ELECTIVE PAPER 6C: INTERNATIONAL TAXATION

SOLUTION TO CASE STUDY 3

I. ANSWERS TO MCQs (Most appropriate answers)

1. (d)
2. (c)
3. (c)
4. (c)
5. (c)
6. (b)
7. (c)
8. (b)
9. (d)
10. (c)

II. ANSWERS TO DESCRIPTIVE QUESTIONS

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

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

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

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

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

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

Since Shivam left on 30th September 2018, he stayed in India during the P.Y. 2018-19 for 183 days. Therefore, he is a resident in India for the P.Y.2018-19.

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

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

(ii) His total stay in India in last seven years preceding P.Y. 2018-19 is 730 days or more.

Thus, Shivam is Resident and Ordinarily Resident in India for the P.Y.2018-19.

As per Country "Q" tax residency rules, Shivam qualifies to be resident for the year 2018-19 in Country "Q", since he stays for 182 days (more than 180 days) in Country "Q" in the Financial Year 2018-19.

Thus, as per the domestic tax laws of India and Country "Q", Shivam qualifies to be a resident both in India and Country "Q" during the year 2018-19. Hence, the tie-breaker rule provided in Article 4(2) of the India-Country "Q" DTAA will come into play.

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

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

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

(a) the residential property is located and

(b) social and cultural activities are closer

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

(ii) Article 26 of India-Country "Q" DTAA deals with the international exchange of information between the tax authorities of the countries. The purpose is wider than mere tax compliances; it is also meant to counter tax evasion and avoidance. The competent authorities of the two Contracting States can exchange information which is 'foreseeably relevant' for the proper application of agreement or for the administration or enforcement of their domestic laws, as long as taxation under the laws in not inconsistent with the treaty agreement.

Paragraph 3 of the Article lists the types of information, the request for which either country is not obligated to comply.

However, paragraph 4 of the Article further clarifies that even though obligation to provide information is subject to the limitation contained in paragraph 3, the requested country cannot decline to supply information solely because it has no domestic interest in such information.

Accordingly, Country "Q" tax authorities are **not justified** in denying to provide information stating that it will not get any revenue benefit by providing such information. Country "Q" is obligated to provide the requested information, even if it has no revenue interest in the case to which the request relates.

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However, in case the reason of denial is in accordance with the specific limitations contained in paragraph 3, then, Country "Q" tax authorities shall be under no obligation to provide the requested information. Hence, denial by tax authorities on the ground that exchange of such information would be contrary to public policy **is justified.**

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

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

(ii) As per section 245N(b)(A)(I), an application for advance ruling can be made *inter-alia* by a non-resident in relation to a transaction which has been undertaken or is proposed to be undertaken by it.

Hence, Cure House Inc., a non-resident applicant, can file an application to Authority of Advance Rulings, alongwith the prescribed fees, for determination in relation the transaction undertaken by it in India i.e., rendering consultancy services in the field of medicine.

As per section 245N(b)(A)(III), a resident applicant who has undertaken or has proposed to undertake one or more transactions of value of INR 100 crore or more in total can file an application for Advance Ruling for determination by the AAR in relation to his/her tax liability arising out of such transactions and such determination shall include the determination of any question of law or of fact specified in the application.

In the present case, since the project value is only INR 70 crore, Sudha, a resident Indian cannot file an application with AAR for determination of her tax liability arising out of the said project.

(b) Section 9(1)(i) requires existence of business connection for deeming business income to accrue or arise in India. DTAAs may, 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.

Hence, business income earned by a resident of Country "Q" can be brought to tax only if he has a PE in India. However, business income of a resident of Country "N" attributable to his business connection in India, can be brought to tax in India.

3. Computation of total income of Shivam for A.Y. 2019-20

Particulars	INR	INR
Income from Salaries		
Salary from services rendered in India (April - September 2018)		
Basic Salary (INR 70,000 x 6)	4,20,000	
Dearness Allowance (INR 30,000 x 6)	1,80,000	

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Special Allowance (INR 5,000 x 6)	30,000	
Bonus	3,00,000	
[Even though bonus is paid in an overseas bank account after the commencement of his overseas assignment, however, since it pertains to services rendered in India, it would be taxable in India]		
		9,30,000
Salary from services rendered in Country "Q" (October 2018 - March 2019)		
Basic Salary [See Note (i)]	3,93,680	
Cost of Living Allowance [See Note (i)]	2,81,200	6,74,880
		16,04,880
Less: Standard deduction u/s 16(ia)		40,000
		15,64,880
Income from House Property at Mumbai		
Net Annual Value [See Note (ii)]	6,00,000	
Less: Standard deduction @ 30%	(1,80,000)	
		4,20,000
Income from Other Sources		
Interest earned from investment of security deposit (INR 1,00,000 @10%)	10,000	
Interest earned on saving bank account with Country "Q" [QGD 150 x INR 48.61] [See Rule 115 in Note (i)]	7,292	
Interest on Securities of a Country "Q" company [QGD 5000 x INR 48.52] [See Rule 115 in Note (i)]	2,42,600	
Interest on bonds issued by Country "P" Government	30,000	
Dividend from a Country "Q" Company (QGD 1000 x INR 48.52] [See Rule 115 in Note (i)]	48,520	
(Dividend from foreign company is taxable in India)		
		3,38,412
Gross Total Income		23,23,292
***Less:* Deductions under Chapter VI-A**		
Deduction u/s 80DD	75,000	
(Flat deduction of INR 75,000 is allowed in respect of medical treatment of dependent disabled, irrespective of the expenditure incurred)		
Deduction u/s 80GG [See Note (iii)]	60,000	1,35,000
Total Income		**21,88,292**
Total Income (rounded off)		**21,88,290**

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Computation of tax liability of Shivam for A.Y. 2019-20

Particulars	INR	INR
Tax on INR 21,88,290		4,68,987
Add: Health and education cess @4%		18,759
Tax Liability		4,87,746
Less: Foreign Tax Credit [See Note (v)]		
- on salary income	98,709	
- on interest income	36,390	1,35,099
Net tax liability		**3,52,647**
Net tax liability (rounded off)		**3,52,650**

Notes:

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

- *Salary* – last day of the month immediately preceding the month in which the salary is due
- *Interest on securities*- last day of the month immediately preceding the month in which the income is due i.e. rate as on 28.02.2019
- *Interest earned on other than securities* i.e. interest on bank deposits- last day of the previous year i.e. rate as on 31.03.2019
- *Dividends* - last day of the month immediately preceding the month in which the dividend is declared, distributed or paid by the company i.e. rate as on 28.02.2019

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

Overseas salary for the period October 2018 to March 2019:

Month	Basic Salary in QGD (1)	Cost of living Allowance (COLA) (2)	Rate of Exchange (3)	Basic Salary in INR (1 x 3)	COLA in INR (2 x 3)
Oct 18	1400	1000	45.95	64,330	45,950
Nov 18	1400	1000	46.85	65,590	46,850
Dec 18	1400	1000	45.10	63,140	45,100
Jan 19	1400	1000	46.95	65,730	46,950
Feb 19	1400	1000	47.83	66,962	47,830
Mar 19	1400	1000	48.52	67,928	48,520
Total	**8400**	**6000**	**-**	**3,93,680**	**2,81,200**

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

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

Deduction shall be lower of the following:

- INR 5,000 per month = INR 60,000
- 25% of the adjusted total income = 25% of INR 22,48,292 = INR 5,62,073
- Actual rent – 10% of adjusted total income = INR 3,00,000 (25,000*12) – INR 2,24,829 (10% of 22,48,292) = INR 75,171

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

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

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

(v) Since Shivam is a resident and ordinarily resident in India for the A.Y.2019-20 by virtue of section 6 of the Income-tax Act, 1961, his global income is taxable in India. In such case, the income arising in Country "Q" is doubly taxed. In order to avoid double taxation, Shivam can take the benefit of DTAA between India and Country "Q" by way of foreign tax credit in respect of the tax paid in Country "Q" or tax paid on such income in India, whichever is lower.

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

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

Calculation of foreign tax credit

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

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Double taxed Interest Income	INR
Interest Income on Securities of Country "Q" company	2,42,600
Computation of foreign tax credit on doubly taxed interest income:	
Lower of:	
Tax withheld in Country "Q" on interest income at 15%, which is also the rate as per the DTAA	36,390
Tax payable in India on interest income@22.29%	54,076
Foreign tax credit	**36,390**

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

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