ELECTIVE PAPER 6C: INTERNATIONAL TAXATION

CASE STUDY - 5

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

They both spend a year preparing a detailed business plan which they pitch to some investor friends. Their investor friends evince interest which prods them to formally incorporate a company, to commence their operations. The company is called RB Pvt. Ltd. which is incorporated in Mauritius on August 15, 2017.

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

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

After the formal registration of the company, they set out to find a suitable office space for the company in the city of Port Louis, Mauritius. In November 2017, they find a small office space in a new business complex close to the city center of Port Louis, Mauritius and take it on lease hold basis for a year. They designate this office space as their registered office where the books of accounts will be kept and maintained.

By April 1, 2018, they employ an office manager cum receptionist Mr. Sundaram to take care of the office. Next, they employ two individuals (Mrs. Indra and Mr. Raghu) with over ten years of experience with leading retail brands in Mauritius. Mrs. Indra and Mr. Raghu are to start implementing the detailed business plan drawn up by Mr. Rai and Mr. Bhandari. For the financial year 2018-19, the aggregate pay roll expenses for these three employees is Rs.15,00,000.

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

The first steps that Mrs. Indra and Mr. Raghu are to take as per the business plan is to finalize any two organic foods grown in Mauritius that will be marketable in New Delhi, India. During the financial year 2018-19 the team has been able to identify black rice and barley as suitable products for supply.

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

Indian retail chain store Modern Bazaar has expressed interest in introducing the products in their stores on a pilot basis. Mr. Bhandari employs Mr. Sharma in June 2018 to take care of paper work and act as his local secretary. Mr. Sharma was born in India and has lived in India throughout. For the months he works during the financial year 2018-19, he is paid a salary of Rs.5,00,000.

During the financial year 2018-19 the company has a total of four board meetings. Each of the meetings is attended by the three directors personally. The first, second and third meeting is held in Mauritius while the next meeting is held in New Delhi, India. Basically, there is a meeting in every quarter.

The first meeting takes up one important matter that is, the grant of a power of attorney to Mrs. Indra to enable the work in Mauritius to go on smoothly. Accordingly, it is decided that all matters of day-to-day importance can be approved by Mrs. Indra. If the matter involves expenditure of more than Rs. 25,000, the approval of Mr. Rai would be mandatory.

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

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

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

After the books of accounts have been closed for the previous year 2018-19, it is assessed that the company made a profit of Rs.15,00,000. The profit comprised the following:

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

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

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

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

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

I. MULTIPLE CHOICE QUESTIONS

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

1. During the P.Y. 2016-17 and P.Y. 2017-18, Mr. Rai was in India on business visits from June 15, 2016 to August 31, 2016 and July 1, 2017 to September 28, 2017, respectively. During the previous year 2018-19, Mr. Rai was in India during April-May 2018 and November 2018. What is the residential status of Mr. Rai for previous years 2017-18 and 2018-19, respectively?

   (a) Non-resident and Resident and Ordinarily Resident, respectively

   (b) Non-resident for both years

   (c) Resident and Ordinarily Resident for both years

   (d) Resident but Not Ordinarily Resident for both years

2. During the Previous Year 2018-19, Mr. Rai received Rs.75,00,000 on account of sale of agricultural land in Mauritius. The money was first received in Mauritius and then remitted to his Indian bank account. Is the sum taxable in India?

   (a) No, as agricultural income is exempt u/s 10(1).

   (b) No, as the income has accrued and arisen outside India and is also received outside India.

   (c) Yes, since it is remitted to India in the same year.

   (d) Yes, as agricultural income earned outside India is not exempted in India in the hands of a resident.

3. Mr. Bhandari only holds the shares in RB Pvt. Ltd. If he sells the shares held by him in RB Pvt. Ltd. for a gain during the Previous Year 2018-19, which of the following statements is true?

   (a) The resultant gain is a short-term capital gain taxable under the normal provisions of the Act.

   (b) The resultant gain is a short-term capital gain taxable@15% u/s 111A.

   (c) The resultant gain is a long-term capital gain taxable@20% u/s 112.

   (d) The resultant gain is a long-term capital gain taxable@10% u/s 112A.

4. Mr. Bhandari receives dividend payment from RB Pvt. Ltd. in his Indian bank account during 2018-19 to the tune of Rs.1,50,000. Which of the following statements is true?

   (a) Mr. Bhandari is liable to pay tax on such dividend as it forms part of his total income

   (b) RB Pvt. Ltd. will have to pay a dividend distribution tax u/s 115-O on such payments

   (c) Mr. Bhandari is eligible for an exemption under section 10(34) in respect of such dividend.

   (d) Both (b) and (c)

5. Which of the following factors is **not** considered under the UN Model Convention to determine the residence of an individual?

   (a) Habitual abode

   (b) Centre of vital interests

   (c) Own house in Calcutta given on rent for the last ten years

   (d) Flat taken on rent in Pune where he is living for the last ten years.

6. If a company is resident of two Contracting States, namely, Country X, being the place of incorporation, and Country Y, being the place of effective management, then, the company would be resident of -

   (a) Country X, being the place of incorporation

   (b) Country Y, being the place of effective management

   (c) Country X or Y, determine by mutual agreement by competent authorities

   (d) Either Country X or Y at the option of the assessee i.e., company

7. Dividend from an Indian company is exempt in the hands of a non-resident shareholder by virtue of section 10(34). Can such income be subject to tax in his hands in accordance with the provisions of the tax treaty?

   (a) Yes, since the provisions of the treaty override the domestic law

   (b) No, due to the non-aggravation principle

   (c) No, due to the equivalent beneficiary principle

   (d) No, due to allocation of taxing rights principle

8. As per the UN Model Convention, the term "Permanent Establishment" would not include -

   (a) a branch

   (b) an office for carrying out routine administrative work.

   (c) a factory for manufacture of goods

   (d) a warehouse for storage of goods in preparatory nature

9. During the previous year 2018-19, RB Pvt. Ltd. entered into contracts for purchase and sale of barley grains with PB Pvt Ltd. PB Pvt. Ltd. is a company incorporated in New Delhi. On account of which of the following facts, would the companies be considered to be associated enterprises?

(a) One of the four directors of PB Pvt. Ltd. is Mr. Bhandari

(b) RB Pvt. Ltd. owns 20% of shares in PB Pvt. Ltd.

(c) RB Pvt. Ltd. extended a loan of Rs.20 lakhs to PB Pvt. Ltd. when the book value of the latter is Rs.42 lakhs

(d) Mr. Bhandari owns 26% of shares in PB Pvt. Ltd.

10. In addition to the answer in question 9 above, what else needs to be proved for invoking a transfer pricing scrutiny as an international transaction?

(a) The transactions between the two companies are held on terms and prices which reflect market control

(b) The transactions are covered by the notified safe harbor rules

(c) RB Pvt. Ltd. is a non-resident company

(d) The aggregate value of the transactions is Rs.50,00,000 in the concerned Previous Year

II. DESCRIPTIVE QUESTIONS

1. The board decides to understand the matter at hand from a tax lawyer. Accordingly, Mr. Bhandari seeks a meeting with a tax lawyer on the question. The lawyer explains the following in an informal conversation:

RB Pvt. Ltd. would be considered to be a resident of India for tax purposes despite it having been incorporated in Port Louis, Mauritius. The reasons for the same are detailed as follows:

- Majority of the board of directors reside in India
- The place of incorporation of the company is irrelevant
- All the revenue generation activity is linked to India

In your opinion, can the Indian tax authorities argue that RB Pvt. Ltd. is resident in India for tax purposes, despite the fact that the company has been incorporated in Mauritius? Would their reasoning be the same as cited by the tax lawyer? ***(10 Marks)***

2. Assume that Mr. Bhandari has opened an office of RB Pvt. Ltd. in Pune from where he and Mr. Sharma execute the work of the company relating to Indian operations. RB Pvt. Ltd. is further considering advertising the product on internet using Facebook. RB Pvt. Ltd. enters into talks with Facebook for hosting the desired advertisements. It negotiated a sum of INR 10 lakhs, which is paid to Facebook for online advertisement services in March, 2018. Assume that Facebook does not have a permanent establishment in India.

(a) Is the fee paid for online advertisement services by RB Pvt. Ltd. to Facebook Inc. taxable in India? Discuss. ***(4 Marks)***

(b) If the answer to (a) is in the affirmative, is there any requirement to deduct tax at source? If tax is not so deducted, what would be the consequence? ***(4 Marks)***

(c) What is the provision incorporated in the Indian tax laws to avoid double taxation of such income? ***(2 Marks)***

3. (a) RB Pvt. Ltd. wants a binding advice relating to their tax liability in India. They have been informed by Modern Foods that while making the payments relating to the product sales, taxes have to be withheld. Is there an avenue available under domestic law for obtaining such binding advice?

(4 Marks)

(b) Should RB Pvt. Ltd. make such application or Modern Bazaar? The total value of the transactions between RB Pvt. Ltd. and Modern Bazaar is Rs.50,00,000 in the previous year 2018-19.

(3 Marks)

(c) Are there grounds on which the request may be denied? ***(3 Marks)***