

ELECTIVE PAPER 6C: INTERNATIONAL TAXATION

SOLUTION TO CASE STUDY 5

I. ANSWERS TO MCQs (Most appropriate answers)

MULTIPLE CHOICE QUESTIONS

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

II. ANSWERS TO DESCRIPTIVE QUESTIONS

Answer to Q.1:

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

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

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

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

Particulars	Rs.
Income from transactions where both purchases and sales are from/to associated enterprises	0

Total income by way of dividend and interest	4,00,000
Total income (Income from Product Sales from Modern Bazaar plus income by way of dividend and interest)	15,00,000

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

Percentage of passive income to total income = $4/15 \times 100 = 27\%$

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

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

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

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

Answer to Q.2:

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

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

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

- (b) RB Pvt. Ltd. is liable to deduct equalization levy of Rs.60,000 from the amount of Rs.10 lakhs payable to Facebook Inc. In case it fails to so deduct equalization levy, it shall, notwithstanding such failure, be liable to pay the levy to the credit of the Central Government by 7th April, 2019. Further, penalty of an amount equal to Rs. 60,000 would be attracted for failure to deduct equalization levy. Also, disallowance of the expenditure of Rs.10 lakhs would be attracted under section 40(a)(ib) while computing business income of RB Pvt. Ltd.
- (c) Section 10(50) of the Income-tax Act, 1961 exempts income arising from providing specified service of online advertisement, which are subject to equalization levy, from income-tax.

Answer to Q.3:

- (a) The one avenue open to RB Pvt. Ltd. is the Authority for Advance Rulings (AAR). The AAR was constituted to provide certainty to non-residents with respect to their tax liabilities in India in respect of any transactions undertaken or proposed to be undertaken. The ruling given by AAR is an authoritative advice and binds the tax authorities and the assessee in respect of the given facts and circumstances, as long as there is no change in the law.

In the present case, RB Pvt. Ltd. seeks to understand whether or not Modern Bazaar can withhold taxes at source when making payments to it. Hence, this avenue would be a viable option for RB Pvt. Ltd.

- (b) In order to approach the AAR the applicant must be eligible under Section 245N of the Income-tax Act, 1961. Eligible applicants include non-residents and some residents. A resident can apply as long as the application pertains to tax liability of the non-resident in India in relation to a transaction which has been undertaken or is proposed to be undertaken by a resident applicant with such non-resident. The value of transactions undertaken does not matter.

Hence, here Modern Bazaar already having entered into transactions with RB Pvt. Ltd. can also make an application before the AAR. Alternately, RB Pvt. Ltd. can make an application in its own name.

- (c) The AAR does not have jurisdiction to hear matters where it feels that the transaction has been entered into, for *prima facie* tax avoidance. Additionally, the matter may not be heard if it is already pending before an income tax authority/ tribunal or any court or involves computation of the fair market value of any property. Here, none of these conditions are applicable.