, where a person located in a NJA is entitled to receive any sum or income or amount on which tax is deductible under Chapter XVII-B, the tax shall be deducted at the highest of the following rates, namely –
(a) at the rate or rates in force;
(b) at the rate specified in the relevant provision of the Act;
(c) at the rate of thirty per cent."
Mr. X can, however, claim refund of excess tax deducted along with interest.
CHAPTER 27 - ADVANCE RULING

EXERCISE

Question 1
Examine whether a person resident in India can seek advance ruling from the Authority for Advance Ruling.

Answer
A resident can make an application to the Authority for Advance Ruling to seek an advance ruling in the following cases:

(i) Section 245N(b)(A)(III) enables a resident referred in section 245N(a)(iia) falling within any such class or category of persons as may be notified by the Central Government to make an application to Authority for Advance Rulings. Such notified resident applicant can seek ruling in relation to his tax liability arising out of a transaction which has been undertaken or is proposed to be undertaken by such applicant, and such determination shall include the determination of any question of law or of fact specified in the application.

A resident in relation to his tax liability arising out of one or more transactions valuing Rs. 100 crore or more in total which has been undertaken or proposed to be undertaken would be an applicant for this purpose.

(ii) Section 245N(b)(A)(IV) enables a resident falling within any such class or category of persons as may be notified by the Central Government to make an application for Advance Ruling. Such notified resident applicant can seek ruling in respect of issues relating to computation of total income which is pending before any income-tax authority or the Appellate Tribunal. Such a resident applicant can make an application to seek determination or decision by the AAR on a question of law or a question of fact relating to such computation of total income specified in the application.

“Public sector companies” as defined in section 2(36A) of the Income-tax Act, 1961 have been notified as applicant for this purpose.

(iii) A resident can also make an application seeking advance ruling in relation to the tax liability of a non-resident arising out of a transaction undertaken or proposed to be undertaken by him with such non-resident.

Question 2
Q, a non-resident, made an application to the Authority for Advance Rulings on 2.7.2018 in relation to a transaction proposed to be undertaken by him. On 31.8.2018, he decides to withdraw the said application. Can he withdraw the application on 31.8.2018?

Answer
Section 245Q(3) of the Income-tax Act, 1961 provides that an applicant, who has sought for an advance ruling, may withdraw the application within 30 days from the date of the application. Since more than 30 days have elapsed since the date of application by Q to the Authority for Advance Rulings, he cannot withdraw the application.

However, the Authority for Advance Rulings (AAR), in M.K.Jain AAR No.644 of 2004, has observed that though section 245Q(3) provides that an application may be withdrawn by the applicant within 30 days from the date of the application, this, however, does not
preclude the AAR from permitting withdrawal of the application after the said period with the permission of the AAR, if the circumstances of the case so justify.

**Question 3**

Examine when can an advance ruling pronounced by the Authority for Advance Rulings be declared void. What is the consequence?

**Answer**

As per section 245T, an advance ruling can be declared to be void ab initio by the Authority for Advance Rulings if, on a representation made to it by the Principal Commissioner or Commissioner or otherwise, it finds that the ruling has been obtained by fraud or misrepresentation of facts. Thereafter, all the provisions of the Act will apply as if no such advance ruling has been made. A copy of such order shall be sent to the applicant and the Principal Commissioner or Commissioner.

**Question 4**

Mr. Balram is a non-resident. The appeal pertaining to the assessment year 2014-15 is pending before the Income-tax Appellate Tribunal, the issue involved being computation of export profit and tax thereon. The same issue persists for the assessment year 2015-16 as well. Mr. Balram’s brother Mr. Krishna has obtained an advance ruling under Chapter XIX - B of Income-tax Act, 1961 from the Authority for Advance Ruling on an identical issue. Mr. Balram proposes to use the said ruling for his assessment pertaining to the assessment year 2015-16. Can he do so?

**Answer**

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

In view of the above provision, Mr. Balram cannot use the advance ruling, obtained on an identical issue by his brother, for his assessment pertaining to the assessment year 2015-16. **Note** – Though the ruling of the Authority for Advance Rulings is not binding on others but there is no bar on the Tribunal taking a view or forming an opinion in consonance with the reasoning of the Authority for Advance Rulings de hors the binding nature [CIT v. P. Sekar Trust (2010) 321 ITR 305 (Mad.).]

**Question 5**

The Authority for Advance Rulings has the powers of compelling the production of books of account – Examine the correctness or otherwise of this statement.

**Answer**

The statement is correct.

Under section 245U, the Authority for Advance Rulings shall have all the powers vested in the Civil Court under the Code of Civil Procedure, 1908 as are referred to in section 131.
Accordingly, the Authority for Advance Rulings shall have the same powers as are vested in a court under the Code of Civil Procedure, 1908, when trying a suit in respect of the following matters, namely:

1. discovery and inspection;
2. enforcing the attendance of any person, including any officer of a banking company and examining him on oath;
3. compelling the production of books of account and other documents; and
4. issuing commissions.

Therefore, the Authority for Advance Ruling has the powers of compelling the production of books of account.

**Question 6**
The term 'Advance Ruling' includes within its scope, a determination by the Authority for Advance Rulings only in relation to a transaction undertaken by a non-resident application. Examine the correctness of this statement, with reference to the provisions of the Income-tax Act 1961.

**Answer**
The statement is not correct.

The term ‘Advance Ruling’ has been defined in section 245N(a) to mean:

(a) a determination by the Authority in relation to a transaction which has been undertaken or is proposed to be undertaken by a non-resident applicant; or

(b) a determination by the Authority in relation to the tax liability of a non-resident arising out of a transaction which has been undertaken or is proposed to be undertaken by a resident applicant with such non-resident; or

(c) a determination by the Authority in relation to the tax liability of a resident applicant, arising out of a transaction which has been undertaken or is proposed to be undertaken by such applicant, and such determination shall include the determination of any question of law or of fact specified in the application.

A resident in relation to his tax liability arising out of one or more transactions valuing Rs. 100 crore or more in total which has been undertaken or proposed to be undertaken would be an applicant for this purpose.

(d) a determination or decision by the Authority in respect of an issue relating to computation of total income which is pending before any income-tax authority or the Appellate Tribunal and such determination or decision shall include the determination or decision on any question of law or of fact relating to such computation of total income specified in the application.

**Question 7**
An Irish company, Phi plc., entered into a contract with an Indian company, Beta Ltd., for provision of technical know-how and made an application to the Authority for Advance Rulings for advance ruling on the rate of withholding tax on receipts from Beta Ltd. Beta Ltd. had also made an application to the Assessing Officer for determination of the rate at which tax is deductible on the said payment to Phi plc. The Authority for Advance Rulings rejected the application of Phi plc. on the ground that the question raised in the application is already pending before an income tax authority. Is the rejection of the application of Phi plc. justified in law?
Answer

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

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

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

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

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

<table>
<thead>
<tr>
<th>Prior to 1.6.2000</th>
<th>On or After 1.6.2000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Provided that the Authority shall not allow the application except in the case of a resident applicant where the question raised in the application is already pending in the applicant’s case before any income-tax authority, the Appellate Tribunal or any court;</td>
<td>Provided that the Authority shall not allow the application where the question raised in the application is already pending before any income-tax authority or Appellate Tribunal or any court.</td>
</tr>
</tbody>
</table>

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

Question 1
Explain the core reasons for difference between the e-commerce transactions and the traditional business transactions causing difficulty to tax the income of e-commerce transactions.

Answer
The core reasons for difference between e-commerce transactions and traditional business transactions causing difficulty to tax the income from e-commerce transactions under the Income-tax Act, are absence of national boundaries, no requirement of physical presence of goods and no requirement of physical delivery (in certain cases). Since e-commerce transactions are completed in cyberspace, it is often not clear as to the place where the transaction is effected, thereby causing difficulty in implementing source rule taxation.

Question 2
E-commerce transactions have replaced concepts generally associated with international transactions traditionally. Discuss briefly the issues involving such transactions.

Answer
The typical taxation issues relating to e-commerce are:
(Rs.) the difficulty in characterizing the nature of payment and establishing a nexus or link between taxable transaction, activity and a taxing jurisdiction,
(2) the difficulty of locating the transaction, activity and identifying the taxpayer for income tax purposes.

Question 3
ABC Ltd., an Indian company, is carrying on the business of manufacture and sale of teakwood furniture under the brand name “PUREWOOD”. In order to expand its overseas sales/exports, it launched a massive advertisement campaign of its products. For the purpose of online advertisement, it utilized the services of PQR Inc., a London based company. During the previous year 2018-19, ABC Ltd. paid Rs. 5 lakhs to PQR Inc. for such services. Discuss the tax implications/TDS implications of such payment and receipt in the hands of ABC Ltd. and PQR Inc., respectively, if –
(i) PQR Inc. has no permanent establishment in India
(ii) PQR Inc. has a permanent establishment in India

Answer
Chapter VIII of the Finance Act, 2018, "Equalisation Levy", provides for an equalisation levy of 6% of the amount of consideration for specified services received or receivable by a non-resident not having permanent establishment in India, from a resident in India who carries out business or profession, or from a non-resident having permanent establishment in India.
“Specified Service” means
(Rs.) online advertisement;
Equalisation Levy

(2) any provision for digital advertising space or any other facility or service for the purpose of online advertisement and
(3) any other service as may be notified by the Central Government.

However, equalisation levy shall not be levied-
- where the non-resident providing the specified services has a permanent establishment in India
- the aggregate amount of consideration for specified service received or receivable during the previous year does not exceed Rs. Rs. lakh.
- where the payment for specified service is not for the purposes of carrying out business or profession

(i) Where PQR Inc. has no permanent establishment in India

In the present case, equalisation levy @6% is chargeable on the amount of Rs. 5,00,000 received by PQR Inc., a non-resident not having a PE in India from ABC Ltd., an Indian company. Accordingly, ABC Ltd. is required to deduct equalisation levy of Rs. 30,000 i.e., @6% of Rs. 5 lakhs, being the amount paid towards online advertisement services provided by PQR Inc., a non-resident having no permanent establishment in India. Non-deduction of equalisation levy would attract disallowance under section 40(a)(ib) of Rs.00% of the amount paid while computing business income.

(ii) Where PQR Inc. has permanent establishment in India and the service is effectively connected to the permanent establishment in India

Equalisation levy would not be attracted where the non-resident service provider (PQR Inc., in this case) has a permanent establishment in India and the service is effectively connected to the permanent establishment in India. Therefore, the ABC Ltd. is not required to deduct equalisation levy on Rs. 5 lakhs, being the amount paid towards online advertisement services to PQR Inc., in this case.

However, tax has to be deducted by ABC Ltd. at the rates in force under section Rs.95 in respect of such payment to PQR Inc. Non-deduction of tax at source under section Rs.95 would attract disallowance under section 40(a)(i) of Rs.00% of the amount paid while computing business income.

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Equalisation Levy                         CA AARISH KHAN AJ Education NeXt

(2) any provision for digital advertising space or any other facility or service for the purpose of online advertisement and
(3) any other service as may be notified by the Central Government.

However, equalisation levy shall not be levied-
- where the non-resident providing the specified services has a permanent establishment in India
- the aggregate amount of consideration for specified service received or receivable during the previous year does not exceed Rs. Rs. lakh.
- where the payment for specified service is not for the purposes of carrying out business or profession

(i) Where PQR Inc. has no permanent establishment in India

In the present case, equalisation levy @6% is chargeable on the amount of Rs. 5,00,000 received by PQR Inc., a non-resident not having a PE in India from ABC Ltd., an Indian company. Accordingly, ABC Ltd. is required to deduct equalisation levy of Rs. 30,000 i.e., @6% of Rs. 5 lakhs, being the amount paid towards online advertisement services provided by PQR Inc., a non-resident having no permanent establishment in India. Non-deduction of equalisation levy would attract disallowance under section 40(a)(ib) of Rs.00% of the amount paid while computing business income.

(ii) Where PQR Inc. has permanent establishment in India and the service is effectively connected to the permanent establishment in India

Equalisation levy would not be attracted where the non-resident service provider (PQR Inc., in this case) has a permanent establishment in India and the service is effectively connected to the permanent establishment in India. Therefore, the ABC Ltd. is not required to deduct equalisation levy on Rs. 5 lakhs, being the amount paid towards online advertisement services to PQR Inc., in this case.

However, tax has to be deducted by ABC Ltd. at the rates in force under section Rs.95 in respect of such payment to PQR Inc. Non-deduction of tax at source under section Rs.95 would attract disallowance under section 40(a)(i) of Rs.00% of the amount paid while computing business income.

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EXERCISE

Question 1
Explain briefly the significant differences between the UN and OECD Model Tax Convention.

Answer
OECD Model is essentially a model treaty between two developed nations whereas UN Model is a model convention between a developed country and a developing country. Further, OECD Model advocates the residence principle, i.e., it lays emphasis on the right of state of residence to tax the income, whereas the UN Model is a compromise between the source principle and residence principle, giving more weight to the source principle as against the residence principle.

Question 2
When does it become necessary to apply the tie-breaker rule? Discuss the manner of application of the tie-breaker rule.

Answer
Every jurisdiction, in its domestic tax law, prescribes the mechanism to determine residential status of a person. If a person is considered to be resident of both the Contracting States, relief should be sought from Article 4 of the Tax Treaty. A series of tie-breaker rules are provided in Paragraph 2 Article 4 of Model Convention to determine single state of residence for an individual.

The tie-breaker rule would be applied in the following manner:
(i) The first test is based on where the individual has a permanent home. Permanent home would mean a dwelling place available to him at all times continuously and not occasionally and includes place taken on rent for a prolonged period of time. Any place taken for a short duration of stay or for temporary purpose, may be for reasons such as short business travel, or a short holiday etc. is not regarded as a permanent home.
(ii) If that test is inconclusive for the reason that the individual has permanent home available to him in both Contracting States, he will be considered a resident of the Contracting State where his personal and economic relations are closer, in other words, the place where lies his centre of vital interests. Thus, preference is given to family and social relations, occupation, place of business, place of administration of his properties, political, cultural and other activities of the individual.
(iii) Paragraph (ii) establishes a secondary criterion for two quite distinct and different situations:
- The case where the individual has a permanent home available to him in both Contracting States and it is not possible to determine in which one he has his centre of vital interests;
- The case where the individual has a permanent home available to him in neither Contracting State.

In the aforesaid scenarios, preference is given to the Contracting State where the individual has an habitual abode.
(iv) If the individual has habitual abode in both Contracting States or in neither of them, he shall be treated as a resident of the Contracting State of which he is a national.

(v) If the individual is a national of both or neither of the Contracting States, the matter is left to be considered by the competent authorities of the respective Contracting States.

Question 3
Explain the meaning of “interest” and “fees for technical services” under the UN Model Convention.

Answer
As per Article 11 of the UN Model Convention, “Interest” essentially means income from debt claims of every kind, whether or not secured by mortgage and whether or not carrying a right to participate in the debtor’s profits, and in particular, income from government securities and income from bonds or debentures, including premiums and prizes attaching to such securities, bonds or debentures. Penalty charges for late payment are not regarded as interest for the purpose of this Article.

As per Article 12A of the UN Model Convention, “Fees for technical services” is defined as payments for managerial, technical or consultancy services but excludes payment to an employee, payment for teaching in an educational institution or for teaching by an educational institution, payments by an individual for services for personal use.

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CHAPTER 30 - APPLICATION & INTERPRETATION OF TAX TREATIES

EXERCISE

Question 1
What do you mean by double taxation? Discuss the connecting factors which lead to Double taxation.

Answer
The taxability of a foreign entity in any country depends upon two distinct factors, namely, whether it is doing business with that country or in that country. Internationally, the term used to determine the jurisdiction for taxation is “connecting factors”. There are two types of connecting factors, namely, “Residence” and “Source”. It means a company can be subject to tax either on its residence link or its source link with a country. Broadly, if a company is doing business with another country (i.e. host/source country), then it would be subject to tax in its home country alone, based on its residence link. However, if a company is doing business in a host/source country, then, besides being taxed in the home country on the basis of its residence link, it will also be taxed in the host country on the basis of its source link.

• **Jurisdictional double taxation**: Accordingly, when source rules overlap, double taxation may arise i.e. tax is imposed by two or more countries as per their domestic laws in respect of the same transaction, income arises or is deemed to arise in their respective jurisdictions. This is known as “jurisdictional double taxation”.

In order to avoid such double taxation, a company can invoke provisions of Double Taxation Avoidance Agreements (DTAAs) (also known as Tax Treaty or Double Taxation Convention– DTC) with the host/source country, or in the absence of such an agreement, an Indian company can invoke provisions of section 91 of the Income-tax Act, 1961, providing unilateral relief in the event of double taxation.

• **Economic double taxation**: ‘Economic double taxation’ happens when the same transaction, item of income or capital is taxed in two or more states but in hands of different person (because of lack of subject identity)

Question 2
“In addition to allocating the taxing rights and elimination of double taxation, there are various other important considerations while entering into tax treaty”. Elucidate.

Answer
In addition to allocating the taxing rights and elimination of double taxation, there are various other important considerations while entering into a tax treaty, as mentioned below:

• Ensuring non-discrimination between residents and non-residents
• Resolution of disputes arising on account of different interpretation of tax treaty by the treaty partner.
• Providing assistance in the collection of the fair and legitimate share of tax.

Further, in addition to above, there are some other principles which must be considered by countries in their tax system –

(i) **Equity and fairness**: Same income earned by different taxpayers must be taxed at the same rate regard less of the source of income.
(ii) **Neutrality and efficiency**: Neutrality factor provides that economic processes should not be affected by external factors such as taxation. Neutrality is two-fold.

(a) Capital export neutrality
(b) Capital import neutrality (CIN).

Capital export neutrality (CEN) provides that business decision must not be affected by tax factors between the country of residence and the target country; whereas CIN provides that the level of tax imposed on non-residents as well as the residents must be similar.

(iii) **Promotion of mutual economic relation, trade and investment**: In some cases, it is observed that avoidance of double taxation is not the only objective. The other objective may be to give impetus to a country’s overall economic growth and development.

**Question 3**
What is the General Rule of Interpretation under Vienna Convention of Law of Treaties?

**Answer**

Article 31 of Vienna Convention of Law of Treaties contains the General Rule of Interpretation. It lays down that following general rule of interpretation:

- A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms thereof in the context and in the light of its object and purpose.
- The context for the purpose of interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexure
  (a) Any agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty;
  (b) Any instrument which was made by one or more parties in connection with the conclusion of the treaty and accepted by the other parties as an instrument related thereto.
- The following shall be taken into account, together with the context in that:
  (a) Any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions;
  (b) Any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation;
  (c) Any relevant rules of international law applicable to relation between the parties.
- A special meaning shall be given to a term if it is established that the parties so intended.

**Question 4**
What are the Extrinsic Aids to interpretation of a tax treaty?

**Answer**

A wide range of extrinsic material is permitted to be used in interpretation of tax treaties. According to Article 32 of the Vienna Convention the supplementary means of interpretation include the preparatory work of the treaty and the circumstances of its conclusion.

According to Prof. Starke one may resort to following extrinsic aids to interpret a tax treaty provided that clear words are not thereby contradicted:

(i) Interpretative Protocols, Resolutions and Committee Reports, setting out agreed interpretations;
(ii) A subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions [Art. 31(3) of the VCLT];
(iii) Subsequent conduct of the state parties, as evidence of the intention of the parties and their conception of the treaty;
(iv) Other treaties, in pari materia (i.e., relating to the same subject matter), in case of doubt.

**Provisions in Parallel Tax Treaties**

If the language used in two tax treaties (say treaties: X and Y) are same and one treaty is more elaborative or clear in its meaning (say treaty X) can one rely on the interpretation/explanations provided in a treaty X while applying provisions of a treaty Y? However, the views of the Indian Judiciary are not consistent in this respect. There are contradictory judgments by Indian courts/tribunal in this regard.

**International Articles/Essays/Reports**

International Article/Essays/Reports are referred as extrinsic aid for interpretation of tax treaties. Like, in case of CIT v. Vishakhapatnam Port Trust (1983) 144 ITR 146 (AP), the High Court obtained “useful material” through international articles.

**Cahiers published by International Fiscal Association (IFA), Netherlands**

“Cahiers de Droit Fiscal International” is the main publication of the IFA, which is published annually and deals with two major topics each year. Cahiers were relied upon in case of Azadi Bachao Andolan’s (supra) case by the SC.

**Protocol**

Protocol is like a supplement to the treaty. In many treaties, in order to put certain matters beyond doubt, there is a protocol annexed at the end of the treaty, which clarifies borderline issues.

A protocol is an integral part of a tax treaty and has the same binding force as the main clauses therein.

Protocol to the India-US tax treaty provides many examples to elucidate the meaning of the term “make available”. Protocol to India France treaty contains the Most Favoured Nation Clause. Thus, one must refer to protocol before arriving at any final conclusion in respect of any tax treaty provision.

**Preamble**

Preamble to a tax treaty could guide in interpretation of a tax treaty. In case of Azadi Bachao Andolan, the Apex Court observed that ‘the preamble to the Indo-Mauritius Double Tax Avoidance Convention (DTAC) recites that it is for the ‘encouragement of mutual trade and investment’ and this aspect of the matter cannot be lost sight of while interpreting the treaty’. These observations are very significant whereby the Apex Court has upheld ‘economic considerations’ as one of the objectives of a Tax Treaty.

**Mutual Agreement Procedure [MAP]**

MAP helps to interpret any ambiguous term/provision through bilateral negotiations. MAP is more authentic than other aids as officials of both countries are in possession of materials/documents exchanged at the time of signing the tax treaty which would clearly indicate the object or purpose of a particular provision. Successful MAPs also serve as precedence in case of subsequent applications.

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CHAPTER 31 - FUNDAMENTALS OF BASE EROSION & PROFIT SHIFTING

EXERCISE

Question 1
What do you understand by base erosion and profit shifting? Describe briefly its adverse effects.

Answer
Base Erosion and Profit Shifting (BEPS) refers to tax planning strategies that exploit gaps and mismatches in tax rules to make profits ‘disappear’ for tax purposes or to shift profits to locations where there is little or no real activity but the taxes are low, resulting in little or no overall corporate tax being paid.

ADVERSE EFFECTS OF BEPS:
(1) Governments have to cope with less revenue and a higher cost to ensure compliance.
(2) In developing countries, the lack of tax revenue leads to significant under-funding of public investment that could help foster economic growth.
(3) BEPS undermines the integrity of the tax system, as reporting of low corporate taxes is considered to be unfair. When tax laws permit businesses to reduce their tax burden by shifting their income away from jurisdictions where income producing activities are conducted, other taxpayers, especially individual taxpayers in that jurisdiction bear a greater share of the burden. This gives rise to tax fairness issues on account of individuals having to bear a higher tax burden.
(4) Enterprises that operate only in domestic markets, including family-owned businesses or new innovative businesses, may have difficulty competing with MNEs that have the ability to shift their profits across borders to avoid or reduce tax. Fair competition is harmed by the distortions induced by BEPS.

Question 2
What are the significant OECD Recommendations under Action Plan 1 of BEPS? Which recommendation has been adopted in Indian tax laws?

Answer
The OECD has recommended several options to tackle the direct tax challenges which include:
(1) Modifying the existing Permanent Establishment (PE) rule to provide that whether an enterprise engaged in fully de-materialized digital activities would constitute a PE, if it maintained a significant digital presence in another country's economy.
(2) A virtual fixed place of business PE in the concept of PE i.e., creation of a PE when the enterprise maintains a website on a server of another enterprise located in a jurisdiction and carries on business through that website.
(3) Imposition of a final withholding tax on certain payments for digital goods or services provided by a foreign e-commerce provider or imposition of an equalisation levy on consideration for certain digital transactions received by a non-resident from a resident or from a non-resident having permanent establishment in other contracting state.
Taking into consideration the potential of new digital economy and the rapidly evolving nature of business operations, it becomes necessary to address the challenges in terms of taxation of such digital transactions.

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

**Meaning of “Specified Service”:**

1. Online advertisement;
2. Any provision for digital advertising space or any other facility or service for the purpose of online advertisement;

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

Further, in order to reduce burden of small players in the digital domain, it is also provided that no such levy shall be made if the aggregate amount of consideration for specified services received or receivable by a non-resident from a person resident in India or from a non-resident having a permanent establishment in India does not exceed **Rs. 1 lakh** in any previous year.

**Question 3**

Discuss the provision incorporated in the Income-tax Act, 1961 in line with the OECD recommendations under Action Plan 4 of BEPS.

**Answer**

In line with the recommendations of OECD BEPS Action Plan 4, new section 94B has been inserted in the Income-tax Act, 1961, to provide a cap on the interest expense that can be claimed by an entity to its associated enterprise. The total interest paid in excess of 30% of its earnings before interest, taxes, depreciation and amortization (EBITDA) or interest paid or payable to associated enterprise for that previous year, whichever is less, shall not be deductible.

The provision is applicable to an Indian company, or a permanent establishment of a foreign company, being the borrower, who pays interest in respect of any form of debt issued by a non-resident who is an 'associated enterprise' of the borrower. Further, the debt is deemed to be treated as issued by an associated enterprise where it provides an implicit or explicit guarantee to the lender, being a non-associated enterprise, or deposits a corresponding and matching amount of funds with such lender.

The provision allows for carry forward of disallowed interest expense for 8 assessment years immediately succeeding the assessment year for which the disallowance is first made and deduction against the income computed under the head "Profits and gains of business or profession" to the extent of maximum allowable interest expenditure.

In order to target only large interest payments, it provides for a threshold of interest expenditure of **Rs. 1 crore** in respect of any debt issued by a non-resident, being an associated enterprise, exceeding which the provision would be applicable. Banks and Insurance business are excluded from the ambit of the said provisions keeping in view of special nature of these businesses.
Question 4
Describe the three tier structure for transfer pricing documentation mandated by BEPS Action Plan 13.

Answer
Action 13 contains a three-tiered standardized approach to transfer pricing documentation which consists of:

(a) **Master file**: Master file requires MNEs to provide tax administrations with high-level information regarding their global business operations and transfer pricing policies. The master file is to be delivered by MNEs directly to local tax administrations.

(b) **Local file**: Local file requires maintaining of transactional information specific to each country in detail covering related-party transactions and the amounts involved in those transactions. In addition, relevant financial information regarding specific transactions, a comparability analysis and analysis of the selection and application of the most appropriate transfer pricing method should also be captured. The local file is to be delivered by MNEs directly to local tax administrations.

(c) **Country-by-country (CBC) report**: CBC report requires MNEs to provide an annual report of economic indicators viz. the amount of revenue, profit before income tax, income tax paid and accrued in relation to the tax jurisdiction in which they do business. CBC reports are required to be filed in the jurisdiction of tax residence of the ultimate parent entity, being subsequently shared between other jurisdictions through automatic exchange of information mechanism.

Question 5
Explain the nexus approach recommended by OECD in BEPS Action Plan 5 which has been adopted in the Income-tax Act, 1961.

Answer
In India, the Finance Act, 2016 has introduced a concessional taxation regime for royalty income from patents for the purpose of promoting indigenous research and development and making India a global hub for research and development. The purpose of the concessional taxation regime is to encourage entities to retain and commercialise existing patents and for developing new innovative patented products. Further, this beneficial taxation regime will incentivise entities to locate the high-value jobs associated with the development, manufacture and exploitation of patents in India.

The nexus approach has been recommended by the OECD under BEPS Action Plan 5. This approach requires attribution and taxation of income arising from exploitation of Intellectual property (IP) in the jurisdiction where substantial research and development (R & D) activities are undertaken instead of the jurisdiction of legal ownership. Accordingly, new section 115BBF has been inserted in the Income-tax Act, 1961 to provide that where the total income of the eligible assessee (being a person resident in India who is the true and first inventor of the invention and whose name is entered in the patent register as the patentee in accordance with the Patents Act, 1970 and includes every such person, being the true and the first inventor of the invention, where more than one person is registered as patentee under Patents Act, 1970 in respect of that patent.) includes any income by way of royalty in respect of a patent developed and registered in India, then such royalty shall be taxable at the rate of 10% (plus applicable surcharge and cess). For this purpose, developed means atleast 75% of the expenditure should be incurred in India by the eligible assessee for any invention in respect of which patent is granted under the Patents Act, 1970.
Question 6
What are the ways in which hybrid mismatch arrangements are used to achieve unintended double non-taxation or long-term tax deferral?

Answer
Hybrid mismatch arrangements are sometimes used to achieve unintended double non-taxation or long-term tax deferral in one or more of the following ways -
(1) Creation of two deductions for a single borrowal;
(2) Generation of deductions without corresponding income inclusions;
(3) Misuse of foreign tax credit; and
(4) Participation exemption regimes.
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