CONTENTS

CASE STUDY - 1

'A' Ltd., an Indian company, was incorporated in the year 2010. It is a wholly owned subsidiary of A Inc, USA. A Ltd. is engaged in the business of manufacturing and selling virtual reality cameras. During the previous year 2019-20, A Ltd. entered into various transactions with the following enterprises for purchase of raw materials, use of technology and sale of finished goods. The earnings before interest, dividend, tax and amortization of A Ltd for Financial year 2019-20 is ₹ 100 crores. The details of the transactions entered into by A Ltd. during F.Y.2019-20 are given hereunder:

S. No	Transaction	Enterprise	Amount (₹ in crores)
1	Purchase of raw-materials	AA Ltd, China	80
2	Payment of royalty	A Inc, USA	5
3	Sale of finished goods	AAA Ltd, Taiwan	50
4	Interest-free loan obtained	A Pty, Singapore	50

Prior to F.Y.2019-20, A Ltd. had obtained loan of ₹ 200 crores @8% from A LLC, Cyprus in April, 2018.

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

- Interest of ₹ 16 crores paid to A LLC, Cyprus on the loan of ₹ 200 crores, which constituted 52% of the total assets of A Ltd.
- A Ltd. obtained loan of ₹ 100 crores from Bank of Chennai, India based on a guarantee provided by A Inc., USA. Interest of ₹ 8 crores paid on such loan and guarantee fee of ₹ 50 lacs paid to A Inc., USA.
- A Ltd. obtained loan of ₹ 50 crores from TN Mercantile Bank, India based on a letter of comfort provided by Mr. Balaji, who is an Indian resident and director of A Ltd. Interest of ₹ 4 crores is paid towards such loan.
- A Ltd. obtained an independent loan of ₹ 300 crores from Union City Bank, India for which interest of ₹ 3 crores has been paid to the bank.
- A Ltd. obtained loan of ₹ 50 crores from Bank of Taiwan, India Branch. Guarantee was provided by AAA Ltd., Taiwan. Interest paid for the concerned year is ₹ 3 crores. Guarantee fees paid to AAA Ltd. is ₹ 25 lakhs. A Ltd. holds shares carrying 25% voting power in AAA Ltd., Taiwan.
- A Ltd. obtained interest-free loan of ₹ 50 crores from A Pty, Singapore. 40% of the directors of A Pty., Singapore is appointed by A Ltd.
- A Ltd. obtained foreign currency loan of $ 10 million from Wells Cargo Bank of USA, in USA, based on a back to back deposit made by A Inc. USA to the tune of $ 5 million in the bank. Interest of ₹ 6 crores is paid on such loan.
- A Ltd. obtained foreign currency loan of $ 20 million from Bank of USA, in USA, based on a

back to back deposit made by A Inc., USA to the tune of $ 20 million in the bank. Interest works out to ₹ 12 crores.

- A Ltd. had to incur a sum of ₹ 1 crore as an interest towards the delayed payment to AA Ltd. China, being its creditor for supply of raw material. 90% of raw materials required by A Ltd. is supplied by AA Ltd., China.

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

I. OBJECTIVE TYPE QUESTIONS

Write the correct answer to each of the following questions by choosing one of the four options given.

1. Which of the following enterprises are associated enterprises/deemed associated enterprises of A Ltd.?
   (a) A Inc., USA; A LLC, Cyprus; and AAA Ltd., Taiwan.
   (b) A Inc., USA; A LLC, Cyprus; and A Pty, Singapore.
   (c) A Inc., USA; A LLC, Cyprus; and AA Ltd., China.
   (d) A Inc., USA; AA Ltd., China; and A Pty, Singapore.

2. Which of the following approaches does India follow in relation to secondary adjustments?
   (a) Deemed equity approach
   (b) Deemed dividend approach
   (c) Deemed loan approach
   (d) Either (a) or (c)

3. If A Ltd. does not furnish transfer pricing report for F.Y.2019-20, what would be the quantum of penalty imposable under the Income-tax Act, 1961 for such a failure?
   (a) 1% of the value of international transaction
   (b) 2% of the value of international transaction
   (c) ₹ 1 crore – fixed penalty
   (d) ₹ 1 lakh – fixed penalty

4. In a case where primary adjustment to transfer price is made *suo motu* by A Ltd., the time limit for repatriation of "excess money" is -
   (a) 60 days from 30th September of the Assessment Year
   (b) 90 days from 30th September of the Assessment Year
   (c) 60 days from 30th November of the Assessment Year
   (d) 90 days from 30th November of the Assessment Year

5. The excess money which is available with the AE, if not repatriated to India within the prescribed time, shall be deemed to be an advance made by A Ltd. to such AE, if the primary adjustment to transfer price, made by it *suo motu* in its return of income, is in respect of -
   (a) A.Y.2016-17 and the amount of primary adjustment is ₹ 2 crores.
   (b) A.Y.2019-20 and the amount of primary adjustment is ₹ 1 crore
   (c) A.Y.2019-20 and the amount of primary adjustment is ₹ 1.05 crore

(d) A.Y.2018-19 and the amount of primary adjustment is ₹ 1 crore.

II. DESCRIPTIVE QUESTIONS

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

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

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

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

SOLUTIONS – CASE STUDY 1

I. ANSWERS TO OBJECTIVE TYPE QUESTIONS

1. (c) A Inc., USA; A LLC, Cyprus; and AA Ltd., China.

2. (c) Deemed Loan Approach

3. (d) ₹ 1 lakh – fixed penalty

4. (d) 90 days from 30th November of the assessment year

5. (c) A.Y.2019-20 and the amount of primary adjustment is ₹ 1.05 crore

II. ANSWERS TO DESCRIPTIVE QUESTIONS

1. Section 94B is applicable to an Indian company or a permanent establishment of a foreign company in India, being the borrower who pays interest in respect of any form of debt issued by

- non-resident, being an associated enterprises (AE) of such borrower or
- by a lender which is not an AE but where the AE provides either implicit or explicit guarantee to such lender or deposits a corresponding and matching amount of funds with the lender, then such debt would be deemed to have been issued by an AE.

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

Particulars	Amount (₹ in crores)
Interest paid to A LLC Cyprus [See Note (i)]	80.00
Interest paid to Bank of Chennai based on guarantee provided by A Inc. USA [See Note (ii)]	8.00
Guarantee Fee paid to A Inc. USA [See Note (iii)]	0.50
Interest paid to TN Mercantile bank based on letter of comfort by director of A Ltd. [See Note (iv)]	Nil
Interest paid to Union City Bank, India [See Note (v)]	Nil
Interest paid to Bank of Taiwan [See Note (vi)]	Nil
Guarantee fee paid to AAA Ltd., Taiwan [See Note (vi)]	Nil
Interest paid to Wells Cargo Bank based on deposits made by A Inc. USA [See Note (vii)]	Nil

Interest paid to Bank of USA based on deposits made by A Inc. USA [See Note (viii)]	12.00
Interest paid to AA Ltd, China, being interest on delayed payment to creditor [See Note (ix)]	1.00
Interest paid or payable to non-resident AE	**101.50**
EBIDTA	200.00
Excess Interest: lower of the following would be disallowed	**41.50**
- Interest paid or payable to non-resident AE in excess of 30% of EBIDTA [₹ 101.50 crores - ₹ 60.00 crores] ₹ 41.50 crores	
- Interest paid or payable to non-resident AE ₹ 101.50 crores	
Therefore, interest paid or payable allowable as deduction under the head "Profits and gains of business or profession" would be ₹ 76.25 crores [₹ 60 crores (₹ 101.50 crores – ₹ 41.50 crores), being the amount paid or payable to non-resident AE ***plus*** ₹ 16.25 crores, being the amount paid to other entities].	76.25

Notes:

(i) Interest paid to a non-resident AE falls within the scope of section 94B. A LLC is deemed to be an AE of A Ltd., since the loan advanced by it constitutes not less than 51% of the book value of total assets of A Ltd. Hence, interest paid to A LLC is to be considered for the purpose of limitation of interest deduction under section 94B.

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

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

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

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

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

considered for the purpose of limitation of interest deduction under section 94B.

(iv) Since the loan is obtained based on a letter of comfort provided by a resident director of A Ltd., the said interest will not be factored for the purpose of excess interest disallowance under section 94B.

(v) Since loan was obtained by A Ltd independently from a third-party lender Union City Bank of India, interest paid on such loan shall not be considered for the purposes of Section 94B, as the same is paid to an enterprise which is not a non-resident AE.

(vi) Since A Ltd.'s voting power in AAA Ltd., Taiwan is less than 26%, AAA Ltd., Taiwan is not an AE of A Ltd. Since loan was obtained by A Ltd from Bank of Taiwan, Indian branch, for which guarantee was given by an enterprise, not being an AE, this interest shall not be considered for the purposes of section 94B. Likewise, guarantee fee paid to AAA Ltd. shall also not be considered for the purposes of section 94B.

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

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

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

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

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

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

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

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

2. **(i)** Multinational groups are often able to structure their financing arrangements to maximize these benefits. To prevent tax erosion on account of such arrangements, country's tax administrations often introduce rules that place a limit on the amount of interest that can be deducted in computing a company's profit for tax purposes. Such rules are designed to counter cross-border shifting of profit through excessive interest payments, and thus aim to protect a country's tax base. Under the initiative of the G-20 countries, the Organization for Economic Co-operation and Development (OECD) in its Base Erosion and Profit Shifting (BEPS) project had taken up the issue of base erosion and profit shifting by way of excess interest deductions by the MNEs in its Action plan 4. The OECD has recommended several measures in its final report to address this issue. In view of the above, section 94B has been inserted in the Income-tax Act, 1961, in line with the recommendations of OECD BEPS Action Plan 4, to provide that interest paid or payable by an entity to its non-resident associated enterprises shall be restricted to 30% of its earnings before interest, taxes, depreciation and amortization (EBITDA) or interest paid or payable to non-resident associated enterprises, whichever is less.

(ii) Section 94B(4) provides that interest amount disallowed in a particular assessment year shall be carried forward and allowed as deduction against the profits and gains, if any, ***of any business*** carried on by the assessee. Therefore, based on the same, it can be concluded that A Ltd shall be eligible to carry forward the disallowed interest amount and claim the same as a deduction against the profits and gains from any business or profession carried on by it.

3. Indian Transfer Pricing regulations provide that any income arising from an international transaction shall be computed having regard to arm's length price. However, section 92(3) provides that transfer pricing provisions shall not apply in cases where such application results an increase in the expenditure or decrease in the revenue of the Indian entity. In the given case, as interest payment to the AE would only result in an increase in the expenditure of A Ltd. and subsequent reduction of profits, transfer pricing provisions under the Income-tax Act, 1961 shall not apply.

CASE STUDY - 2

M/s. Vaish & Co., an Indian firm, is a leading Delhi-based international tax consultant, specializing in transfer pricing assignments. The following are the details pertaining to some of its assignments:

(1) ABC Ltd., an Indian Company, supplied steel manufactured by it to ABC Inc., Country A during the previous year 2019-20. ABC Limited also supplied the same product to another Country A based company, PQR Inc. The transactions with ABC Inc. are priced at Euro 800 per MT (FOB), whereas the transactions with PQR Inc. are priced at Euro 1200 per MT (CIF). Insurance and Freight amounts to Euro 400 per MT. ABC Ltd. wants to know if transfer pricing provisions would be attracted in such a case.

(2) Sigma Ltd., operating in India, is one of the dealers for the goods manufactured by Epsilon Ltd., Country B. During the course of assessment, the Assessing Officer, after verification of transactions between Sigma Ltd. and Epsilon Ltd., opined that transfer pricing provisions would become applicable in this case. The Assessing Officer adjusted the total income of Sigma Ltd. by making an addition of Rs.2 crore to the declared income of Rs.6 crore for A.Y.2020-21. It also issued show cause notice asking the company to explain why penalty should not be levied for failure to report such transactions and maintain the requisite records. Sigma Ltd is of the opinion that transfer pricing provisions would not be applicable in its case and hence, there is no question of levy of such penalty. Sigma Ltd. wants to know the lines in which reply needs to be given to the show cause notice.

(3) XYZ Motors Ltd., an Indian company declared business income of Rs.585 crores computed in accordance with Chapter IV-D of the Income-tax Act, 1961 but before making transfer pricing adjustments in respect of the following transactions for the year ended on 31.3.2020:

(i) 8,500 vans sold to LMN Inc., Country A, at a price which is less by Euro 280 each van than the price charged from PQR Inc., Country A.

(ii) 4500 vans sold to GHI Inc., Country D at a price which is less by Euro 100 each van than the price charged from PQR Inc., Country A.

(iii) Royalty of $ 80,00,000 was paid to RST Ltd., Country C, for use of technical know-how in the manufacturing of van. However, RST Ltd. had provided the same know-how to Birla Motors Ltd. for $ 60,00,000.

(iv) Loan of Euro 74 crores carrying interest @8% p.a. advanced by HIT Ltd., a Country D company, was outstanding on 31.3.2020. The said Country D company had also advanced a loan of similar amount to Aravalli Ltd. @7% p.a. Total interest paid for the year was EURO
5.92 crores.

XYZ Motors Ltd. wants to know the provisions of the Income-tax Act, 1961 affecting all these transactions. It also wants to know its business income chargeable to tax for A.Y.2020-21.

(4) OMR Limited, an Indian company, is engaged in manufacturing electronic components. OMR Limited has borrowed Country L $ equivalent to Rs.200 lakhs from Omega Inc., a Country L based company at LIBOR plus 200 points. The LIBOR prevalent at the time of borrowing is 5% for Country L $. The borrowings allowed under the External

Commercial Borrowings guidelines issued under Foreign Exchange Management Act are LIBOR plus 300 basis points. OMR Limited wants to know whether transfer pricing provisions are attracted in respect of this transaction.

Exhibit A: Shareholding pattern of ABC Ltd.

Shareholder	Number of equity shares
Ganga Ltd., India	20,000
Yamuna Ltd., India	10,000
Saraswati Ltd., India	10,000
Thames Inc., Country A	30,000
ABC Inc., Country A	1,20,000
General public	1,10,000

Exhibit B : Details relating to PQR Inc.

(1) Shareholding pattern of PQR Inc.

Shareholder	Number of equity shares
Peru Inc., Country A	30,000
Andes Inc., Country A	40,000
Niagra Inc., Country A	25,000
Atlanta Inc., Country A	15,000
EFG Ltd., India	50,000
General Public	80,000

(2) List of Lenders:

1	Barclays Bank
2	Grindlays Bank
3	Bank of America
4	American Express Bank

(3) List of Borrowers:

1	Titanic Inc., Country A
2	Bolivia Inc., Country A
3	Detro Inc., Country A
4	Santro Inc., Country A

(4) PQR Inc. has not provided guarantee in respect of loan taken by any person

(5) PQR Inc's loans are guaranteed by Peru Inc. and Andes Inc.

(6) The directors of PQR Inc. are appointed by Peru Inc. and Andes Inc.

(7) PQR Inc. purchases steel from different suppliers in India. Only 10% of its requirement is met out of supplies from ABC Ltd.

(8) PQR Inc. manufactures auto parts using steel purchased from different suppliers. It is also a dealer in automobiles.

(9) Apart from XYZ Motors Ltd., it is a dealer for automobiles manufactured by several other companies in India and other countries.

(10) List of Debtors for sales:

1	Michigan Inc., Country A
2	Celro Inc., Country A
3	Dolphin Inc., Country A
4	Elephanta Inc., Country A

Exhibit C: Details relating to Sigma Ltd.

(1) Shareholding pattern of Sigma Ltd.

Shareholder	Number of equity shares
Himalaya Ltd., India	75,000
Satpura Ltd., India	90,000
Vindhyas Ltd., India	45,000
Epsilon Ltd., Country B	1,40,000
Aravalli Ltd., India	25,000
General public	1,50,000

(2) Particulars of turnover of Sigma Ltd.

Previous Year	Turnover
2016-17	Rs.435 crores
2017-18	Rs.455 crores
2018-19	Rs.482 crores
2019-20	Rs.417 crores

Exhibit D: Details relating to XYZ Motors Ltd.

(1) Shareholding pattern of XYZ Motors Ltd.

Shareholder	Number of equity shares
DEF Ltd., India	6,000
GHI Inc., Country D	3,000
LMN Inc., Country A	50,000
RST Ltd., Country C	10,000
HIT Ltd., Country D	1,000
Others	60,000

(2) Total book value of its assets. as on 31.3.2020 : Rs.12,000 crores.

(3) XYZ Motors Ltd. has neither entered into advance pricing agreement nor has it opted for safe harbor rules.

(4) The manufacture of vans by XYZ Motors Ltd is wholly dependent on the use of know-how owned by RST Ltd. RST Ltd. is the sole owner of such technical knowhow.

(5) The value of 1 Country C $ and of 1 EURO was Rs.60 and Rs.81, respectively, throughout the year.

Exhibit E : Details relating to Birla Motors Ltd., India

(1) Shareholding pattern of Birla Motors Ltd.

Shareholder	Number of equity shares
Sahara Ltd., India	15,000
Thar Ltd., India	20,000
Gobi Ltd., India	7,000
Sunderbans Ltd., India	8,000
General Public	1,50,000

(2) List of Lenders:

1	State Bank of India
2	Bank of Baroda
3	Union Bank of India
4	Sundaram Finance Ltd.
5	Apple Finance Ltd.

(3) List of Borrowers:

1	Xansa Ltd., India
2	Munnar Ltd., India
3	Podhigai Ltd., India
4	Vanasthali Ltd., India

(4) Birla Motors Ltd. has not provided guarantee in respect of loan taken by any person

(5) Birla Motors Ltd.'s loans are guaranteed by Sahara Ltd. and Thar Ltd.

(6) The directors of Birla Motors Ltd. are appointed by Sahara Ltd. and Thar Ltd.

(7) Birla Motors Ltd. uses the technical know how provided by a few companies outside India, including RST Ltd.

(8) Birla Motors Ltd. is not a shareholder of RST Ltd; It does not appoint any of the directors of RST Ltd.

Exhibit F : Details relating to OMR Ltd.

(1) Shareholding pattern of OMR Ltd.

Shareholder	Number of equity shares
A Ltd., India	5,000

B Inc., Country L	7,000
C Inc., Country L	14,000
D Ltd., India	12,000
E Inc., Country L	8,000
Omega Inc., Country L	10,000
Others	24,000

(2) Total book value of assets of OMR Ltd as on 31.3.2020 : Rs.3,000 crores.

(3) OMR Ltd. has neither entered into advance pricing agreement nor has it opted for safe harbor rules.

(4) Loan advanced by Omega Inc., Country L to OMR Ltd : Rs.1,600 crores

Note*: In all the above exhibits, the shareholding pattern is reflective of the voting power, i.e., all shares have equal voting rights.*

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

I. MULTIPLE CHOICE QUESTIONS

Write the most appropriate answer to each of the following questions by choosing one of the four options given.

1 If Fulcrum Ltd. had entered into an agreement for sale of 1000 units of non-core auto components to Mr. Rajiv, an unrelated party, on 13.7.2019, and Mr. Rajiv had entered into an agreement for sale of such components with Gigo Inc. on 8.7.2019, which of the following statements is correct?

(a) Transfer pricing provisions would not be attracted since Fulcrum Ltd. and Mr. Rajiv are not associated enterprises

(b) Transaction between Fulcrum Ltd. and Mr. Rajiv would be deemed to be an international transaction between associated enterprises, only if Mr. Rajiv is a non-resident.

(c) Transaction between Gigo Inc. and Mr. Rajiv would be deemed to be an international transaction between associated enterprises, only if Mr. Rajiv is a non-resident.

(d) Transaction between Fulcrum Ltd. and Mr. Rajiv would be deemed to be an international transaction between associated enterprises, whether or not Mr. Rajiv is a non-resident.

2 In respect of the transaction referred to in Q.1 above, what would be the penalty leviable if Fulcrum Ltd. fails to report the above transaction?

(i) 2% of the value of transaction
(ii) 50% of tax payable on under-reported income
(iii) 200% of tax payable on under-reported income

(a) Only (i) above

(b) (i) and (ii) above

(c) (i) and (iii) above

(d) No penalty is leviable since Fulcrum Ltd. and Rajiv are not associated enterprises

3 Let us suppose Alpha Ltd. has entered into an advance pricing agreement (APA) in respect of its transactions with Xylo Inc. for the P.Y.2019-20. The company decides to make an application for roll back of the said APA. However, rollback provision shall not be available in respect of the said transaction for a rollback year, if –

(i) such application has the effect of reducing total income declared in the return of income of the said year

(ii) determination of the arm's length price of the said transactions for the said year has been the subject matter of appeal before Commissioner (Appeals) and the Commissioner (Appeals) has passed an order disposing of such appeal at any time before signing of the agreement

(iii) determination of the arm's length price of the said transactions for the said year has been the subject matter of appeal before the Appellate Tribunal and the Appellate Tribunal has passed an order disposing of such appeal at any time before signing of the agreement

(iv) return of income for the relevant roll back year has been furnished by the company under section 139(4)

The most appropriate answer is –

(a) and (ii) above.

(b) (i) and (iii) above

(c) (i), (ii) and (iv) above

(d) (i), (iii) and (iv) above.

4 Assuming that Fulcrum Ltd.'s business income of A.Y.2020-21 has increased by Rs.2 crores due to application of arm's length price by the Assessing Officer, and the same has been accepted by Fulcrum Ltd., then, -

(a) business loss of A.Y.2019-20 cannot be set-off against the enhanced income

(b) deductions under Chapter VI-A cannot be claimed in respect of the enhanced income.

(c) unabsorbed depreciation of A.Y.2014-15 cannot be set-off against the enhanced income

(d) business loss referred to in (a) above, deductions referred to in (b) above and unabsorbed depreciation referred to in (c) above cannot be set-off against the enhanced income.

5 Assuming that there has been an increase in the total income of Alpha Ltd. by Rs.3 crores due to application of arm's length price, and the same has been accepted by Alpha Ltd., the said sum of Rs.3 crores

(a) is not required to be repatriated if the said increase is as per the safe harbor rules

(b) is not required to be repatriated if the said increase is determined by an advance pricing agreement

(c) need not be repatriated in both cases (a) and (b) mentioned above. However, had the increase been made by the Assessing Officer during the course of assessment, the same has to be repatriated failing which it would be treated as a deemed advance.

(d) has to be repatriated in both cases (a) and (b) mentioned above, failing which the same would be treated as a deemed advance.

II. DESCRIPTIVE QUESTIONS

1. (i) Would transfer pricing provisions be attracted in respect of the transaction of supply of steel by ABC Ltd. to ABC Inc.? If so, compute the arm's length price of such transaction.

   (ii) Examine whether transfer pricing provisions would be attracted in respect of transactions between Sigma Ltd. and Epsilon Ltd. If so, what is the penalty leviable for defaults, if any, by Sigma Ltd. in compliance of the requisite provisions under the Income-tax Act?

2. (i) Examine whether transfer pricing provisions are attracted in respect of the transactions entered into by XYZ Motors Ltd. Also, compute the total income of XYZ Motors Ltd. chargeable to tax for A.Y.2020-21.

   (ii) Would transfer pricing provisions be attracted in respect of the transaction of borrowal of funds by OMR Ltd. from Omega Inc? Examine.

SOLUTIONS – CASE STUDY 2

I. ANSWERS TO MCQs

MCQ No.	Answer
1.	(d)
2.	(c)
3.	(d)
4.	(b)
5.	(d)

II. ANSWERS TO DESCRIPTIVE QUESTIONS

Answer to Q.1

(i) Since ABC Inc., a foreign company, holds 40% [1,20,000×100/3,00,000] of the voting power in ABC Ltd., an Indian company, ABC Ltd. and ABC Inc. are deemed to be associated enterprises as per section 92A(2). In this case, ABC Limited, the Indian company, supplied steel manufactured by it to its associated enterprise, ABC Inc. ABC Ltd. supplies similar product to PQR Inc., Country A. From the information given in Exhibits A & B, ABC Ltd. does not have any shareholding in PQR Inc; and PQR Inc also does not have any shareholding in ABC Ltd. PQR Inc. has neither borrowed nor lent money to ABC Ltd. It has not given a guarantee on behalf of ABC Ltd. nor has ABC Ltd. given any guarantee on its behalf. The supplies made by ABC Ltd. to PQR Inc. constitute only 10% of the requirement of PQR Inc. Therefore, from the information given in Exhibits A & B, it would be logical to infer that ABC Ltd. and PQR Inc are unrelated parties. Therefore, the transactions between ABC Limited and PQR Inc. can be considered as comparable uncontrolled transactions for the purpose of determining the arm's length price of the transactions between ABC Ltd. and ABC Inc. Accordingly, comparable Uncontrolled Price (CUP) method of determination of arm's length price (ALP) can be applied in this case.

Transactions with ABC Inc. are on FOB basis, whereas transactions with PQR Inc. are on CIF basis. This difference has to be adjusted before comparing the prices.

Particulars	Amount (in Euro)
Price per MT of steel to PQR Inc.	1,200
Less: Cost of insurance and freight per M.T.	400
Adjusted Price per M.T.	800

Since the adjusted price for PQR Inc., Country A and the price fixed for ABC Inc. are the same, the arm's length price is Euro 800 per MT. Since the sale price to associated enterprise (i.e., ABC Inc.) and unrelated party (i.e., PQR Inc.) is the same, the transaction with associated enterprise ABC Inc. has also been carried out at arm's length price.

(ii) Sigma Ltd., India and Epsilon Ltd., Country B are deemed to be associated enterprises, since Epsilon Ltd. holds shares carrying 26.66% [1,40,000 × 100/5,25,000], voting power in Sigma Ltd, from the information given in Exhibit C. Since Epsilon Ltd. is a non-resident, the transactions of purchase by Sigma Ltd. of goods manufactured by Epsilon Ltd. for sale in India would fall within the meaning of "international transaction" under section 92B. Therefore, transfer pricing provisions would be attracted in this case and the arm's length

price have to be applied to such transactions.

Accordingly, penalty would be leviable under the provisions of the Income-tax Act, 1961 for failure to report such transactions and maintain requisite records in respect of such transactions.

The penalty leviable under the provisions of the Income-tax Act, 1961 in respect of its failures are -

(1) Failure to report transactions with Epsilon Ltd. would attract penalty of Rs.133.536 lakhs, being @ 200% of the amount of tax payable on under reported income of Rs.2 crore, since it is a case of misreporting of income referred under section 270A(9) read with section 270A(8).

Computation of penalty leviable under section 270A

Particulars	Rs
Under-reported income [Rs. 8 crore – Rs.6 crore]	**2,00,00,000**
Tax payable on under-reported income:	
Tax on under-reported income of Rs. 2 crore *plus* total income of Rs. 6 crore declared *[30% of Rs. 8 crore + surcharge@ 7% + EC@4%]*	2,67,07,200
Less: Tax on total income declared *[30% of Rs. 6 crore + Surcharge@7% + EC@4%]*	2,00,30,400
	66,76,800
Penalty leviable@200% of tax payable on under-reported income	1,33,53,600

(2) Failure to report the transaction and maintain the requisite records as required under section 92D in relation to international transaction makes it liable for penalty under section 271AA which would be 2% of the value of international transaction with Epsilon Ltd.

However, if reasonable cause can be shown by Sigma Ltd. for failure to maintain requisite records under section 92D, penalty under section 271AA can be avoided.

Answer to Q.2

(i) Any income arising from an international transaction between two or more "associated enterprises" shall be computed having regard to arm's length price.

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 in the case study along with Exhibit D, it is clear that "XYZ Motors Ltd." is deemed to be associated with :-

(1) LMN Inc., Country A, as per section 92A(2)(a), because this company holds shares carrying 38.46% [50,000 ×100/1,30,000] (i.e., more than 26%) of the voting power in XYZ Motors Ltd.;

(2) RST Ltd., Country C, as per section 92A(2)(g), since this company is the sole owner of the technology used by XYZ Motors Ltd. in the manufacturing process and the manufacture of vans by XYZ Motors Ltd. is wholly dependent on the use of know-how owned by RST Ltd.;

However, GHI Inc., Country D is not an associated enterprise of XYZ Motors Ltd. since its voting power in XYZ Motors Ltd. is only 2.31% [3,000 × 100/1,30,000]. Further, HIT Ltd., Country D, is not an associated enterprise of XYZ Motors Ltd., since this company has financed an amount which is only 49.95% [74 × 81 × 100 /12,000] (i.e., less than 51%) of

the book value of total assets of XYZ Motors Ltd. Also, it holds shares carrying only 0.77% [1,000 × 100/1,30,000] voting power in XYZ Motors Ltd.

The transactions entered into by XYZ Motors Ltd. with LMN Inc. and RST Ltd. are, therefore, to be adjusted accordingly to work out the income chargeable to tax for the A.Y. 2020 -21.

(1) From the details given in Exhibit B & D, it would be logical to conclude that XYZ Motors Ltd. and PQR Inc. are unrelated parties on the same lines of reasoning for concluding ABC Ltd. and PQR Inc. are unrelated parties. Therefore, the price charged from PQR Inc. can be taken as the price of a comparable uncontrolled transaction for determining the arm's length price of the transaction with LMN Inc.

(2) From the details given in Exhibit E, it would be logical to conclude that RST Ltd. and Birla Motors Ltd. are unrelated parties. Birla Motors Ltd. does not have any voting power in RST Ltd.; nor does RST Ltd. have any voting power in Birla Motors Ltd. Birla Motors Ltd. does not solely depend on technical knowhow provided by RST Ltd. It has neither lent nor borrowed money from RST Ltd. Also, it has neither provided guarantee to, nor obtained guarantee from, RST Ltd. It has not appointed any of the directors of RST Ltd; nor has RST Ltd. appointed any of its directors. Therefore, it is apparent that Birla Motors Ltd. and RST Ltd. are unrelated parties. Therefore, the price charged by RST Ltd. from Birla Motors Ltd. for use of technical knowhow can be taken as the price of a comparable uncontrolled transaction for determining the arm's length price of the transaction with XYZ Motors Ltd.

Particulars		**(Rs. in crores)**
Income of XYZ Motors Ltd. as computed under Chapter IV-D, prior to adjustments as per Chapter X		585.00
Add:	Difference on account of adjustment in the value of international transactions:	
(i)	Difference in price of van @ Euro 280 each for 8,500 vans (Euro 280 x 8,500 x Rs.81) sold to LMN Inc.	19.278
(ii)	Difference for excess payment of royalty of $ 20,00,000 ($ 20,00,000 x Rs.60) to RST Ltd.	12.000
Total Income		**616.278**

(ii) Omega Inc., Country L and OMR Limited, the Indian company are deemed to be associated enterprises, since Omega Inc. has advanced loan constituting 53.33% of the book value of total assets of OMR Ltd. [1,600 × 100/3,000] , as per the information given in Exhibit F. Accordingly, transfer pricing provisions would be attracted. The arm's length rate of interest can be determined by using CUP method having regard to the rate of interest on external commercial borrowing permissible as per guidelines issued under Foreign Exchange Management Act. The interest rate permissible is LIBOR plus 300 basis points i.e., 5% + 3% = 8%, which can be taken as the arm's length rate. The interest rate applicable on the borrowing by OMR Limited, India from Omega Inc., Country L, is LIBOR plus 200 basis points i.e., 5% + 2% = 7%. Since the rate of interest, i.e. 7% is less than the arm's length rate of 8%, the borrowing made by OMR Ltd. is not at arm's length. However, in this case, the taxable income of OMR Ltd., India, would be lower if the arm's length rate is applied. Hence, no adjustment is required since the law of transfer pricing will not apply if there is a negative impact on the existing profits.

CASE STUDY - 3

Sigma Corporation Ltd. (SCL), is a company incorporated under the Companies Act, 2013, having factory and registered office in Mumbai. It is engaged in manufacture, purchase and sale of men's wear, selling various kinds of garment products according to the requirement of the buyers across the world. The company has sold different garment products in the Financial Year 2019-20 to different vendors in the Indian and outside Indian market, including sale of T-shirts to one its associated enterprises, namely, John Miller of UK, to whom it had sold 2,50,000 pieces at the rate of ₹ 1,000 per piece.

Major portion of the income of SCL is from sale of manufactured products. The company (SCL) maintains a gross profit margin of 30% on the selling price. However, it has purchased the T-shirts sold to its UK based associated enterprise John Miller from Mudra Garments Ltd. of Ahmedabad at a price of ₹ 840 per piece.

Following functional differences were noted between the transaction with the UK based customer and other parties:

(a) Sales to third parties had been made with a specialized packaging for which 3% margin is included in the selling price.

(b) Tagging on the product purchased is being required by the other clients for which cost was ₹ 3 per piece, whereas in case of sales made to John Miller of UK, no tagging is to be done.

(c) Products sold to third parties involve a credit period of 6 months for which 0.5% per month margin on selling price is ensured by Sigma Corporation Ltd.

SCL, for the purpose of diversification, is now contemplating to expand its business operations by establishing an affiliate in the Mediterranean. Two countries under consideration of the Board of SCL are Spain and Cyprus. SCL intends to repatriate all after-tax foreign source income from the affiliate to India. In India, the corporate income/may be taken as 30 percent.

At this point, Sigma Corporation Ltd. is not certain whether it would be better to establish the affiliate operation in two countries as a branch operation or a wholly-owned subsidiary of the parent company.

In Cyprus, the marginal corporate tax rate is 20 percent and the foreign branch profits are also taxed at the same rate. In Spain, the corporate income is taxed at 25 percent and additionally, foreign branch income is also taxed at the same rate of 25 percent.

The withholding tax treaty rates with India on dividend income paid from Cyprus is 15 percent and when paid from Spain is 20 percent.

The Chief Financial Officer (CFO) of the company appraised the Board of Directors that the matters of the company pending before the tax authorities are involving several issues for which a show cause notice for A.Y. 2019-20 has been issued by the A.O. The issues of concern as has been raised in this notice in brief are:

(i) The. company has not maintained proper records of the international transactions required under the Income-tax Act, 1961 (Act) and has also defaulted in not obtaining the report of the auditors within the prescribed time.

(ii) The transactions entered into with the associated enterprises during the previous year for determination of ALP have been referred by the AO to the TPO on 22.12.2020 for the reason of under-reporting.

(iii) The total international transactions carried out by the company during the previous year

were of ₹ 200 crores and why penal action should not be taken against the company for the defaults stated in para-1.

The CFO further informed that the TPO to whom a reference was made by the A.O., had of his own, selected one more, party M/s Sun Apparels for determination of the ALP, which is an un-related person and not an associated enterprise but based at UK and whether it is resident or non-resident is also not known.

SCL is contemplating to file an application for advance ruling with the Authority for Advance Ruling.

The Board of SCL now asked you to help them by advising in determination in the context of taxation provisions contained under the Act, relating to international business as prevailing in India and other countries, as well as the expert opinion on the various issues raised in the show cause notice by the AO as appraised by the CFO.

Required:

(a) (i) Determine the Arm's Length Price (ALP) of the transactions of sale of T-shirts during the year to the AE John Miller of UK and its probable impact on the income of the company for A.Y.2020-21.

(ii) Can TPO invoke his powers in relation to an international transaction not referred to him? Is the action taken by the TPO in relation to determination of ALP of the transactions undertaken by the company with M/s Sun Apparels of UK justified?

(b) (i) Where and in which country should the new affiliate be situated and which organizational structure (i.e. wholly owned subsidiary or branch) is to be selected?

(ii) Discuss whether the total tax liability in Cyprus or in Spain would be the least for operating a foreign branch or a wholly owned subsidiary of the parent company.

(c) Choose the most appropriate option for the following (option to be written in capital letters A, B, C or D)

(1) Two methods were found suitable for determination of the Arm's Length Price (ALP). As per CUP methods, it was found to be ₹ 1,200 per unit and as per resale price method, it was ₹ 1,250 per unit. The ALP per unit will be taken as

(A) ₹ 1,200 since it is more favourable to the assessee

(B) ₹ 1,250 since it is more favourable to the Department

(C) ₹ 1,225

(D) None of the above

(2) An assessee having specified domestic transactions covered by section 92BA, should furnish audit report, if the value ·of such transactions exceeds

(A) ₹ 2 crores

(B) ₹ 20 crores

(C) ₹ 10 crores

(D) None of the above

(3) An assesse deriving income from profits of business of an eligible industrial undertaking for which 100% deduction is available u/s 80-1B has entered into

international transactions with an associated enterprise for ₹ 200 crores. The TPO has made an addition of ₹ 15 crores in respect of the ALP. The normal GP margin is 10%. The additional deduction u/s 80-IB which can be claimed by the assessee on account of the increase in the ALP is

(A) Nil

(B) ₹ 20 crores

(C) ₹ 25 crores

(D) ₹ 15 crores

(4) The OECD member countries have accepted the concept of Arm's Length Price (ALP) for reaping the following benefit:

(A) Minimises double taxation

(B) Real taxable profits can be determined

(C) Artificial price distortion is reduced

(D) All the three above

(5) In the context of transfer pricing provisions, international transaction should be in the nature of

(A) Purchase, sale or lease of tangible or intangible property

(B) Provision of service

(C) Lending or borrowing money

(D) Any of the above

SOLUTIONS – CASE STUDY 3

(a) (i) Sigma Corporation Ltd. (SCL) maintains a gross profit margin of 30% on the selling price. It purchased T-shirts from an unrelated enterprise which are sold to its UK based AE at a price of ₹ 840 per piece. Under comparable uncontrolled transactions, the sale price of T-shirts would be ₹ 1,200 [₹ 840/(100-30)].

Such sale price has to be adjusted by taking into consideration the functional differences existing between the transactions with the Associated enterprise and other unrelated parties. Accordingly, the arm's length price has to be computed in the following manner:

Computation of Arm's Length Price

Particulars	₹	₹
Sale price of T-shirt	1,200	
Less: Differences to be adjusted		
- Margin on specialized packaging (1,200 x 3%)	36	
- Margin for providing 6 months' credit facility [₹1200 x (0.5% x 6 months)]	36	
- Cost of tagging of ₹ 3 per piece	3	
Adjusted sale price per T-shirt	1,125	
Arm's Length value of the sale transaction (₹ 1,125 x 2,50,000)		**28,12,50,000**
Less: Transaction value of sales to AE (₹ 1,000 x 2,50,000)		25,00,00,000
Total Income of SCL Ltd to be increased by		**3,12,50,000**

(ii) Yes; The TPO can generally do so in respect of international transactions.

As per section 92CA(2A), the Transfer Pricing Officer (TPO) can also determine the ALP of other international transactions not referred to him and identified subsequently in the course of proceedings before him.

As per section 92CA(2B), where in respect of an international transaction, the assessee has not furnished the report under section 92E and such transaction comes to the notice of the TPO during the course of proceeding before him, the transfer pricing provisions shall apply as if such transaction is referred to the TPO by the Assessing Officer under section 92CA(1).

As per section 92B, "International transaction" means a transaction between two or more associated enterprises, either or both of whom are non-residents, in the nature of, inter alia, purchase, sale or lease of tangible or intangible property.

The transaction entered into by the company, SCL, with M/s Sun Apparels of UK, is not an international transaction, since it is with an un-related person, not being an associated entity.

Therefore, the action taken by the TPO in relation to determination of ALP of the transactions undertaken by the company with M/s Sun Apparels of UK is **not** justified.

(b) (i)

Particulars	Cyprus		Spain	
	Branch	Subsidiary	Branch	Subsidiary
Tax rate in the foreign country	20%	20%	25%	25%

Tax on profit repatriations/withholding tax on dividend	-	15% of 80% = 12%	-	20% of 75% = 15%
Total tax paid in the foreign country	**20%**	**32%**	**25%**	**40%**
Tax payable in India	**30%**	**12%**	**30%**	15% of 75% = **11.25%**

Situation 1 : Assuming that Foreign Tax Credit is available in respect of branch profit tax

Particulars	Cyprus		Spain	
	Branch	Subsi-diary	Branch	Subsi- diary
Foreign Tax Credit	20%, if such credit is available in respect of branch profit tax (assuming that full credit is available in respect of branch profit tax)	12%	25%, if such credit is available in respect of branch profit tax (assuming that full credit is available in respect of branch profit tax)	11.25%
Net tax payable	**30%**	**32%**	**30%**	**40%**

In Situation 1, where FTC is available in respect of the entire branch profit tax, it would be advisable to establish a branch in the place of subsidiary. The branch can be established either in **Cyprus or in Spain.**

Situation 2 : Assuming that Foreign Tax Credit is not available in respect of branch profit tax

Foreign Tax Credit	0%, assuming such credit is not available in respect of branch profit tax	12%	0%, assuming such credit is not available in respect of branch profit tax	11.25%
Net tax payable	**50%**	**32%**	**55%**	**40%**

In Situation 2, where FTC is not available in respect of branch profit tax, it would be advisable to establish a subsidiary in Cyprus

Note - The answer to this question may be based on either of the situations given above or on the basis of the following other factors, which also need to be considered for selecting the new affiliate as branch and subsidiary:

Particulars	Branch	Subsidiary

Separate Legal Entity	It is not a separate legal entity; the parent company would be liable to tax in respect of profits attributable to the branch, which is a permanent establishment.	A subsidiary is a separate legal entity from the parent, although owned by the parent corporation. A subsidiary qualifies as a "resident" for treaty benefits in the other Contracting State. Its profits are independently taxed in its hands
Taxability of profits repatriated	The profits repatriated by the branch to the head office do not suffer double taxation.	The profits from which the dividend is distributed may be subject to double taxation. In the country in which the subsidiary company is incorporated, corporate income- tax is leviable in respect of its profits. The profits distributed would be subject to tax on dividends in the hands of the holding company in India.
Set-off of loss incurred	The losses from branch can be offset against the profits of the company.	The losses of the subsidiary are not eligible for setoff against the profits of the parent company.
Compliance cost	Relatively lower compliance cost.	Greater compliances to be met.

(ii) Total tax liability

In Situation 1, where FTC is available in respect of the entire branch profit tax, it would be advisable to establish a branch in the place of subsidiary.

The branch can be established either in Cyprus or in Spain. The tax liability would be 30% (plus applicable surcharge and cess)

Hence, from the tax incidence point of view, the tax liability will remain the same. Choice of the country has to be determined based on other factors.

Where alternative view has been taken for Qn. 1(b)(i)

In Situation 2, where FTC is not available in respect of the entire branch profit tax, it would be advisable to establish a subsidiary in Cyprus.

The tax liability would be 32% (plus applicable surcharge and cess)

(c) (1) D

(2) B

(3) A

(4) D

(5) D

CASE STUDY - 4

Mr. Abhinav, a citizen of India, aged 48 years, for the first time, moved for employment purpose to Country "X", a country outside India, on 1st September, 2015. He was employed with a consulting firm in Country "X". Since then, he has visited India during the P.Y.2015-16, 2016-17, 2017-18, 2018-19, 2019-20 for 30 days, 50 days, 50 days, 170 days and 150 days, respectively, for both personal and professional purposes. His family comprises of himself, his spouse Mrs. Archana (aged 45 years); his mother, Mrs. Kamala (aged 81 years); and his two sons, Rohan and Kapil, aged 19 years and 15 years, respectively. In addition, Mr. Abhinav's unmarried sister Ms. Geetha, aged 42 years, is living with his family in Country "X" since September, 2015. Ms. Geetha and Mrs. Kamala have been visiting India during the P.Y. 2015-16, 2016-17, 2017-18, 2018-19, 2019-20 for 50 days, 50 days, 120 days,
150 days and 150 days, respectively.

In the year 2018-19, Mr. Abhinav resigned from his job and started his own consultancy in Country "X" for providing technical services. He entered into an agreement with ABC Ltd, an Indian company, on 01.06.2018 and pursuant to the agreement, Fees for Technical Services (FTS) of INR 10,00,000, is payable to Mr. Abhinav every year for a period of five years. The agreement is approved by the Central Government. Mr. Abhinav also entered into an agreement with the Government of Country "Y" for provision of technical services for a period of three years. The FTS payable to Mr. Abhinav every year for a period of three years under this agreement in foreign currency is equivalent to INR 15,00,000.

During the previous year 2019-20, Mr. Abhinav became partner in a partnership firm M/s Lotus & Co., India and contributed INR 50 lakhs towards capital. He was paid interest @10% as interest on capital and profit share of INR 4 lakhs every year by the firm.

His friend Mr. George, a citizen and resident of Country "X", borrowed money from Mr. Abhinav and invested the same in bonds issued by MNO Ltd., an Indian Company in April, 2019. Mr. George visited India during the P.Y.2019-20 for the period from 10th April, 2019 to 15th May, 2019. During the previous year 2019-20, interest on borrowings in foreign currency equivalent to INR 1,95,000 was paid by Mr. George to Mr. Abhinav in his bank account in Country "X".

Mr. Abhinav also earned income of foreign currency equivalent to INR 3,00,000 from his house property in Country 'X' deposited in an Indian Bank at Country 'X' and subsequently brought to India. Also, he had paid property tax of foreign currency equivalent to INR 3,000 on the said property. During the previous year 2019-20, the rental income earned was invested in deposits in India in the ratio of 30:20:50 in NRO savings account, 5 year fixed deposits and NRE savings account. Interest earned on such deposits is INR 4,000, 5,000 and 9,000, respectively.

On 30.06.2019, he sold shares of Prime Pvt. Ltd., India for INR 12,00,000 and of Hello Pvt. Ltd., India for INR 9,30,000 net of transfer expenses. These shares were purchased by him in convertible foreign currency on 01.12.2016 at a cost of INR 6,20,000 and on 01.01.2019 at a cost of INR 7,50,000 respectively. On 31.10.2019, he invested the sale proceeds of INR 10,50,000 in purchase of shares of Cheers Pvt. Ltd., India.

Further, on 01.12.2019, Mr. Abhinav sold 2000 shares of PQR Pvt. Ltd., India, for INR 15 each. 1500 of such shares were acquired on 01.10.2017 @ INR 10 each and 500 shares were acquired on 31.10.2018 @INR 12 each.

In April, 2019, he had taken a loan of INR 50 lakhs @10% from SBI for construction of residential house in Pune. The construction is completed in May, 2020. He prepaid INR 3 lakhs in March, 2020 to the bank.

He had also purchased the following capital assets in April, 2019 and he transferred the same outside India to Mr. Thomas, a resident of Country "X", in March, 2020 –

- Rupee Denominated Bonds of INR 1,00,000 of LMN Ltd., an Indian Company, issued outside India, for INR 2,00,000.
- Government Securities of INR 1,00,000 through an intermediary dealing in settlement of securities, for INR 1,50,000

Mr. Thomas, a citizen of India, visits India for 100 days every year.

Mrs. Archana, a painter by profession, earned income of INR 3,00,000 from exhibition conducted in Mumbai. Rohan and Kapil are pursuing education in Country 'X'. Mr. Abhinav paid foreign currency equivalent to INR 60,000 to Catheral School, Country 'X,' towards their annual tuition fees. Kapil won an excellence award of INR 25,000 at the Science Olympiad held in Mumbai in February, 2020.

Mr. Abhinav paid foreign currency equivalent to INR 50,000 to an Insurance Company in Country 'X' towards life insurance premium to insure his life and life of Mrs. Archana. Mr. Abhinav has also paid INR 20,000 to New India Assurance Company, India, for health insurance of himself and Mrs. Archana, INR 35,000 to insure health of Mrs. Kamala and INR 25,000 to insure the health of Ms. Geetha.

In December, 2016, Ms. Geetha bought, in foreign currency, 500 Global Depository Receipts of PQR Ltd, an Indian Company, which were issued in accordance with the notified scheme of the Central Government. In January, 2020, she sold 300 GDRs outside India to Mr. Frank, a citizen and resident of Country 'X' and 200 GDRs to Mr. Kamal, a Resident but not ordinarily resident in India.

EXHIBIT

COST INFLATION INDICES

Financial Year	Cost Inflation Index
2001-02	100
2002-03	105
2003-04	109
2004-05	113
2005-06	117
2006-07	122
2007-08	129
2008-09	137
2009-10	148
2010-11	167
2011-12	184
2012-13	200
2013-14	220
2014-15	240
2015-16	254
2016-17	264
2017-18	272
2018-19	280
2019-20	289

I. OBJECTIVE TYPE 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. Based on the above facts, Mr. Abhinav's residential status in India for P.Y.2019-20 and P.Y.2015-16 is -
   (a) Non-resident for both the years
   (b) Non-resident for P.Y.2019-20 and Resident but not ordinarily resident for P.Y.2015-16
   (c) Resident but not ordinarily resident for P.Y.2019-20 and Resident for P.Y.2015-16
   (d) Non-resident for P.Y.2018-19 and Resident and ordinarily resident for P.Y.2015-16.

   *(**Note** – Assume that the rules for determining residential status for A.Y.2016-17 were the same as it is for A.Y.2020-21)*

2. Which of the following benefits are not allowable to Ms. Geetha, while computing her total income and tax liability for A.Y.2020-21 under the Income-tax Act, 1961?
   (a) Deduction of 30% of gross annual value while computing her income from house property in Bangalore, India
   (b) Tax rebate of INR 12,500 from tax payable on her total income upto INR 5,00,000
   (c) Deduction for donation made by her to Prime Minister's National Relief Fund
   (d) Deduction for interest earned by her on NRO savings account.

3. Unexhausted basic exemption limit, if any, of Mr. Thomas, for A.Y.2020-21 can be adjusted against –
   (a) Only LTCG taxable@20%
   (b) Only STCG taxable@15%
   (c) Both (a) and (b)
   (d) Neither (a) nor (b)

4. Comment on the tax consequences of sale transaction undertaken by Ms. Geetha during the PY 2019-20 under the Income-tax Act, 1961 -
   (a) Capital gains arising on sale of 500 GDRs shall be subject to tax @20% with indexation benefit in India
   (b) No capital gains would arise on sale of 500 GDRs in India, since the GDRs are purchased in foreign currency
   (c) No capital gains would arise on sale of 300 GDRs, but capital gains arising on sale of 200 GDRs shall be taxed in India @10% without indexation benefit
   (d) No capital gains would arise on sale of 300 GDRs, but capital gains arising on sale of 200 GDRs shall be taxed @20% with indexation benefit in India

5. Interest income earned by Mr. George during the P.Y.2019-20 on bonds, issued by MNO Ltd., an Indian company, under a scheme notified by the Central Government, which were purchased by him in convertible foreign currency, is -
   (a) taxable@10%
   (b) taxable@15%
   (c) taxable@20%
   (d) not taxable

II. DESCRIPTIVE QUESTIONS

1. (i) As a tax consultant for M/s Lotus & Co., India, you need to advise the firm regarding tax deduction at source on the payments (i.e. interest on capital and share of profit) made to Mr. Abhinav during the previous year 2019-20, considering that Mr. Abhinav is a resident of Country 'X', with which India has no DTAA. In case tax is not deductible at source, is there any other related requirement to be complied with by the firm?

   (ii) If India has a DTAA with Country 'X' providing for deduction of tax at 10%, then, what is the remedy available in case M/s Lotus & Co., India has deducted tax at the requisite rate provided under the Income-tax Act, 1961?

2. Using the information given in the facts of the case, compute Mr. Abhinav's total income and tax liability for the Assessment Year 2020-21, assuming that he is a resident of Country X, with which India has no DTAA and he opts for computing his income in accordance with the provisions of Chapter XII-A of the Income-tax Act, 1961. You may ignore the amount of advance tax and TDS credit appearing in Form 26AS. Also, ignore the effect of first proviso to section 48, wherever applicable.

SOLUTIONS – CASE STUDY 4

I. ANSWERS TO MCQs

MCQ No.	Answer
1.	(d)
2.	(b)
3.	(d)
4.	(c)
5.	(a)

II. ANSWERS TO DESCRIPTIVE QUESTIONS

1.

(i) Section 194A requiring deduction of tax at source on any income by way of interest, other than interest on securities credited or paid to a resident, excludes from its scope, income credited or paid by a firm to its partner. However, section 195 which requires tax deduction at source on payment to non-residents, does not provide for any exclusion in respect of payment of interest by firm to its non-resident partner. Therefore, tax has to be deducted under section 195 @ 30%, being the rate in force in respect of Interest on capital paid to Mr. Abhinav.

As per section 10(2A), share of profit received by partner from the total income of firm is exempt from tax. Therefore, the share of profit paid to non-resident Indian is not liable for tax deduction at source.

However, section 195(6) provides that the person responsible for paying any sum, whether or not chargeable to tax, to a non-corporate non-resident or to a foreign company shall be required to furnish the information relating to payment of such sum in the prescribed form and manner.

(ii) The CBDT has, vide Circular No.7/2007 dated 23.10.2007, laid down the procedure for refund of tax deducted at source under section 195 of the Income-tax Act, 1961 to the person deducting tax at source from the payment to a non-resident. The said Circular allowed refund to the person making payment under section 195, *inter alia*, when there occurs payment of tax at a higher rate under the Income-tax Act, 1961 while a lower rate is prescribed in the relevant double taxation avoidance treaty entered into by India.

Hence, M/s Lotus & Co., India can claim tax refund of excess tax deducted at source under section 195 where tax has been deducted at source at the rate of 30% provided under the Income-tax Act, 1961 while a lower rate i.e., 10% is prescribed under the DTAA with Country 'X'.

2. Computation of Total Income of Mr. Abhinav for A.Y. 2020-21

Particulars	INR	INR	INR
Profits & Gains of Business & Profession			
Income from partnership firm M/s Lotus & Co., India		5,00,000	
- Interest on Capital *[See Note (ii)]*	4,00,000		
- Share of Profit			
Less: Exempt under section 10(2A)	(4,00,000)	-	
Fees for technical services received from ABC Ltd., India		10,00,000	
Fees for technical services received from Government of Country "Y" *[See Note (iii)]*			15,00,000
Capital Gains *[See Working Note]*			
Short-term capital gain on sale of shares of -			
- PQR Pvt. Ltd.	1,500		
- Hello Pvt. Ltd	1,80,000	1,81,500	
Long- term capital gain on sale of shares of			
- PQR Pvt. Ltd.	Nil		
- Prime Pvt. Ltd.	72,500	72,500	2,54,000
Income from Other Sources			
Interest earned on deposits:			
- Interest earned on NRO saving deposits		4,000	
- Interest earned on fixed deposits		5,000	
- Interest on NRE savings account [Exempt u/s 10(4)(ii)] *[See Note (v)]*		-	9,000
Gross Total Income			17,63,000
***Less:* Deductions under Chapter VI-A**			
Deduction under section 80C *[See Note (viii)]*			
Life insurance premium for self and his spouse	50,000		
Term deposit [Five year term deposit]	60,000		
Repayment of housing loan borrowed for construction of residential house	-	1,10,000	
Deduction under section 80D [*See Note (ix)]*			

Health insurance of self and spouse	20,000		
Health insurance of mother	25,000	45,000	
Deduction u/s 80TTA *[See Note (x)]*		4,000	1,59,000
Total Income			**16,04,000**

Computation of Tax Liability of Mr. Abhinav for A.Y. 2020-21

Particulars	INR	INR
Tax@10% on fee for technical services under section 115A		1,00,000
Tax@10% on long-term capital gain on sale of foreign exchange assets under section 115E[1]		7,250
Tax on balance income of INR 5,31,500		18,800
		1,26,050
Add: Education cess @4%		5,042
Tax liability		**1,31,092**
Tax liability (rounded off)		**1,31,090**

Working Note:

Computation of Capital Gain on sale of shares purchased in convertible foreign currency

Particulars	INR
LTCG on sale of shares of Prime Pvt. Ltd., since held for more than 24 months	
(As per the provisions of Chapter XII-A, long term capital gain, on sale of any specified asset in foreign currency, shall be calculated at flat rate of 10% without indexation. Shares of Prime Pvt. Ltd fall under the category of "specified assets")	
Sale Consideration	12,00,000
Less: Cost of Acquisition	(6,20,000)
Long term capital gain	5,80,000
Less: Exemption under section 115F	
5,80,000*10,50,000/12,00,000	(5,07,500)
Long-term capital gain as per Chapter XII-A	**72,500**
*(**Note** - Since within a period of six months after the date of transfer of a long term foreign exchange asset, Mr. Abhinav has invested part of the net consideration in any specified asset, namely shares of Cheers Pvt. Ltd., he is eligible to claim proportionate deduction as per section 115F)*	

STCG on sale of shares of Hello Pvt. Ltd., since held for less than 24 months	
Sale Consideration	9,30,000
Less: Cost of Acquisition	(7,50,000)
Short term Capital Gain	**1,80,000**
(Provisions of Chapter XII-A are only applicable in respect of long term capital gain from transfer of foreign exchange assets.)	

Computation of Capital Gain on sale of shares of PQR Pvt. Ltd.

Particulars	INR
LTCG on sale of 1500 shares acquired on October 1, 2017	
(As per section 2(42A), share of an unlisted company, if sold after period of 24 months from the acquisition date will be considered as long-term capital asset)	
Sale Consideration [1,500 x INR 15]	22,500
Less: Cost of Acquisition [1,500 x INR 10]	(15,000)
Long term Capital Gain	**7,500**
Less: Exemption u/s 54F [since the amount invested in construction of house at Pune exceeds the net sale consideration of INR 22,500 on sale of shares, the entire capital gain would be exempt. The construction of the house in Pune was completed within the prescribed time i.e., within three years after the date of transfer]	7,500
STCG on sale of 500 shares acquired on October 31, 2018	Nil
Sale Consideration [500 x INR 15]	7,500
Less: Cost of Acquisition [500 x INR 12]	(6,000)
Short term Capital Gain	**1,500**

Notes:

(i) Mr. Abhinav is a person who, staying outside India, comes on a visit to India every year. Hence, the minimum period of stay in India for Mr. Abhinav to be treated as a resident is 182 days in any previous year. For A.Y.2020-21, Mr. Abhinav is a non-resident since his stay in India in the P.Y.2019-20 is less than 182 days. In case of a non-resident, only income which accrues or arises or is deemed to accrue or arise in India or is received or is deemed to be received in India is taxable in India. Income which accrues or arises outside India is not taxable in India. Rental income from property in Country 'X' received there and subsequently brought to India is not taxable in India in the hands of Mr. Abhinav, since it neither accrues to him in India nor is it received by him in India.

(ii) Interest on capital paid by the partnership firm is includible as business income in the hands of the partner, only to the extent the interest is allowed as deduction in the hands of firm. In this case, the entire interest of INR 5 lakhs is included in the income of Mr. Abhinav assuming that the same has been fully allowed as deduction in the hands of firm.

(iii) Fees for technical services received from ABC Ltd., an Indian company, would be chargeable to tax under the head "Profits and gains of business or profession" in the hands of Mr. Abhinav. Since Mr. Abhinav is a resident of a country 'X' with which India has no DTAA, such fees for technical services would be taxable @10% as per section 115A.

However, fees for technical services received in foreign currency by Mr. Abhinav from the Government of Country "Y" would not be taxable in India, since such income has neither accrued in India nor is the same received in India.

(iv) As per section 9(1)(v)(c), interest payable by a non-resident would be deemed to accrue or arise in India, where the interest is payable on any debt incurred, or money borrowed and used, for the purpose of a business or profession carried on by such non-resident in India. In the present case, Mr. George, a non-resident had purchased bonds of MNO Ltd., an Indian company out of the money borrowed. Consequently, the interest received by Mr. Abhinav in foreign currency equivalent to INR 1,95,000 will not be taxable in India, since such interest is neither received nor is it deemed to accrue or arise in India. Mr. George is a non-resident in India for A.Y.2020-21 since his stay in India during the P.Y.2019-20 is only 36 days.

(v) As per section 10(4)(ii), in case of an individual, any income by way of interest on moneys standing to his credit in Non-resident External Account (NRE A/c) would be exempt, provided the individual is a person resident outside India, as defined in Foreign Exchange Management Act (FEMA), 1999. Here, it is assumed that Mr. Abhinav qualifies to be person resident outside India as per FEMA, 1999 and hence, interest of INR 9,000 from NRE A/c is exempt from tax in his hands.

(vi) Transfer outside India of Rupee denominated bonds of an Indian company issued outside India and Government Securities through an intermediary dealing settlement of securities by Mr. Abhinav, a non-resident, to Mr. Thomas, another non-resident, would not be regarded as a transfer under section 47 for levy of capital gains tax. Thomas is a non-resident since he has stayed in India only for 100 days in the P.Y.2019-20. Being a citizen of India residing in Country "X", he has to come and stay in India for atleast 182 days in a year to be treated as a resident.

(vii) As per section 64(1A), all income accruing to minor child is includible in the hands of the parent, whose total income before including minor's income is higher, after providing deduction of INR 1,500 per child under section 10(32). However, if minor child has earned the income because of his skill or talent then it will not be included in the hand of parents. Hence, income generated by Mr. Abhinav's minor son, Kapil, by winning Science Olympiad shall not be clubbed with Mr. Abhinav's income.

(viii) Under section 80C, deduction is allowed for life insurance premium paid for self or spouse or any child, even though such premium is paid outside India. It is assumed that the annual premium is not more than 10% of actual capital sum assured. However, deduction in respect of tuition fees paid by individual to any university, college, school or other educational institution for full time education of his two children would be allowed only if, such institution is situated in India. Thus, payment for life insurance premium paid by Mr. Abhinav is fully allowable as deduction but no deduction would be allowed for annual tuition fees, since it is for education abroad. Further, no deduction is allowable under section 80C for A.Y.2020-21 in respect of repayment of housing loan, since the property in Pune is under-construction and no amount is chargeable to tax as income from house property, during the previous year

2019-20.

(ix) Mr. Abhinav is eligible for deduction of INR 20,000 in respect of health insurance premium of self and spouse, since the same is less than INR 25,000. He is also eligible for deduction in respect of premium paid for insuring the health of his mother, subject to a maximum of INR 25,000. However, he would not be eligible for claiming higher deduction of upto INR 30,000 under section 80D, as applicable to senior citizen, for the insurance on the health of his mother, since she is non-resident. Further, he is not eligible for any deduction in respect of the premium paid to insure the health of his sister, Ms. Geetha, since sister is not included within the definition of "family".

(x) As per section 80TTA, deduction in respect of interest earned on savings deposits with a bank, co-operative society carrying on the business of banking or post office is allowed to the extent of INR 10,000. Mr. Abhinav can, therefore, claim deduction u/s 80TTA on account of NRO saving bank interest of INR 4,000. However, no deduction is allowed on interest earned on time deposits.

Therefore, interest earned on fixed deposits by Mr. Abhinav shall not be eligible for deduction under section 80TTA.

CASE STUDY – 5

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

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

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

The details of the assignments are as follows -

Assignment 1 [Client – Mr. Harry Smith]

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

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

Assignment 2 [Client – MNO Ltd.]

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

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

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

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

Based on the above facts, answer the following questions –

Multiple Choice Questions

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

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

2. MNO Ltd. is a company -
   (a) resident in India, since it has carried on the operation of purchase of goods in India
   (b) non-resident in India, since its registered head office is in Country 'X'
   (c) non-resident in India, since key management decisions are taken in Country 'X'
   (d) non-resident in India, due to reasons stated in (b) and (c) above.

3. The effective rate of income-tax applicable on total income of M/s. Pacific Airlines is –
   (a) (a) 42.432%
   (b) (b) 44.512%
   (c) (c) 43.68%
   (d) (d) 46.592%

4. Salary paid by M/s. Hari Om & Co. to its partners falls within the limits prescribed under section 40(b)(v). Does Hari Om & Co. have to deduct tax on salary paid to its partners?
   (a) Yes; tax is deductible at source under section 192 on salary paid to its partners.
   (b) No; salary paid to partners is not subject to tax deduction at source
   (c) Yes; tax is deductible at source under section 192 on salary paid to resident partners and under section 195 on salary paid to the non-resident partner
   (d) Salary paid to resident partners is not subject to tax deduction at source; but tax has to be deducted under section 195 on salary paid to the non-resident partner

5. Mr. Harish and Mr. Austin Smith have been appointed as senior officials of Country L embassy and Country Y embassy, respectively, in India in October, 2019. Mr. Harish and Mr. Austin Smith are subjects of Country L and Country Y, respectively, and are not engaged

in any other business or profession in India. The remuneration received by Indian officials working in Indian embassy in Country L is exempt but in Country Y is taxable. The tax treatment of remuneration received by Mr. Harish and Mr. Austin Smith from embassies of Country L and Country Y, respectively, in India for the P.Y.2019-20 is:

(a) Exempt from income-tax under section 10
(b) Taxable under the Income-tax Act, 1961
(c) Remuneration received by Mr. Harish is exempt but remuneration received by Mr. Austin Smith is taxable
(d) Remuneration received by Mr. Harish is taxable but remuneration received by Mr. Austin Smith is exempt.

DESCRIPTIVE QUESTIONS

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

   (b) Let us suppose that there has been a failure to deduct tax at source on the amount of Rs.2 lakh paid by XYZ Ltd. to Mr. Harry Smith for advertisement of shaving cream. The Assistant Commissioner of Income-tax imposed penalty on the company for failure to deduct tax at source. The company seeks your advice on whether penalty is imposable for such failure and if so, in this case, whether such levy is in order. Examine.

2. (a) Examine whether the income of MNO Ltd. would be subject to tax in India. If so, compute the income chargeable to tax in India.

(b) Determine the income of M/s. Pacific Airlines chargeable to tax in India

SOLUTIONS – CASE STUDY 5

I. ANSWERS TO MCQs

MCQ No.	Answer
1.	(c)
2.	(b)
3.	(c)
4.	(d)
5.	(b)

II. ANSWERS TO DESCRIPTIVE QUESTIONS

1. (a) Mr. Harry Smith is a non-resident in India for A.Y.2020-21, since he has stayed in India only for 54 days in the P.Y.2019-20. Ms. Rita Smith would also be non-resident in India for A.Y.2020-21, since she has also stayed in India only for 54 days in the P.Y.2019-20.

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

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

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

Particulars	₹	₹
Income taxable under section 115BBA		
Income from participation in swimming competition in India	15,00,000	
Advertisement of product on TV	2,00,000	
Contribution of articles in newspaper	20,000	
Income taxable under section 115BB		
Income from horse races	25,000	
Total income	**17,45,000**	
Tax@ 20% under section 115BBA on ₹ 17,20,000		3,44,000
Tax@ 30% under section 115BB on income of ₹ 25,000 from horse races		7,500
		3,51,500
Add: Education cess@4%		14,060
Total tax liability of Harry Smith for the A.Y.2020-21		**3,65,560**

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

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

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

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

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

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

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

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

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

(i) the amount paid or payable, whether in or out of India, to the assessee on account of the carriage of, *inter alia*, passengers from any place in India; and

(ii) the amount received or deemed to be received in India by or on behalf of the assessee on account of the carriage of, *inter alia*, passengers from any place outside India.

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

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

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

CASE STUDY – 6

About the company

Rup Ram Limited (RRL), is a domestic company, with its head office located at Mumbai. The company has several divisions dealing in manufacture, purchase and sale of several products.

RRL possesses the following assets as on 31-3-2020, whose book values are as under:

Type of asset	(₹ in crores)
Intangible assets	20
Land and Building	250
Plant and Machinery	140
Vehicles	25

The market value of these assets as on 31-3-2020 is ₹ 750 crores.

Information from Manager, HR

Manager, Human Resources (HR) Division informs you that as on 31 3-2020, there were 340 employees, in the rolls of RRL, resulting in wages/salary payments to the tune of ₹ 11.2 crores.

Subsidiary's presence in India

RRL has a foreign subsidiary Snow White & Co. Inc. (SWC), incorporated in Singapore.

The subsidiary has assets present in India. It has 40 godowns in India, whose market value as on 31-3-2020 is ₹ 40 crores, the book value being ₹ 25 crores, split into ₹ 10 crores for land component and balance for building portion. WDV as on 31 -3-2020 for income-tax purposes is ₹ 13.2 crores.

Other fixed assets (all purchased on 14-6-2019) are to the tune of ₹ 10 crores (WDV for the purposes of the Income-tax Act, 1961 (Act) ₹ 8.6 crores). Besides these, there is no other asset in India.

At the beginning of the year, SWC had 22 godowns in India, whose market value was ₹ 15 crores, the book value being ₹ 10 crores, split into ₹ 7 crores for land component and balance for building portion. WDV for the Act purposes is ₹ 6.7 crores.

Assets position of SWC outside India

	As on 1-4-2019	As on 31-3-2020
No. of godowns owned	10	11
	(All values in ₹ Crores)	
Godowns : Land portion (Book value)	8	12
(Market value)	20	25
Godowns : Building part (Book value)	5	12
(Market value)	4.5	11
Godowns : Building part (WDV for taxation)	4.2	10.2
Other assets: (Book value)	12	20
(Market value)	14	22
(WDV for taxation)	4.2	10.2

Employees strength of SWC

There are 30 persons employed in India, for whom annual payment of ₹ 1.2 crores is incurred by

SWC. There are 10 other persons, who, though not directly employed by SWC, perform the work like other employees. Outlay to them is ₹ 34 lakhs. All these employees are residents in India,

SWC employs 42 employees outside India, for whom the total payroll expenditure involved is ₹ 3 crores (converted into INR)

Income pattern from Indian operations of SWC

The income earned by SWC during the year ended 31-3-2020 from its Indian operations as well as other operations is as under:

Type of Income	(₹ in crores)	
	In India	Outside India
From sale made to RRL	42	-
From purchases made from RRL and sold to third parties	10	15
Income from other trading operations with third parties	5	70
Dividends and interest	8	5

Technical know how

RRL has entered into a complicated technical know-how agreement with Jew Inc., of Israel. The tax rate applicable and the amount taxable are posing to be ticklish. The annual payment of the technical know-how is likely to be around ₹ 150 crores. Jew Inc., has entered into identical agreements with three other Indian companies.

Required:

Multiple Choice Questions

Find the most suitable alternative to the following (option to be given in **capital letters A**, B, C or D)

1. Surcharge Applicable to a foreign company whose total income is ₹ 1.2 crores is
   (A) Nil
   (B) 2%
   (C) 7%
   (D) 10%

2. Following income which is accruing or arising outside India, directly or indirectly , is not deemed to be income accruing or arising in India:
   (A) Through or from any business connection in India.
   (B) Through or from any property in India.
   (C) Through transfer of capital asset located outside India.
   (D) Through or from any asset or sources of income in India.

3. Remuneration received for services rendered in India by a foreign national employed by foreign enterprise is exempt, if the number of days stay in India of such foreign national does not exceed
   (A) 60 days
   (B) 90 days
   (C) (B) 30 days
   (D) (D) None of the above

4. Following income from 'Salaries' which is payable by _____would be deemed to accrue or arise in India:
   (A) The Government to a citizen of India for services rendered outside India.
   (B) The Government to a non-resident for services rendered outside India.
   (C) The Government to a non-citizen or non-resident for services rendered outside India.
   (D) The Government or any other person to a non-citizen or non-resident for services rendered outside India.

5. An applicant, who has sought for an advance ruling, may withdraw the application within
   (A) 30 days from the date of the application
   (B) 30 days from the end of the month in which the application has been made
   (C) 60 days from the date of the application.
   (D) 60 days from the end of the month in which the application has been made

DESCRIPTIVE QUESTIONS

(a) The Board of Directors wish to know whether the foreign subsidiary SWC will be regarded as a company engaged in active business outside India for POEM purposes. Advise them suitably. The Board is also looking for your suggestions in this regard.

(b) Jew Inc. has a sister concern, Silver LLC., which has obtained advance ruling on an identical technical know-how agreement with another Indian company. Can RRL make use of this ruling for its assessment proceeding? What course of action will you advise?

(c) RRL has made an application to the Assessing Officer for determination of the tax rate applicable for the technical know-how payment to be made to Jew Inc. When this is pending, Jew Inc., has filed an application before the AAR. Can the AAR reject the application on the ground that similar issue is pending before the Assessing Officer?

I. ANSWERS TO MCQs

MCQ No.	Answer
1.	(b)
2.	(c)
3.	(b)
4.	(a)
5.	(a)

II. ANSWERS TO DESCRIPTIVE QUESTIONS

(a)

A company shall be said to be engaged in "active business outside India" for POEM, if

- the passive income is not more than 50% of its total income; **and**
- less than 50% of its total assets are situated in India; **and**
- less than 50% of total number of employees are situated in India or are resident in India; **and**
- the payroll expenses incurred on such employees is less than 50% of its total payroll expenditure.

Snow White & Co. Inc (SWC) shall be regarded as a company engaged in active business outside India for POEM purpose only if it satisfies all the four conditions cumulatively.

Condition 1: Passive income test

The passive income of SWC should not be more than 50% of its total income

Passive Income	Rs. in crores
From sales made by SWC to RRL [See Note below]	-
From purchases made from RRL and sold to third parties	-
Dividend and Interest	13
Total passive global income	**13**
Total income of SWC	**155**
Percentage of passive income earned	**8.4%**

Total income of SWC during the P.Y. 2018-19 is ₹ 155 crores, being ₹65 crores in India [₹42 crores + ₹10 crores + ₹5 crores + ₹8 crores] and ₹90 crores outside India [₹15 crores + ₹70 crores + ₹5 crores]

Since passive income of SWC i.e., 8.387% is less than 50% of its total income, **the first condition (Passive income test) is satisfied.**

Note - Passive income, inter alia, includes income from the transactions where both the purchase and sale of goods is from/to its associated enterprises. In the facts of the case study, income of ₹ 42 crores earned from sales made to RRL is given, but whether these sales are made out of purchases from associated enterprises or out of third party purchases is not given in the question. This income of ₹ 42 crores is not included in the passive income assuming that the purchases have not been made from associated enterprises. However, if it is assumed that the sales are made out of the purchases made from associated enterprises ₹ 42 crores has to be included in computing passive income. In such a case, passive income and the percentage of passive income to total income would be ₹ 55 crores and 35.48%.

Even in this case, since passive income of SWC is only 35.48% of total income (i.e., less than 50% of total income), the first condition is satisfied.

Condition 2: Assets Test

SWC should have less than 50% of its total assets situated in India

Value of assets is determined in the following manner:

In case of pool of fixed asset, being treated as a block for depreciation	The average of its value for tax purposes in the country of incorporation of the company at the beginning and at end of the year;
In case of any other asset	Value as per books of account

Value of assets of SWC:

Particulars	In India (₹ in crores)	Outside India (₹ in crores)
Godowns (building portion only), being depreciable asset, at average of its WDV as on 31.3.2019 and as on 31.3.2020	$\frac{6.7 + 13.2}{2}$ = **9.95**	$\frac{4.2 + 10.2}{2}$ = **7.20**
Other fixed assets, being depreciable assets, at average of its WDV as on 31.3.2019 and as on 31.3.2020	$\frac{0 + 8.6}{2}$ = **4.30**	$\frac{4.2 + 10.2}{2}$ = **7.20**
Land [Value as per books of account on 31.3.2020]	**10.00**	**12.00**
Total	**24.25**	**26.40**

Percentage of assets situated in India to total assets = ₹24.25 crores/₹50.65 crores x 100 = **47.88%**

Since the value of assets of SWC situated in India is less than 50% of its total assets, **the second condition (Assets test) is also satisfied.**

Condition 3: Number of employees test

Less than 50% of the total number of employees of SWC should be situated in India or should be resident in India

SWC employed 30 persons in India and 10 other persons, who are resident in India but not directly employed by SWC though they perform work like any other employee.

For counting the number of employees in India, the average of the number of employees as at the beginning and at the end of the year has to be considered and it would include persons, who, though not employed directly by the company, perform tasks similar to those performed by the employees.

Therefore, number of **employees situated in India or are resident in India is 40 i.e., 30+10**

Total number of employees of SWC is 82, being 42 employed outside India and 40 in India or resident in India.

Percentage of employees situated in India or are resident in India to total number of employees is 40/82 x 100 = **48.78%**

Since employees situated in India or are residents in India of SWC are less than 50% of its total employees, **the third condition (Number of employees test) is satisfied** for active business outside India test.

Condition 4: Payroll expenses Test

The payroll expenses incurred on employees situated in India or residents in India should be less than 50% of its total payroll expenditure

Payroll expenditure on employees situated in India or are residents in India is **₹ 1.54 crores** i.e., ₹1.20 crores **plus** ₹0.34 crores Total payroll expenditure of SWC is **₹ 4.54 crores** being expenditure on employees situated in India or are residents in India and expenditure on employees outside India [i.e., ₹ 1.54 crores + ₹3 crores]. Percentage of payroll expenditure on employees situated in India or are resident in India to total payroll expenditure is ₹1.54 crores/₹4.54 crores x 100 = **33.92%** Since payroll expenditure on employees situated in India or are residents in India of SWC is less than 50% of its total payroll expenditure, **the fourth condition (Payroll expenses test) is also satisfied**.
Conclusion: Since SWC satisfies all the above four conditions cumulatively, SWC will be **regarded as a company engaged in active business outside India**
Suggestions to the Board of Directors The following suggestions may be offered to the Board of Directors: (a) Income from transactions with associated enterprises like RRL should be scrupulously and constantly monitored, so that the conditions above continue to be satisfied in future years; (b) Steps may be taken to improve trade with unrelated third parties; (c) Percentage of Indian assets to total assets is almost 48%. If there is any plan to acquire assets in India, it must be ensured that this does not cross 50% (d) Percentage of employees situated in India or are resident in India to the total number of employees is 48.78%. In case of any future employment, this ratio has to be borne in mind.

(b) 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 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, RRL cannot use the advance ruling, obtained on an identical issue by Silver LLC, a sister concern of Jew Inc., in its assessment proceedings.

Hence, the best course would be to file a fresh application for advance ruling in respect of this agreement between RRL and Jew Inc.

Note - The Madras High Court, in CIT v. P. Sekar Trust (2010) 321 ITR 305, observed that though the advance ruling pronounced does not become a precedent, it has persuasive value where the facts warrant such reference to the rulings of AAR. There is no legitimate bar for relying on the reasoning in an advance ruling.

Accordingly, there is no legitimate bar in RRL relying on advance rulings obtained on an identical issue by Silver LLC in its assessment proceedings.

Therefore, based on the Madras High Court ruling, RRL may be advised to use the advance ruling pronounced in Silver LLC's case in its assessment proceedings.

(c) 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 in the context of clause (i) thereof 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 Jew Inc 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 RRL.

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:

Prior to 1.6.2000	On or After 1.6.2000
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;	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.

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 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 Jew Inc., even if the question raised in the application is pending before the Assessing Officer in RRL's case**.

CASE STUDY – 7

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 child hood friendship, a step further.

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

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

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

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

By April 1, 2019, they employ an office manager cum receptionist Mr. Sundaram to take care of the office. Next, they employ two individuals (Mrs. Indra and Mr. Raghu) with over ten years of experience with leading retail brands in Mauritius. Mrs. Indra and Mr. Raghu are to start implementing the detailed business plan drawn up by Mr. Rai and Mr. Bhandari. For the financial year 2019-2020, 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 2019 -20 the team has been able to identify black rice and barley as suitable products for supply.

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

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

During the financial year 2019-20 the company has a total of four board meetings. Each of the meetings is attended by the three directors personally. The first, second and third meeting is held

in Mauritius while the next meeting is held in New Delhi, India. Basically, there is a meeting in every quarter.

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

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

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

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

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

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

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

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

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

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

1. During the P.Y. 2017-18 and P.Y. 2018-19, Mr. Rai was in India on business visits from June 15, 2017 to August 31, 2017 and July 1, 2018 to September 28, 2018, respectively. During the previous year 2019-20, Mr. Rai was in India during April – May 2019 and November 2019. What is the residential status of Mr. Rai for previous years 2018-19 and 2019-20, respectively?
   (a) Non-resident and Resident and Ordinarily Resident, respectively
   (b) Non-resident for both years
   (c) Resident and Ordinarily Resident for both years
   (d) Resident but Not Ordinarily Resident for both years
2. During the Previous Year 2019-20, Mr. Rai received Rs.75,00,000 on account of sale of agricultural land in Mauritius. The money was first received in Mauritius and then remitted to his Indian bank account. Is the sum taxable in India?

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

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

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

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

3. Mr. Bhandari only holds the shares in RB Pvt. Ltd. If he sells the shares held by him in RB Pvt. Ltd. for a gain during the Previous Year 2019-20, which of the following statements is true?

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

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

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

(d) The resultant gain is a long-term capital gain exempt u/s 10(38).

4. Mr. Bhandari receives dividend payment from RB Pvt. Ltd. in his Indian bank account during 2019 -20 to the tune of Rs.1,50,000. Which of the following statements is true?

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

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

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

(d) Both (b) and (c)

5. During the previous year 2019-20, RB Pvt. Ltd. entered into contracts for purchase and sale of barley grains with PB Pvt Ltd. PB Pvt. Ltd. is a company incorporated in New Delhi. On account of which of the following facts, would the companies be considered to be associated enterprises?

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

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

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

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

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?

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, 2019. 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.

   (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?

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

SOLUTIONS – CASE STUDY 7

I. ANSWERS TO MCQs

MCQ No.	Answer
1.	(b)
2.	(b)
3.	(a)
4.	(a)
5.	(d)

II. ANSWERS TO DESCRIPTIVE QUESTIONS

Answer to Q.1:

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

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

(1)	(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 × 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.

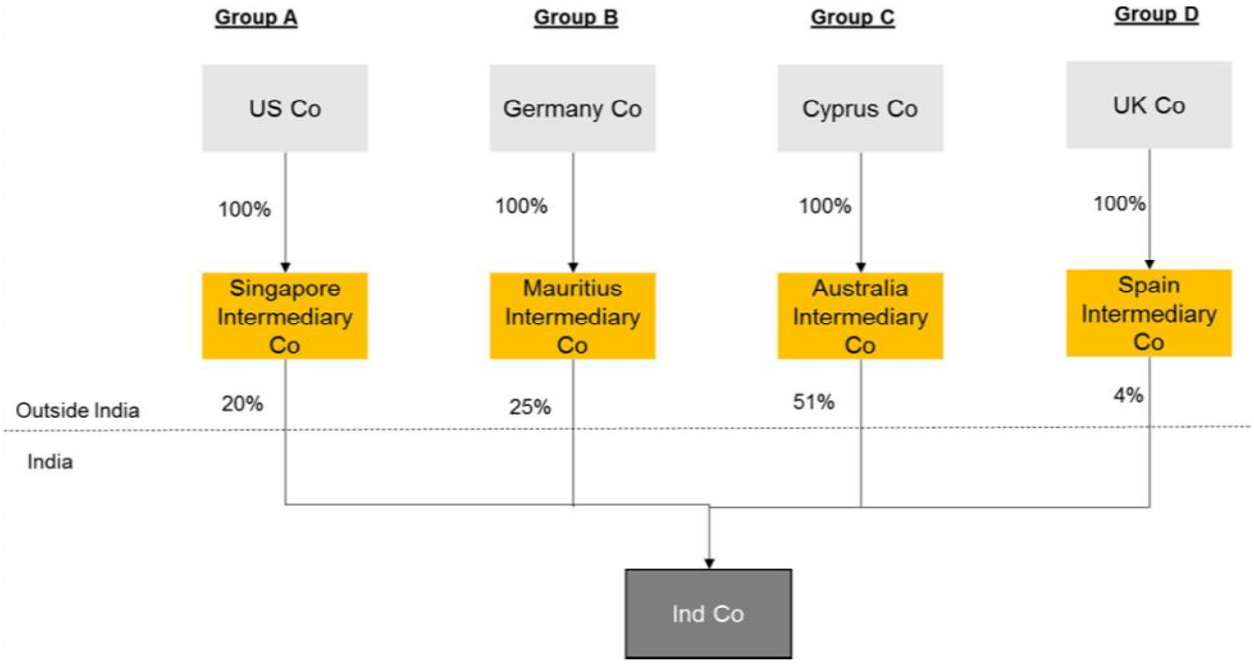
In the hands of RB Pvt. Ltd. Ltd., the amount of Rs.10 lakhs paid to Facebook Inc. would be allowable as business expenditure, provided equalization levy has been deducted at source.

(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 lakhs would be attracted for failure to deduct equalization levy. Also, disallowance of the expenditure of Rs.10 lakhs would be attracted under section 40(a)(ib) while computing business income of RB Pvt. Ltd.

(c) Section 10(50) of the Income-tax Act, 1961 exempts income arising from providing specified service of online advertisement, which are subject to equalization levy, from income-tax.

CASE STUDY – 8

Ind Co is an unlisted, private limited, Indian company incorporated under the Companies Act, 1956 and is engaged in the business of the manufacturing of automobile components. Ind Co is held by 4 groups of shareholders (Groups A, B, C and D) in different proportions. Groups A, B, C and D are headquartered in US, Germany, Cyprus and UK respectively. However, these headquarter companies do not hold shares of Ind Co directly, but hold the shares through intermediary companies in Singapore, Mauritius, Australia, Spain respectively, as depicted in the shareholding pattern below:



The date of acquisition of shares by each of the Groups is given below:

Date of acquisition			
Group A	**Group B**	**Group C**	**Group D**
Date of acquisition by US Co in Singapore Intermediary Co - 1 April 2013	Date of acquisition by Germany Co in Mauritius Intermediary Co - 1 April 2013	Date of acquisition by Cyprus Co in Australia Intermediary Co - 1 April 2013	Date of acquisition by UK Co in Spain Intermediary Co - 1 April 2013
Date of acquisition by Singapore Intermediary Co in Ind Co - 1 March 2018	Date of acquisition by Mauritius Intermediary Co in Ind Co -1 April 2013	Date of acquisition by Australia Intermediary Co in Ind Co - 1 April 2013	Date of acquisition by SpainIntermediaryCo in Ind Co - 1 April 2013

Each of the Groups are now proposing to restructure their shareholding in Ind Co. Alternatively, they are also considering the proposal of exiting from Ind Co by transferring their stake to a buyer to be identified. The restructuring/ exit is proposed to be undertaken on 31 May 2019 by each of the Groups.

The last accounting year end (for the purpose of complying with the tax laws of the territory) for each of the entities and their respective book values as on such date are provided below:

Group A	Group B	Group C	Group D
US Co – 31 December 2018	Germany Co – 31 March 2019	Cyprus Co – 31 March 2019	UKCo-31March 2019

Book value – INR 500 crores	Book value – INR 200 crores	Book value – INR 100 crores	Book value – INR 100 crores
Singapore Intermediary Co – 30 June 2018 Book value – INR 25 crores	Mauritius Intermediary – 31 December 2018 Book value – INR 25 crores	Australia Intermediary Co – 31 December 2018 Book value – INR 100 crores	Spain Intermediary Co - 31 March 2019 Book value – INR 7 crores

Ind Co follows 1 April - 31 March as the Financial Year and the book value of Ind Co as on 31 March 2019 was INR 100 crores.

The book values (after reduction of liabilities), fair market values (after reduction of liabilities) and liabilities of some of the entities as on 31 May 2019 (i.e. date of transfer) is as below:

Particulars	Book value (INR crores)	Fair market value (INR crores)	Liabilities (INR crores)
Group A			
US Co	550	1000	100
Singapore Intermediary Co	30	50	0
Group B			
Germany Co	200	500	50
Mauritius Intermediary Co	30	60	0
Group C			
Cyprus Co	100	400	0
Australia Intermediary Co	120	300	0
Group D			
UK Co	120	150	50
Spain Intermediary Co	7	12	0
Ind Co	110	180	20

Groups A, B, C and D hold no other shares or assets in India other than investment in shares of Ind Co.

Note: Assume the fair market value and liability of all the companies as on 31.3.2019 is same as it is on 31.05.2019

I. OBJECTIVE TYPE QUESTIONS

Write the most appropriate option to each of the following questions by choosing one of the four options given.

1. Based on the facts in the case, where US Co proposes to transfer shares of Singapore Intermediary Co, which of the following Double Taxation Avoidance Agreements ('DTAA'), would be applicable for analysing the taxability in the hands of US Co in India -
   (a) US-Singapore DTAA
   (b) India- Singapore DTAA
   (c) India-US DTAA
   (d) None of the DTAAs are applicable

2. With respect to transfer of shares of Singapore Intermediary Co by US Co, which of the following would be the 'specified date' for the purpose of determining whether such shares derive its value substantially from assets located in India:
   (a) 30th June 2018
   (b) 31st December 2018
   (c) 31st March 2019
   (d) 31st May 2019

3. Ind Co is required to report details with respect to transfer of shares of Singapore Intermediary Co by US Co in which of the following forms-
   (a) Form 3CEA
   (b) Form 3CT
   (c) Form 49D
   (d) There is no reporting requirement on Ind Co and reporting requirement applies only on Singapore Intermediary Co

4. What is the timeline within which Ind Co is required to furnish information pertaining to transfer of shares of Mauritius Intermediary Co by Germany Co if the transaction has the effect of directly or indirectly transferring rights and management of Ind Co -
   (a) Within the due date for filing return of income for the year in which the transfer has taken place
   (b) Within 90 days from the date of the transaction
   (c) Within 90 days from the end of the Financial Year in which such transfer has taken place
   (d) There is no requirement on Ind Co to furnish information

5. The fair market value of an unlisted share, held directly or indirectly by a company or an entity registered or incorporated outside India, for the purposes of clause (i) of sub-section (1) of section 9, shall be computed in accordance with which of the following methods -
   (a) Net asset value, as certified by a Chartered Accountant
   (b) Discounted Cash Flow method, as certified by a Chartered Accountant, as increased by liabilities, if any, considered in such valuation
   (c) Any internationally accepted valuation methodology for valuation of shares on arm's length basis, as determined by a merchant banker or a Chartered Accountant, as increased by liabilities, if any, considered in such valuation
   (d) Fair market value of all assets of the company computed on an arm's length basis, as certified by a Chartered Accountant

II. DESCRIPTIVE QUESTIONS

1. Examine the tax consequences of the following transactions under section 9(1)(i) of the Income-tax Act, 1961 and the applicable Double Taxation Avoidance Agreements -
   (a) Transfer of shares of Singapore Intermediary Co by US Co to an unrelated Buyer
   (b) Transfer of shares of Mauritius Intermediary Co by Germany Co to an unrelated Buyer
   (c) Transfer of shares of Australia Intermediary Co by Cyprus Co to an unrelated Buyer
   (d) Transfer of shares of Spain Intermediary Co by UK Co to an unrelated Buyer

2. Compute the capital gains chargeable to tax in India in the hands of US Co from transfer of shares of Singapore Intermediary Co to an unrelated Buyer for INR 50 crores and the tax applicable on such capital gains. Also comment on whether the capital gains would be long-term capital gains or short-term capital gains.

   US Co had acquire shares of Singapore Intermediary Co for INR 10 crores.

EXHIBIT

EXTRACTS OF ARTICLE ON CAPITAL GAINS FROM DOUBLE TAXATION AVOIDANCE AGREEMENTS

India-US DTAA

"ARTICLE 13 - ***GAINS***

Except as provided in Article 8 (Shipping and Air Transport) of this Convention, each Contracting State may tax capital gains in accordance with the provisions of its domestic law."

India- Singapore DTAA

"ARTICLE 13 – ***CAPITALGAINS***

1. *Gains derived by a resident of a Contracting State from the alienation of immovable property, referred to in Article 6, and situated in the other Contracting State may be taxed in that other State.*

2. *Gains from the alienation of movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State or of movable property pertaining to a fixed base available to a resident of a Contracting State in the other Contracting State for the purpose of performing independent personal services, including such gains from the alienation of such a permanent establishment (alone or together with the whole enterprise) or of such fixed base, may be taxed in that other State.*

3. *Gains from the alienation of ships or aircraft operated in international traffic or movable property pertaining to the operation of such ships or aircraft shall be taxable only in the Contracting State of which the alienator is a resident.*

4A. Gains from the alienation of shares acquired before 1 April 2017 in a company which is a resident of a Contracting State shall be taxable only in the Contracting State in which the alienator is a resident.

4B. Gains from the alienation of shares acquired on or after 1 April 2017 in a company which is a resident of a Contracting State may be taxed in that State.

4C. However, the gains referred to in paragraph 4B of this Article which arise during the period beginning on 1 April 2017 and ending on 31 March 2019 may be taxed in the State of which the company whose shares are being alienated is a resident at a tax rate that shall not exceed 50% of the tax rate applicable on such gains in that State.

5. Gains from the alienation of any property other than that referred to in paragraphs 1, 2, 3, 4A and 4B of this Article shall be taxable only in the Contracting State of which the alienator is a resident."

India-Germany DTAA

"ARTICLE 13 – ***CAPITAL GAINS***

1. *Gains derived by a resident of a Contracting State from the alienation of immovable property situated in the other Contracting State may be taxed in that other State.*

2. *Gains from the alienation of movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State or of movable property pertaining to a fixed base available to a resident of a Contracting State in the other Contracting State for the purpose of performing independent personal services, including such gains from the alienation of such a permanent establishment (alone or with the whole enterprise) or of such fixed base, may be taxed in that other State.*

3. *Gains from the alienation of ships or aircraft operated in international traffic or movable property pertaining to the operation of such ships or aircraft shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated.*

4. *Gains from the alienation of shares in a company which is a resident of a Contracting State may be taxed in that State.*

5. *Gains from the alienation of any property other than that referred to in paragraphs 1 to 4 shall be taxable only in the Contracting State of which the alienator is a resident."*

India-Mauritius DTAA

"ARTICLE 13 – ***CAPITAL GAINS***

1. *Gains from the alienation of immovable property, as defined in paragraph (2) of article 6, may be taxed in the Contracting State in which such property is situated.*

2. *Gains from the alienation of movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State or of movable property pertaining to a fixed base available to a resident of a Contracting State in the other Contracting State for the purpose of performing independent personal services, including such gains from the alienation of such a permanent establishment (alone or together with the whole enterprise) or of such a fixed base, may be taxed in that other State.*

3. *Notwithstanding the provisions of paragraph (2) of this article, gains from the alienation of ships and aircraft operated in international traffic and movable property pertaining to the operation of such ships and aircraft, shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated.*

3A. Gains from the alienation of shares acquired on or after 1st April 2017 in a company which is resident of a Contracting State may be taxed in that State.

3B. However, the tax rate on the gains referred to in paragraph 3A of this Article and arising during the period beginning on 1st April, 2017 and ending on 31st March, 2019 shall not exceed 50% of the tax rate applicable on such gains in the State of residence of the company whose shares are being alienated;

4. *Gains from the alienation of any property other than that referred to in paragraphs 1, 2, 3 and 3A shall be taxable only in the Contracting State of which the alienator is a resident.*

5. *For the purposes of this article, the term "alienation" means the sale, exchange, transfer, or relinquishment of the property or the extinguishment of any rights therein or the compulsory acquisition thereof under any law in force in the respective Contracting States.*

India-Cyprus DTAA

"ARTICLE 13 – ***CAPITAL GAINS***

1. *Gains derived by a resident of a Contracting State from the alienation of immovable property referred to in Article 6 and situated in the other Contracting State may be taxed in that other State.*

2. *Gains from the alienation of movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State or of movable property pertaining to a fixed base available to a resident of a Contracting State in the other Contracting State for the purpose of performing independent personal services, including such gains from the alienation of such a permanent establishment (alone or with the whole enterprise) or of such fixed base, may be taxed in that other State.*

3. *Gains from the alienation of ships or aircraft operated in international traffic or movable property pertaining to the operation of such ships or aircraft shall be taxable only in the Contracting State of which the alienator is a resident.*

4. *Gains from the alienation of shares of the capital stock of a company the property of which consists directly or indirectly principally of immovable property situated in a Contracting State may be taxed in that State.*

5. *Gains from the alienation of shares other than those mentioned in paragraph 4 in a company which is a resident of a Contracting State may be taxed in that State.*

6. *Gains from the alienation of any property other than that referred to in paragraphs 1, 2, 3, 4 and 5, shall be taxable only in the Contracting State of which the alienator is a resident."*

India-UK DTAA

"Article 14- ***Capital Gains***

1. *Except as provided in Article 8 (Air Transport) and 9 (Shipping) of this Convention, each Contracting State may tax capital gains in accordance with the provisions of its domestic law."*

India-Spain DTAA

"Article 14 – ***Capital Gains***

1. *Gains derived by a resident of a Contracting State from the alienation of immovable property, referred to in Article 6, and situated in the other Contracting State may be taxed in that other State.*

2. *Gains from the alienation of movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State or of movable property pertaining to a fixed base available to a resident of a Contracting State in the other Contracting State for the purpose of performing independent personal services, including such gains from the alienation of such a permanent establishment (alone or together with the whole enterprise) or of such fixed base, may be taxed in that other State.*

3. *Gains from the alienation of ships or aircraft operated in international traffic or of movable property pertaining to the operation of such ships or aircraft shall be taxable only in the Contracting State of which the alienator is a resident.*

4. *Gains from the alienation of shares of the capital stock of a company the property of which consists, directly or indirectly, principally of immovable property situated in a Contracting State may be taxed in that State.*

5. *Gains for the alienation of shares of the capital stock of a company forming part of a participation of at least 10 per cent in a company which is a resident of a Contracting State may be taxed in that Contracting State.*

6. *Gains from the alienation of any property other than that mentioned in paragraphs 1, 2, 3, 4 and 5 shall be taxable only in the Contracting State of which the alienator is a resident."*

SOLUTIONS – CASE STUDY 8

I. ANSWERS TO MCQs

MCQ No.	Answer
1.	(c)
2.	(d)
3.	(c)
4.	(c)
5.	(c)

II. ANSWERS TO DESCRIPTIVE QUESTIONS

Answer to Q.1:

Income of a non-resident from transfer of a capital asset situated in India is deemed to accrue in India as per the provisions of section 9(1)(i) of the Income-tax Act, 1961. As per *Explanation 5* to section 9(1)(i), an asset being any share or interest in a company or entity incorporated outside India shall be deemed to be situated in India if, if the share or interest, derives directly or indirectly, its value substantially from assets located in India.

Further, *Explanation 6* to section 9(1)(i), provides that the share or interest in a company or entity registered or incorporated outside India, shall be deemed to derive its value substantially from the assets (whether tangible or intangible) located in India, if on the specified date, the value of Indian assets:

- exceeds the amount of INR 10 crores; and
- represents at least 50% of the value of all assets owned by the company, or entity, as the case may be

Specified date for this purpose would be the date on which the accounting period of the company or entity ends preceding the date of transfer of a share or an interest.

However, in case the book value of the assets of the company or entity on the date of transfer exceeds by at least 15%, the book value of the assets as on the last balance sheet date preceding the date of transfer, the date of transfer shall be the specified date.

Value of an asset means Fair Market value as on specified date, of such asset without reduction of liabilities.

Further, section 90(2) provides that where the Indian Government has entered into DTAAs which are applicable to the taxpayers, then, the provisions of the Act or the provisions of the DTAA, whichever is more beneficial to the taxpayer, shall apply.

In light of the above, the provisions of the DTAA and the provisions of the Act have been examined with respect to the each of the Groups below.

(a) Transfer of shares of Singapore Intermediary Co by US Co.

In the instant case, specified date is 31.05.2020

Fair value of assets of Singapore Intermediary Co as on 31.5.2020 - INR 50 crores Fair value of Ind Co as on 31.5.2020 (without reduction of liabilities) - INR 200 crores Fair value

of Ind Co as held by Singapore Intermediary Co (20%) - INR 40 crores
Since, the value of assets located in India i.e., INR 40 crores exceeds INR 10 crores and also exceeds 50% of the value of assets of Singapore Intermediary Co, the shares of Singapore Intermediary Co would be deemed to derive its value substantially from assets located in India.

Hence, the shares of Singapore Intermediary Co would be deemed to be a capital asset situated in India and the capital gains from transfer of shares of Singapore Intermediary Co would be deemed to accrue or arise in India. Accordingly, the gains would be taxable in the hands of US Co in India as per the Income-tax Act, 1961. However, the provisions of the applicable DTAA would need to be examined.

The India-US DTAA would be the applicable DTAA, for the purpose of analysing taxability in India of the transfer of shares of Singapore Intermediary Co by US Co, since in the instant case, India is the 'country of source' and US is the 'country of residence'.

As per Article 13 of the India-US DTAA, US and India may tax capital gains in accordance with the provisions of its domestic law. Hence, the capital gains income from transfer of shares of Singapore Intermediary Co by US Co shall be taxable in India.

(b) Transfer of shares of Mauritius Intermediary Co by Germany Co.

In the instant case, specified date is 31.05.2020

Fair value of assets of Mauritius Intermediary Co as on 31.5.2020 - INR 60 crores Fair value of Ind Co as on 31.5.2020 (without reduction of liabilities) - INR 200 crores Fair value of Ind Co as held by Mauritius Intermediary Co (25%) - INR 50 crores
Since, the value of assets located in India i.e., INR 50 crores exceeds INR 10 crores and also exceeds 50% of the value of assets of Mauritius Intermediary Co, shares of Mauritius Intermediary Co would be deemed to derive its value substantially from assets located in India.

Hence, the shares of Mauritius Intermediary Co would be deemed to be a capital asset situated in India and the capital gains from transfer of shares of Mauritius Intermediary Co would be deemed to accrue or arise in India. Accordingly, the gains would be taxable in the hands of Germany Co in India as per the Income-tax Act, 1961. However, the provisions of the applicable DTAA would need to be examined.

The India-Germany DTAA would be the applicable DTAA, for the purpose of analysing taxability in India of the transfer of shares of Mauritius Intermediary Co by Germany Co, since in the instant case, India is the 'country of source' and Germany is the 'country of residence'.

Clauses (1) to (3) of Article 13 of the India-Germany DTAA, would not be relevant to the instant case. As per clause (4) of Article 13 of the India-Germany DTAA, *"gains from the alienation of shares in a company which is a resident of a Contracting State may be taxed in that State".*

In the instant case, the shares being transferred are those of Mauritius Intermediary Co, which is not a resident of India. Accordingly, the instant case would not be covered under clause (4) of Article 13 and the residual clause (5) of Article 13 would be applicable. As per clause (5), "*Gains from the alienation of any property other than that referred to in paragraphs 1 to 4 shall be taxable only in the Contracting State of which the alienator is a resident"*. The alienator is Germany Co, which is a resident of Germany and not India and accordingly, the capital gains shall be taxable only in Germany and is not taxable in India.

Since the provisions of the DTAA can be applied, where they are more beneficial to the taxpayer than the provisions of the Act, in the instant case, the provisions of the DTAA can be applied and accordingly, the capital gains would not be taxable in India.

(c) Transfer of shares of Australian Intermediary Co by Cyprus Co.

In the instant case, specified date is 31.05.2020

Fair value of assets of Australian Intermediary Co as on 31.5.2020 - INR 300 crores Fair value of Ind Co as on 31.5.2020 (without reduction of liabilities) - INR 200 crores Fair value of Ind Co as held by Australian Intermediary Co (51%) - INR 102 crores
Since, the value of assets located in India i.e., INR 102 crores exceeds INR 10 crores but it does not represent at least 50% of the value of assets of Australian Intermediary Co, shares of Australian Intermediary Co would not be deemed to derive its value substantially from assets located in India.

Hence, the shares of Australia Intermediary Co would not be deemed to be a capital asset situated in India and the capital gains from transfer of shares of Australia Intermediary Co would not be deemed to accrue or arise in India. Accordingly, the gains would not be taxable in the hands of Cyprus Co in India as per the Income-tax Act, 1961.

Accordingly, it would not be necessary to examine the provisions of the applicable DTAA.

(d) Transfer of shares of Spain Intermediary Co by UK Co.

In the instant case, specified date is 31.03.2020

Fair value of assets of Spain Intermediary Co as on 31.3.2020 - INR 12 crores

Fair value of Ind Co as on 31.3.2020 (without reduction of liabilities) - INR 200 crores Fair value of Ind Co as held by Spain Intermediary Co (4%) - INR 8 crores
Since, the value of assets located in India i.e., INR 8 crores does not exceed INR 10 crores, shares of Spain Intermediary Co would not be deemed to derive its value substantially from assets located in India.

Hence, the shares of Spain Intermediary Co would not be deemed to be a capital asset situated in India and the capital gains from transfer of shares of Spain Intermediary Co would not be deemed to accrue or arise in India. Accordingly, the gains would not be taxable in the hands of UK Co in India as per the Income-tax Act, 1961.

Accordingly, it would not be necessary to examine the provisions of the applicable DTAA.

Answer to Q.2:

Computation of capital gains chargeable to tax and tax amount in India on transfer of shares of Singapore Intermediary Co by US Co

S. No	Particulars	Amount (INR crores)
1.	Full value of consideration for transfer of shares of Singapore Intermediary Co	50.00
2.	Cost of acquisition of shares of Singapore Intermediary Co	10.00
3.	Long-term capital gains	40.00
4.	Fair Market Value of all the assets of the Singapore Intermediary Co as on the specified date (31 May 2019)	50.00

5.	Fair Market Value of assets of the Singapore Intermediary Co located in India as on the specified date (31 May 2019) , i.e., Fair value of Ind Co as held by Singapore Intermediary	40.00
6.	Long-term capital gains (income) attributed to assets located in India [(3)*(5)/(4)]	32.00
7.	Long-term capital gains tax at 10% (as per section 112)	3.20

Notes:

1. The capital assets, being transferred, in the instant case, are the shares of Singapore Intermediary Co. Since, the shares of Singapore Intermediary Co have been held by US Co for more than 24 months, the capital gains would be long-term capital gains.
2. As per Rule 11UC, the income attributed to assets located in India would be based on the proportion of fair market value of assets located in India on the specified date, from which the share derives its value substantially to the fair market value of all assets of Singapore Intermediary Co.
3. As per section 112(1)(c)(iii), in case of a foreign company, the long term capital gain on unlisted securities is chargeable to tax @10% without indexation and fluctuation benefit.
4. The rate of 10% is excluding cess and surcharge, if any, depending on the total income of the company.

CASE STUDY – 9

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

Income earned in foreign nations

Arjun has derived income from two other nations E and F, with which India does not have DTAA. The particulars of income earned in the two nations E and F are as under:

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

Income earned in India

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

The Manager (Finance) has informed that following investments were made in India during the year ended 31-3-20:

Particulars of Income	(Rs. In lakhs)
Purchase of residential house at Jaipur on 22-3-20 in wife's name	37
Contribution to PPF	1.50

Income-tax rate structure:

Country E

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

Country F

Flat 27% without any basic exemption limit.

Tax treatment/ concessions in other nations

(i) No statutory allowance/deduction in respect of house property income in Country E as well as Country F.

(ii) Loss from firm can be set off against other business income in Country F only.

(iii) Agricultural income is exempt in Country E only.

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

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

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

I. OBJECTIVE TYPE QUESTIONS

Write the most appropriate option to each of the following questions by choosing one of the four options given.

1. Let us say Arjun has earned income from house property in Country X which is taxable under the domestic tax laws of Country X. Such income is also taxable in the hands of Arjun in India, since he is resident in India. Assume that the DTAA between India and Country X provides for taxation of such income in the source state only. In this situation,
   (a) Such income is exempt in India by virtue of the DTAA between India and Country X
   (b) Such income will be exempt in India, provided that Arjun obtains a Tax Residency Certificate from the Government of Country X.
   (c) Such income is taxable in India, since Arjun is resident in India.
   (d) Such income is taxable in India, since the Income-tax Act, 1961 does not provide for exemption of income from house property outside India.

2. Assume that Arjun has earned an income of Rs.4 lakhs by way of lump sum consideration for copyright of a literary book from a publisher in Country Y, with which India does not have a DTAA. The same has been taxed at a flat rate of 5% in Country Y. In India, his gross total income is Rs.7 lakhs. The double taxation relief available is -
   (a) Rs.20,000
   (b) Rs.7,800
   (c) Rs.1,950
   (d) Nil

3. Assume that Arjun had acquired a factory building in Country Z for Rs.24 lakhs on 21 -3-2017, for which Rs.18 lakhs was invested from explained sources which had suffered tax in India. This asset comes to the knowledge of the Assessing Officer on 20-5-2019. The market value of the asset as on 1-4-2019 is Rs.40 lakhs. The value of undisclosed foreign asset as per Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 (BM Act) is
   (a) Rs.40 lakhs
   (b) Rs.22 lakhs
   (c) Rs.10 lakhs
   (d) Rs.6 lakhs

4. Continuing the facts of MCQ 3., assume that the Assessing Officer has issued the notice under BM Act on 30-5-2019. The time limit for completion of assessment under the BM Act is
   (a) 31-3-2022
   (b) 30-5-2021
   (c) 31-3-2023
   (d) 30-5-2022

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

   (i) Both undisclosed income and undisclosed asset would be taxable in the P.Y.2020-21

   (ii) Both undisclosed income and undisclosed asset would be taxable in the P.Y.2017 -18

   (iii) Undisclosed income is taxable in the P.Y.2017-18 and undisclosed asset in the P.Y.2020-21

   (iv) Undisclosed asset is taxable in the P.Y.2017-18 and undisclosed income in the P.Y.2020-21

   (v) The value of undisclosed asset is Rs.4.2 lakhs

   (vi) The value of undisclosed asset is Rs.5.2 lakhs

   (vii) The value of disclosed asset is Rs.5.3 lakhs The correct answer is –

   (a) (i) and (vi)

   (b) (ii) and (v)

   (c) (iii) and (vi)

   (d) (iv) and (vii)

II. DESCRIPTIVE QUESTIONS

1. Ascertain the income-tax liability of Mr. Arjun Batra for the assessment year 2020-21.

SOLUTIONS – CASE STUDY 9

I. ANSWERS TO MCQs

MCQ No.	Answer
1.	(a)
2.	(d)
3.	(c)
4.	(a)
5.	(c)

II. ANSWERS TO DESCRIPTIVE QUESTIONS

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

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

Computation of tax liability of Mr. Arjun Batra for A.Y.2020-21	Rs.
Tax on Rs.35.7 lakhs, being non-agricultural income [Rs.32.5 lakhs] + agricultural income [Rs.3.2 lakhs]	
Tax on LTCG of Rs.8 lakhs@20%	1,60,000
(+) Tax on other income of Rs.27.7 lakhs	6,43,500
	8,03,500
(-) Tax on Rs.5.7 lakhs, being agricultural Income [Rs.3.2 lakhs] + Basic Exemption Limit [Rs.2.5 lakhs]	26,500

	7,77,000
Add: Health and education cess @4%	31,080
Indian rate of tax = 8,08,080 x 100/32,50,000 = 24.864%	**8,08,080**
Less: Rebate u/s 91 on income of Country E + Country F	4,49,179
Tax payable in India	**3,58,901**
Tax payable (Rounded off)	**3,58,900**
Computation of average rate of tax in Country E	**Rs. in lakhs**
Gross rental receipts from commercial property [No deduction is allowed from this in Country E]	2.0
Share income from partnership firm (loss) to be ignored	-
Business income	2.2
STCG from sale of vacant site on 1-11-2019	15.0
Agricultural income [Exempt in Country E]	-
Total income	**19.2**
Rates of tax in Country E	
Upto 3 lakhs Nil	-
3 to 6 lakhs 15%	0.45
Above 6 lakhs 22%	2.904
	3.354
Average rate of tax in Country E = 3.354 x 100/19.2 = 17.469%	
Doubly Taxed Income (in Country E)	**Rs. in lakhs**
Gross rental receipts form commercial property (Rs.2 lakhs – Rs.0.6 lakhs, being 30% of Rs.2 lakhs)	1.4
Share of loss from partnership firm	(1.0)
Business income	2.2
STCG from sale of vacant site on 1-11-2019	15.0
	17.6
Double Taxation Relief at India rate of tax or rate of tax in Country E, whichever is lower	17.469%
Double Taxation Relief = 17.469% of Rs.17.6 lakhs = Rs.3,07,454	
Doubly Taxed Income (in Country F)	**Rs. in lakhs**
Gross rental receipts from commercial property [Rs.3 lakhs (-) 30% of Rs.3 lakhs]	2.1
Business income	3.3
Share of loss from partnership firm	(1.5)
Agricultural income	1.8
Total income	**5.7**
Rate of Tax in Country F	27%
Double Taxation Relief at Indian rate of tax (24.864%) or rate of tax in Country F (27%), whichever is lower	24.864%
Double Taxation Relief = 24.864% of Rs.5.7 lakhs = Rs.1,41,725	
Double Taxation Relief [Country E & Country F] = Rs.3,07,454 + Rs.1,41,725	4,49,179

CASE STUDY – 10

About the assessee

The assessee is a famous movie actor Mr. Ajitabh Khan (AK). He has business interest in few other nations as well. He is a resident in India for the Assessment Year 2020 -21.

About yourself

You are the CEO with CA background. You have sound knowledge of the Indian and Foreign tax laws. The date on which various events happened and have been summarized in this case study is 31-3-2020.

Phone call from Manager (Legal) 09.40 hours

A phone call has been received from the Manager (Legal) that a search is being conducted by the Income-tax department at one of the premises of the assessee. No further details are available now.

E-mail from Taxation Manager at 18.00 hours

The Taxation Manager has emailed you the summarized information of income earned by AK during the year ended 31-3-2020 as under: (₹ in crores)

Income from house property (Computed)	4.3
Business income:	
From being the owner of cricket team in Asian Premier League	12.4
Acting in movies	9.415

AK has paid PPF of ₹ 1.2 lakhs and Life Insurance Premium of ₹ 2 lakhs.

Phone call from Manager (Legal) 20.30 hours

The search conducted by the IT Department has come to an end. It appears that some incriminating documents have been unearthed. It is likely that it has come to the notice of the Department that the assessee has earned income of ₹ 12 crores (as converted into INR) in Dubai during the Financial Year 2017-18, which has not been reflected in the return of income filed by AK for the Assessment Year 2018-19 or in any other year.

Further, the presence of certain building, in Panama Islands, which are not appearing in the books of account and financial statements filed with the IT Department. These buildings were purchased for 35.2 million USD on 12-3-2016. For acquiring this asset, brokerage of 2% has been paid to a real estate agent.

Additionally, there are materials to show that the assessee owns 5 rare pieces of art work, acquired on 12-6-2018 in Macau Islands for a price of 3.8 million USD.

E-mail from International Division Manager at 21.00 hours

The International Division Manager has intimated details of income earned from two countries outside India, L and M, with which India does not have any Double Taxation Avoidance Agreement. The summarized data are as under: (₹ in crores)

Type of Income	**L**	**M**
Loss from house property (Computed)	1.3	-
Business income:		
Own	7.2	2.9
Share income from partnership firm	4.8	-
Agricultural income	-	1.2

In country L, share income is not exempt and loss from house property is not eligible for being set off against other income. In country M, agricultural income is also chargeable to income-tax.

In country L, AK has paid income-tax of ₹ 2.16 crores and in country M ₹ 80 lakhs on the total income earned there.

Inputs from Forex Team (Email received at 21.15 hours)

The prevailing rates of exchange on various dates are as under:

Date	1-4-2015	12-3-2016	1-7-2017	31-3-2018	1-4-2019	1-6-2020	1-4-2021
1 USD = INR	64.05	64.50	65.10	64.75	65.55	65.60	65.65

Email from Xavier LLP (Registered valuers) at 23.45 hours

The fair market value of the assets acquired abroad were indicated by the registered valuers on various dates are thus:

Sl.No.	Description of Asset	Date	Amount (million USD)
1	Buildings in Panama Island	01-07-2017	38
		31-03-2018	38
		01-04-2019	40
2	Art pieces in Macau	12-06-2018	4
		01-04-2019	4.2

Required:

I. OBJECTIVE TYPE QUESTIONS

Find the most suitable alternative for the following (Option to be given in **capital letters A, B, C or D):**

1. A shopping complex was purchased by the assessee in Colombo for ₹ 5 crores on 12-3-2017. Out of this, investment of ₹ 3 crores is from disclosed sources, which had been offered for tax. This asset comes to the knowledge of the Assessing Officer on 27-12-2019. If the fair market of the house as on the relevant date to be adopted is ₹ 8 crores, the undisclosed foreign income under the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 (BM Act) will be taken as (₹ crores)

   (A) 5

   (B) 3.2

   (C) 3.8

   (D) None of the above

2. Under the BM Act, the rate of exchange to be adopted for conversion purposes will be the rate specified by

   (A) RBI

   (B) SBI

   (C) Central Government

   (D) CBDT

3. The Assessing Officer has detected undisclosed foreign income of ₹ 3 crores earned during the year ended 31-3-2019. There is foreign loss of ₹ 1.2 crores also, hitherto not shown in the income-tax return filed for the Assessment Year 2019-20. The quantum of undisclosed foreign income assessed under the BM Act will be

   (A) ₹ 1.8 crores

(B) ₹ 1.2 crores

(C) ₹ 3 crores

(D) None of the above

4. Unquoted shares acquired in Tokyo on 21-3-2018 came to the notice of the Assessing Officer on 12-3-2020. There is no explanation of the source for the same. The converted value of the shares on 21-3-2018, 1-4-2018, 1-4-2019 and 1-4-2020 are ₹ 12, 13, 14 and 15 crores, respectively. The undisclosed foreign income representing the value of the undisclosed foreign asset, as per the BM Act is

(A) ₹ 12 crores

(B) ₹ 13 crores

(C) ₹ 14 crores

(D) ₹ 15 crores

5. Under the BM Act, a tax authority below the rank of Commissioner can retain the impounded books normally for a period of

(A) 120 days

(B) 90 days

(C) 60 days

(D) 30 days

II. DESCRIPTIVE QUESTIONS

1. AK wants to know the income-tax liability for the Assessment Year 2020-21, with workings. You are required to provide the same.

2. In respect of the foreign income and foreign assets unearthed by the Department during the search, discuss the tax implications under the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 (BM Act). AK wants to know the year of taxability and the tax amount. Your answer should also cover discussion on the applicable provisions concerned.

SOLUTIONS – CASE STUDY 10

I. ANSWERS TO MCQs

MCQ No.	Answer
1.	(b)
2.	(a)
3.	(c)
4.	(c)
5.	(d)

II. ANSWERS TO DESCRIPTIVE QUESTIONS

1. Since Ajitabh Khan is resident in India for the P.Y.2019-20, his global income would be subject to tax in India. Therefore, income earned by him in Country L & M would be taxable in India. He is however entitled to deduction under section 91, since India does not have a DTAA with Country L & M, and all conditions under section 91 are satisfied.

Computation of tax liability of Ajitabh Khan for A.Y.2020-21

Particulars		₹	₹
I	**Income from house property**		
	Income from house property in India	4,30,00,000	
	Less: Loss from house property in Country L	1,30,00,000	
			3,00,00,000
II	**Profits and gains of business or profession**		
	Business income in India		
	From being the owner of cricket team in Asian Premier League	12,40,00,000	
	From acting in movies	9,41,50,000	
		21,81,50,000	
	Business income in Country L		
	Own 7,20,00,000		
	Share income from firm **(see note)** 4,80,00,000	12,00,00,000	
	Business income in Country M	2,90,00,000	
			36,71,50,000
III	**Income from Other Sources**		
	Agricultural income from Country M		1,20,00,000
Gross Total Income			**40,91,50,000**
Less: Deductions under Chapter VI-A			
	Under section 80C		
	PPF ₹1,20,000 & LIC ₹2,00,000		
	Total ₹3,20,000, restricted to		1,50,000
Total Income			**40,90,00,000**
Computation of tax liability:			
Tax on total income		**12,25,12,500**	
[30% x ₹40,80,00,000 + ₹1,12,500]			

Add: Surcharge@37% (since his total income exceeds ₹5 crore)	4,53,29,625	
	16,78,42,125	
Add: Education Cess @4%	67,13,685	
Tax liability (rounded off)	**17,45,55,810**	**17,45,55,810**
Less: Deduction under section 91 **[See Working Notes 1 & 2 below]**		2,72,60,000
Net Tax liability (rounded off)		**14,72,95,810**

Working Note 1: Computation of deduction under section 91			
Particulars			**₹**
I	**Deduction under section 91 in respect of income doubly taxed in India and Country L**		
	Doubly taxed income:		
	Country L (i.e., ₹ 7.2 crores, being business income (+) ₹ 4.8 crores, being taxable share income from firm (-) ₹ 1.3 crores, loss from house property)	₹10,70,00,000	
	Lower of Indian rate of tax and rate of tax in Country L [**See Working Note 2 below]**	**18%**	
	Deduction u/s 91 = 18% x ₹10.70 crores		1,92,60,000
II	**Deduction under section 91 in respect of income doubly taxed in India and Country M**		
	Doubly taxed income:		
	Country M (i.e., ₹ 2.9 crores, being business income (+) ₹ 1.2 crores, being taxable agricultural income)	₹4,10,00,000	
	Lower of Indian rate of tax and rate of tax in Country M [**See Working Note 2 below]**	**19.51%**	
	Deduction u/s 91 = 19.512% x ₹4.10 crores		80,00,000
Deduction under section 91			**2,72,60,000**

Working Note 2: Computation of average rate of tax in India, Country L & M		
(1)	Average rate of tax in India [17,45,55,810 x 100/40,90,00,000]	42.679%
(2)	Average rate of tax in Country L [2,16,00,000 x 100/12,00,00,000]	18%
(3)	Average rate of tax in Country M [80,00,000 x 100/4,10,00,000]	19.512%

Note: It is logical to take a view that exemption under section 10(2A) in hands of the partner would be available only in respect of share income from an Indian firm. In this case, since the share income is from a foreign firm, the same is taxable in India in the hands of the partner. The above solution has been worked out on the basis of this view.

2. As per section 3(1) of Black Money and Imposition of Tax Act, 2015, every assessee would be liable to tax@30% in respect of his undisclosed foreign income and asset of the previous year.

However, an undisclosed asset located outside India shall be charged to tax on its value in the previous year in which such asset comes to notice of the Assessing Officer.

As per section 41, in case, where tax has been computed in respect of undisclosed foreign income and asset, the Assessing Officer may direct the assessee to pay by way of penalty, in addition to tax, if any, payable by him, a sum equal to three times the tax so computed.

As per section 43, if any person, being a resident other than not ordinarily resident in India, who has furnished the return of income for any previous year, fails to furnish any information in relation to an asset (including financial interest in any entity) outside India held as a beneficial owner or otherwise, or in respect of which such person was a beneficiary, or if such failure is in relation to any income from a source located outside India, at any time during such previous year, the Assessing Officer may direct such person to pay, by way of penalty, a sum of ₹ 10 lakh.

In this case, search by IT department is conducted on Mr. Ajitabh Khan's, a resident, premises on 31.3.2020 and undisclosed foreign income and assets were found. The undisclosed foreign income would be charged to tax@30% in the P.Y.2017 -18. The undisclosed foreign asset would be charged to tax@30% in the P.Y.2019 -20, being the year in which it came to the notice of the Assessing Officer. The Assessing Officer may direct penalty, in addition to tax payable by him, a sum equal to three times the tax so computed and ₹ 10 lakh for not disclosing foreign assets and income.

Undisclosed foreign income

Undisclosed foreign income of ₹ 12 crores earned in Dubai during the F.Y.2017-18 is chargeable to tax in the A.Y.2018-19.

The tax payable is 30% of ₹ 12 crores = ₹ 3.6 crores.

Undisclosed foreign assets

Though the building in Panama Islands was purchased in the P.Y.2015 -16 and pieces of art work was acquired in the P.Y.2018-19 in Macau islands, the same is chargeable to tax in India under the Black Money Act in the A.Y.2020-21 only, since these assets came to the notice of the Assessing Officer in the P.Y.2019-20.

Particulars	Million $	₹ (in crores)
Undisclosed foreign assets:		
Building in Panama Islands		
Purchase price	35.200	
Add: Brokerage (2% of $ 35.2 million)	0.704	
Cost of acquisition	35.904	
Market value as on valuation date, being value on 1st April of the previous year i.e., on 01.04.2019	40.00	
Fair market value of building in Panama Islands [being higher of cost of acquisition and the price that the property shall ordinarily fetch if sold in the open market on the valuation date]	40.00	

Relevant rate of exchange for the purpose of conversion into Indian currency [being the rate of exchange on 1st April of the previous year i.e., on 01.04.2019] - 65.55		
Fair market value in Indian currency in crores (40 million x 65.55/10)		262.200
5 pieces of art work		
Cost of acquisition	3.80	
Market value as on valuation date, being value on 1st April of the previous year i.e., on 01.04.2019	4.20	
Fair market value [being higher of cost of acquisition and the price that the artistic work shall ordinarily fetch if sold in the open market on the valuation date]	4.20	
Relevant rate of exchange for the purpose of conversion into Indian currency [being the rate of exchange on 1st April of the previous year i.e., on 01.04.2019] – 65.55		
Fair market value in Indian currency in crores (4.2 million x 65.55/10)		27.531
Total undisclosed foreign assets		**289.731**
Tax payable @ 30%		**86.92**

CASE STUDY – 11

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

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

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

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

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

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

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

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

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

He has also purchased shares of Country "Q" Company and dividend of QGD 1,000 was credited to his bank account on March 31, 2020. Just like Indian tax laws, dividend paid by Country "Q"

Company is exempt in the hands of shareholders.

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

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

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

Other points:

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

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

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

I. OBJECTIVE TYPE QUESTIONS

Write the most appropriate answer to each of the following questions by choosing one of the four options given.

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

2. Mr. Arvind opened a bank account in Country "P" on 1.7.2017. He has made deposits of foreign currency equivalent to INR 5 lakhs on 1.7.2017, INR 7 lakhs on 1.10.2017, INR 12 lakhs on 1.9.2019 and INR 25 lakhs on 1.3.2020, in that bank, out of Indian income which has not been assessed to tax in India. The deposit of INR 12 lakhs on 1.9.2019 is made out of the withdrawal of earlier deposits made on 1.7.2017 and 1.12.2017 with the said bank. Further, out of INR 25 lakhs deposited by him on 1.3.2020, Mr. Arvind withdrew INR 2 lakhs on 31.3.2020. The value of an undisclosed asset in form of bank account under the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 will be taken as:
   (a) INR 49 lakhs
   (b) INR 47 lakhs
   (c) INR 37 lakhs
   (d) INR 35 lakhs

3. If Cure House Inc. opts for advance ruling for the project of providing consultancy in field of medicine, such ruling shall be binding on:
   (a) Cure House Inc., in relation to the abovementioned project
   (b) Jurisdictional Assessing Officer of Cure House
   (c) Both (a) and (b)
   (d) Cure House Inc. and Jurisdictional Assessing Officer in relation to the abovementioned project and for any future transaction of similar nature in India

4. Which of the following would **not** be considered as a permanent home of Mr. Shivam in context of the relevant rule in the DTAA with Country "Q" for dual residency?
   (i) House in Defence Colony, Delhi where his family lives
   (ii) Own house in Mumbai which has been let out
   (iii) Rent-free accommodation provided by his employer in Country "Q"

   The correct answer is -
   (a) Only (i) above
   (b) Only (ii) above
   (c) Only (iii) above
   (d) Both (i) and (iii) above

5. Mr. Arvind acquired a flat in Country "P" in the P.Y.2015-16 for INR 50 lakhs. Out of the said sum, INR 20 lakhs was assessed to tax in total income of the P.Y.2015-16 and earlier years. This asset comes to the notice of the Assessing Officer in the year 2019-20. If the value of the flat on 1.4.2019 is INR 90 lakhs, the amount chargeable to tax in the year 2019-20 would be:
   (a) INR 90 lakhs
   (b) INR 70 lakhs
   (c) INR 54 lakhs
   (d) INR 30 lakhs

II. DESCRIPTIVE QUESTIONS

1. (i) With reference to the DTAA between India and Country "Q", examine whether Shivam is a resident in India or Country "Q" in the previous year 2019-20.

   (ii) With reference to the DTAA between India and Country "R", comment on whether provision of consultancy services through Sudha would lead to creation of PE in India for Cure House Inc., a Country "R" company.

2. Determine the total income and tax liability of Shivam for the previous year 2019-20 as per the provisions of the Income-tax Act, 1961. Advance tax calculations may be ignored. Ignore the perquisite value of rent free accommodation provided to Shivam in Country "Q". Indicate reasons for treatment of each item. Working Notes should form part of your answer.

EXHIBIT I

Telegraphic Transfer Buying Rate

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

Date	Exchange Rate (INR)	Date	Exchange Rate (INR)
30.09.2019	45.95	31.01.2020	47.83
31.10.2019	46.85	29.02.2020	48.52
30.11.2019	45.10	31.03.3020	48.61
31.12.2019	46.95		

EXHIBIT II

EXTRACTS OF DTAA BETWEEN INDIA AND COUNTRY "Q"

ARTICLE 4

FISCAL DOMICILE

1. *For the purposes of this Agreement, the term "resident of a Contracting State" means any person who is a resident of a Contracting State in accordance with the taxation laws of that State.*
2. *"Where by reason of the provisions of paragraph 1, an individual is a resident of both Contracting States, then his status shall be determined as follows:*
   - *(a) he shall be deemed to be a resident of the State in which he has a permanent home available to him; if he has a permanent home available to him in both States, he shall be deemed to be a resident of the State with which his personal and economic relations are closer (centre of vital interests) ;*
   - *(b) if the State in which he has his centre of vital interests cannot be determined, or if he has not a permanent home available to him in either State, he shall be deemed to be a resident of the State in which he has an habitual abode ;*
   - *(c) if he has an habitual abode in both States or in neither of them, he shall be deemed to be a resident of the State of which he is a national ;*
   - *(d) if he is a national of both States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement*

EXHIBIT III

EXTRACT OF DTAA BETWEEN INDIA AND COUNTRY "R"

ARTICLE 5

PERMANENT ESTABLISHMENT

1. *For the purposes of this Agreement, the term "permanent establishment" means a fixed place of business through which the business of an enterprise is wholly or partly carried on.*
2. *The term "permanent establishment" includes especially:*

(a) *a place of management;*
(b) *a branch;*
(c) *an office;*
(d) *a factory;*
(e) *a workshop;*
(f) *a sales outlet;*
(g) *a warehouse in relation to a person providing storage facilities for others;*
(h) *a farm, plantation or other place where agricultural, forestry, plantation or related activities are carried on; and*
(i) *a mine, an oil or gas well, a quarry or any other place of extraction of natural resources.*

3. *The term "permanent establishment" shall also include:*

(a) *a building site, a construction, installation or assembly project or supervisory activities in connection therewith, where such site, project or activities continue for a period or periods aggregating more than 180 days;*

(b) *the furnishing of services including consultancy services by an enterprise through employees or other personnel by the enterprise for such purpose, but only where activities of that nature continue (for the same or a connected project) within the Contracting State for a period or periods aggregating more than 180 days within any twelve-month period.*

SOLUTIONS – CASE STUDY 11

I. ANSWERS TO MCQs

MCQ No.	Answer
1.	(d)
2.	(c)
3.	(c)
4.	(b)
5.	(c)

II. ANSWERS TO DESCRIPTIVE QUESTIONS

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

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

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

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

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

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

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

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

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

(ii) His total stay in India in last seven years preceding P.Y. 2019-20 is 730 days or more.

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

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

This Rule provides that where an individual is a resident of both the countries, he shall be

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

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

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

(a) the residential property is located and

(b) social and cultural activities are closer

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

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

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

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

Particulars	INR	INR
Income from Salaries		
Salary from services rendered in India (April - September 2019)		
Basic Salary (INR 70,000 x 6)	4,20,000	
Dearness Allowance (INR 30,000 x 6)	1,80,000	
Special Allowance (INR 5,000 x 6)	30,000	
Bonus	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 2019 - March 2020)		
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)		50,000
		15,54,880
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		23,13,292
***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		**21,78,292**
Total Income (rounded off)		**21,78,290**

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

Particulars	INR	INR
Tax on INR 21,78,290		4,65,987
Add: Health and education cess @4%		18,639
Tax Liability		4,84,626
Less: Foreign Tax Credit [See Note (v)]		
- on salary income	98,078	
- on interest income	36,390	1,34,468
Net tax liability		**3,50,158**
Net tax liability (rounded off)		**3,50,160**

Notes:

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

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

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

Overseas salary for the period October 2019 to March 2020:

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

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

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

Deduction shall be lower of the following:

- INR 5,000 per month = INR 60,000
- 25% of the adjusted total income = 25% of INR 22,38,292 = INR 5,59,573
- Actual rent – 10% of adjusted total income = INR 3,00,000 (25,000*12) – INR 2,23,829 (10% of 22,38,292) = INR 76,171

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

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

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

(v) Since Shivam is a resident and ordinarily resident in India for the A.Y.2020-21 by virtue

of section 6 of the Income-tax Act, 1961, his global income is taxable in India. In such case, the income arising in Country "Q" is doubly taxed. In order to avoid double taxation, Shivam can take the benefit of DTAA between India and Country "Q" by way of foreign tax credit in respect of the tax paid in Country "Q" or tax paid on such income in India, whichever is lower.

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

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

Calculation of foreign tax credit

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

Double taxed Interest Income	**INR**
Interest Income on Securities of Country "Q" company	2,42,600
Computation of foreign tax credit on doubly taxed interest income:	
Lower of:	
Tax withheld in Country "Q" on interest income at 15%, which is also the rate as per the DTAA [750(5000 x 15%) x 48.52]	36,390
Tax payable in India on interest income@22.25%	53,979
Foreign tax credit	**36,390**

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

CASE STUDY – 12

Athena Ltd. is a company specializing in manufacture of electronic products such as hair straighteners and curlers. Athena Ltd. was incorporated in Country A in September 2013.

Athena Ltd. set up its own manufacturing facility by July 2014 and set up its first retail store in December 2014 in Country A. The retail store displayed and sold the various variants of straighteners and curlers that it had manufactured. The products are sold under Athena's registered trade mark. The first retail store showed tremendous success and sales. Given the success, between the years 2015 to 2018, Athena grew its network of retail stores in Country A. By the end of 2018 it had set up a total of ten retail stores in Country A.

The board of directors of Athena Ltd. consisted of Mr. Lim, his wife Mrs. Lim and his dear friend Mr. Chang and his wife Mrs. Chang. Mr. Lim, Mrs. Lim, Mr. Chang and Mrs. Chang were all residents and citizens of Country B. The board meetings of Athena Ltd. were regularly held in Country A with each director being personally present for such meetings. All decisions relating to setting up and expansion of the retail stores network were taken up duly by the board of directors with unanimous agreement.

Athena Ltd. seeks to expand its presence to other countries including India in the previous year 2019-20. India is a potential market and seems to be a profitable move for the company.

The board thinks that before any substantial investment is made in the Indian market, it would be fit to gain a comprehensive understanding of the Indian market in terms of consumer choices, market rivals, legal compliances, business regulations, etc. Hence, it devises a four stage strategy to launch the Indian operations.

Stage I:

Athena Ltd. will hire three professionals residing in India based on prescribed qualifications. It would be ideal for the team to comprise one lawyer, one accountant and one business professional.

The functions to be discharged by such professionals include authoring a detailed project report enumerating the domestic landscape of the Indian legal and business regulations that would govern the proposed business in India. For example, what are the legal and regulatory compliances required for setting up a business? What is the projected growth trend of the hair care industry? Who are the market rivals and what is their respective market share? The project report would also include financial projections regarding the profitability for next five years.

The professionals are expected to work independently but can raise any queries to the board of directors of Athena Ltd. These professionals will be given two months to complete the report and present the findings to the board of directors. The remuneration of the professionals would be taken care of, by Athena Ltd.

Pursuant to the strategy, Mr. Hari, Mr. Rajesh and Mr. Ravi were hired by Athena Ltd. on March 1, 2019. Their monthly remuneration were fixed at Rs.75,000, Rs.82,000 and Rs.80,000 respectively, for the two month period. The report was duly submitted by them to the board of Athena Ltd. on April 30, 2019. The board was happy to receive the report and duly considered the findings submitted.

Stage II:

Having implemented the first stage, the next step would be to hire an agent with well-established industry knowledge and with networks and connections in the hair care industry in India. The agent was to work exclusively for Athena Ltd. The initial term of engagement would be four months, which may be extended to another term, if found agreeable to both parties.

The agent will be expected to identify potential companies and individuals who can serve as advisors/investors/local partners for Athena Ltd. as and when it intends to establish its local presence in India. The agent can hold the first round of discussions and negotiations with any such interested party. Based on such discussions, the agent must convey the expectations of the interested party to Athena Ltd. While the agent can enter into any such preliminary negotiations with the advisors / investors/ local partners, the desired terms of relationship would be subject to the consideration, confirmation and final approval of Athena Ltd. The agent also had to identify potential customers and promote the company's products. For this purpose, hair curlers and hair straightners would be supplied to the agent, who in turn has to market these products to potential customers. The Board of Athena Ltd. decided that, as a promotional offer, a discount of 30% can be offered initially to such customers.

After a host of interviews, Mr. Shyam was found eligible for the position of the agent. The terms of engagement of Mr. Shyam were fixed for four months. Mr. Shyam acted as an agent from June 2019 to September 2019. He received a remuneration of Rs.1,50,000 per month for the performance of his functions, as described above.

After a series of discussions, Mr. Shyam identified Mr. Garg, Mr. Patnaik and Mr. Sharma as suitable advisors who have relevant industry experience in the hair care and hospitality industries. Mr. Shyam was also able to identify potential customers in western states of India, namely, Maharashtra, Gujarat and Goa and effect sales to such customers during the said period.

Stage III:

The third step is to launch and sell the products in India using e-commerce, given the wide spread use of digital means such as websites and phone based apps by Indians for shopping online. The website, **www.athena.in**, was designed and hosted such that Indian users can make use of its services for placing orders in India. The website was hosted on a server based in Cayman Islands, owned and operated by Athena Ltd. The business was carried on through the server, which carries on the entire set of operations. The Indian user merely has to click on the desired product and fill in the details of the desired address for delivery and make payment using a payment gateway, after which the order is confirmed and delivery is ensured.

In order to enable the delivery of the straighteners and curlers to Indian customers, Athena Ltd. identified warehouse(s) where the stock can be maintained and from which the orders of the customers can be satisfactorily met. Athena Ltd. directly supplied the stock from the Country A entity to the local warehouses.

The website was functional for the said purpose in October, 2019 and thereafter, online sales were effected through the website at the price decided by Athena Ltd. During October 1, 2019 to December 31, 2019 Athena Ltd. was able to sell 2500 units of hair straightners and 1500 units of hair curlers to customers based in India. The hair dryer was priced at Rs.2,500 while the hair curler was priced at Rs.3,500.

Stage IV:

As a fourth step, the board of Athena Ltd. reviewed the strategies adopted. Encouraged by the

positive market response in India, the board of Athena Ltd. decided to set up a branch in Mumbai in January, 2020. Mr. Garg and Mr. Patnaik, who are residing in Mumbai, are now entrusted with spearheading the Indian operations and expansion strategy. Sales were effected through the Mumbai branch from January, 2020 itself.

Athena Ltd. is also considering advertising the product on the internet using websites such as Google Inc. The board believes that using digital means of advertising would give the necessary push to sales by educating interested Indian customers of the product range which would contribute to better sales and profits, in turn.

The company enters into talks with Google Inc. for hosting the desired advertisements. It negotiated a sum of Rs.30,00,000, which is paid to Google Inc. in March, 2020 for online advertising services.

Additional facts to be able to answer the questions:

Google Inc does not have a permanent establishment in India.

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

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

I. OBJECTIVE TYPE QUESTIONS

Write the correct answer to each of the following questions by choosing one of the four options given.

1. The income earned by Athena Ltd. from sale of hair straightners and hair curlers in India during the period from June, 2019 to December, 2019 –
   (a) Would not be taxable in India, since no business connection is established on account of Mr. Shyam not having authority to conclude contracts on behalf of Athena Ltd.
   (b) Would be taxable in India, since business connection would be established on account of Mr. Shyam securing orders in India wholly for Athena Ltd.
   (c) Would not be taxable in India, since Athena Ltd. does not have a PE in India
   (d) Would be taxable in India, since Athena Ltd. has a PE in India

2. 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.

3. Which of the following may be viewed by the tax authorities as a tax avoidance measure undertaken by Athena Ltd.?
   (a) Choosing Google Inc., a company not having a PE in India, for advertising its products.
   (b) Hosting the website on a server based in Cayman islands
   (c) Both (a) and (b)
   (d) Entering into limited period engagements with persons resident in India.

4. In respect of remuneration of Rs.1,50,000 per month paid by Athena

Ltd. to Mr. Shyam, which of the following statements is correct, having regard to the provisions of the Income-tax Act, 1961 (provisions of DTAA may be ignored) –

(a) No tax is deductible at source as per the provisions of the Income-tax Act, 1961 since Athena Ltd. is a foreign company and is not resident in India

(b) Tax has to be deducted at source under section 192 at the average rate of income-tax computed on the basis of the rates in force.

(c) Tax has to be deducted at source at the rates in force under section 195

(d) Tax has to be deducted at source@5%

5. As per the provisions of the Income-tax Act, 1961, who can act as a representative assessee in respect of the income deemed to accrue or arise in India in the hands of Athena Ltd.?

(a) Only an employee of Athena Ltd.

(b) Only a trustee of Athena Ltd.

(c) Only an agent of Athena Ltd.

(d) All the above

II. DESCRIPTIVE QUESTIONS

1. In relation to the income earned during previous year 2019-20, does Athena Ltd. have a permanent establishment in India? Answer the question in relation to activities undertaken in each of four stages in the case study.

2. (i) What may be viewed as a strategy which has been adopted by Athena Ltd. to avoid tax in India in the third stage? Examine.

(ii) Which action plan of BEPS addresses the tax challenges arising out of the strategy adopted by Athena Ltd. in the third stage? What were the recommendations thereunder to address such challenges?

SOLUTIONS – CASE STUDY 12

I. ANSWERS TO MCQs

MCQ No.	Answer
1.	(c)
2.	(b)
3.	(b)
4.	(d)
5.	(d)

II. ANSWERS TO DESCRIPTIVE QUESTIONS

Answer to Q.1:

First stage: Professionals have been hired in India for preparing a report over a period of two months. Based on the contents of the report, it is possible to take a view that the work done by the professionals is merely preparatory and auxiliary in nature. Once the activities are preparatory and auxiliary in nature, the activities cannot be classified as triggering a PE implication for Athena Ltd. in India as per Article 5(4) of the India-Country A DTAA. In any case, at this stage, there is no revenue generation to trigger the concept of PE.

Second stage: Article 5(6) of the DTAA with Country A does not expressly provide for exclusivity of relationship with the principal as a test of agent's dependence. However, "exclusive" relationship with the principal is a relevant factor, although not entirely determinative, in ascertaining an agent's independence. In this case, considering that Shyam is an agent exclusively for Athena Ltd., it is possible to take a view that he is a dependent agent. As per Article 5(5) of the DTAA with Country A, a dependent agent in India would constitute a PE for Athena Ltd. Only if it is shown that he has the authority to conclude contracts in the name of Athena Ltd. In this case, it can be seen that the role of the agent does not extend to concluding contracts on behalf of the principal. Here, the agent can only engage in preliminary negotiations with the final say being reserved exclusively for Athena Ltd. alone. Further, he has to identify potential customers and sell the products at the initial offer price which is also decided by the Board of Athena Ltd. Due to these reasons, the agent in India does not constitute a PE for Athena Ltd.

Third stage: The traditional meaning and understanding of a fixed place PE connotes a physical space which is at the disposal of the non-resident enterprise and through which the latter conducts its business. With respect to a website, it has been held that it is merely a software. In the absence of the server supporting the website being located in India (here, it is in Cayman Islands), there can be no PE liability for Athena Ltd. The server, through which business is carried on, is located in Cayman Islands, a no tax jurisdiction, and not in India.

Furthermore, a warehouse in India would not constitute a PE as per Article 5(4) of the India-Country A DTAA.

Fourth stage – In this stage, Athena Ltd. sets up a branch in Mumbai, which constitutes a PE in India as per Article 5(1)/(2) of the India-Country A DTAA. Accordingly, profits of Athena Ltd. as are attributable to the PE in India would be liable to tax in India.

Answer to Q.2:

(i) The rise of e-commerce has led to an emergence of digital economy. Physical locations of the servers of such digital businesses were considered to establish the tax jurisdiction in which the profits of digital businesses could be taxed. Servers were, therefore, placed in tax efficient jurisdictions, even though the main income generation and customers were from other jurisdictions.

In the third stage, the business in India is to be carried on through the website hosted on the server located in Cayman islands, which is a no tax jurisdiction. In fact, the server located in Cayman islands carries on the entire set of operations. A website consists of data and programmes in digitised form which is stored on a server of the internet service provider. On the other hand, a permanent establishment, as the name itself suggests, is a fixed place of some permanence from where a business is carried on. Therefore, existence of a website in India would not constitute a permanent establishment.

However, the server is a system which carries out activities initiated by an end-user's computer. In this case, Athena Ltd. itself owns and operates the server and the business is carried on through the server, it could be construed to be a permanent establishment. However, the server is located in Cayman islands, which is a no tax jurisdiction. Location of the server owned and operated by Athena Ltd., which constitutes a PE in this case, in a no tax jurisdiction may be viewed as a strategy adopted by Athena Ltd. to avoid tax in India, considering the fact that Athena Ltd. is a Country A based company, its Board of Directors are residents of Country B and it wishes to expand its market in India. However, it has chosen to locate the server through which it carries on business in a fourth place, namely, Cayman islands, which is a no tax jurisdiction. This may be viewed as a strategy adopted by Athena Ltd. to avoid tax in India in the third stage.

(ii) Owing to the 'intangibility' attached to the digital model of business, tax authorities often face challenges in rightly bringing to tax the profits earned from a digital business.

Action Plan 1 of the BEPS project was developed by the OECD which outlines the methods and principles based on which physical and digital economies can be taxed at par.

The OECD recommends the following options to address the challenges of the digital economy -

- Modifying the existing Permanent Establishment (PE) rule to provide 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.
- 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
- Imposition of a final withholding tax on certain payments for digital goods or services provided by a foreign e-commerce provider or imposition of a equalisation levy on consideration for certain digital transactions received by a non-resident from a resident or from a non-resident having PE in other contracting state.

CASE STUDY – 13

M/s Gryffindors LLP ("the firm") is a Country X based partnership firm engaged in the practice of law. The firm is the largest law firm in Country X and advises fortune 500 clients on various legal matters namely Corporate Mergers & Acquisitions, Tax, Trade law, Construction, Arbitration, Anti-trust laws, Energy, Banking laws etc. The firm has global offices in Country Y and Country Z. The firm does not have any presence in India owing to regulatory requirements and, therefore, does not have any office in India. The firm is a tax resident of Country X but by virtue of the tax laws in Country X, it is a fiscally transparent entity.

The following are the assignments entered into by the firm and its global offices. Assignment A is an ongoing assignment and Assignment B pertains to a future assignment which the firm is proposing to undertake. The facts and nature of the assignments containing India nexus are provided below.

Assignment A

Client Name: Vidyut India Limited, an Indian Company which is a subsidiary of a Vidyut AG, an entity in Country Y.

Nature of Assignment: Vidyut India has entered into a contract with an Indian construction company for construction of a pharma research and development unit in India. Vidyut India also has a group entity, Vidyut Z Inc, in Country Z, from whom necessary inputs are obtained for construction of the pharma research and development centre. The construction agreement provided that the law in Country Y will govern the contract. There is currently a dispute in the contract and as per the agreement, the adjudication proceedings were initiated on 30th August 2019. Gryffindors Y is a registered firm in Country Y engaged by Vidyut India to represent it in the adjudication proceedings in India. Further, as part of the adjudication proceedings, site visits are essential in India and Country Z. For the site visit in Country Z, Gryffindors Z, a Country Z registered partnership firm was engaged for which Vidyut India would compensate the Country Z firm separately.

Additional Details:

- As per the terms of agreement, the activities are to be carried on in Country Y, Country Z and India.
- Except a site visit and an adjudication hearing in Chennai between 21st and 24th September, 2019, no other activity is carried on in India by Gryffindors Y. The total time spent in India was 6 days between 19th September and 24th September, 2019.
- Meanwhile, another site visit in Country Z was for 10 days for which partners from Gryffindors Z undertook the visit and provided its report to Gryffindors Y, Country Y. For the time spent by the Country Z firm, it had raised an invoice to Vidyut India.
- Apart from the 6 days in India and 10 days in Country Z, major part of the adjudication proceedings were at Country Y.
- Gryffindors Y produced a tax residency certificate from Country Y. It is also to be noted that Gryffindors Y is a fiscally transparent entity as per the tax laws of Country Y. Gryffindors Y is only liable for trade tax in Country Y.
- Gryffindors Z produced a tax residency certificate from Country Z tax authorities certifying that it is a tax resident of Country Z. It is also to be noted that Gryffindors Z is a fiscally transparent entity as per the Country Z tax laws.

Assignment B

Client Name: Abhimanyu Holdings Bank Limited, a banking company registered in India.

Nature of Assignment: Abhimanyu Holdings Bank Limited is contemplating to acquire a Country X based national bank. Therefore, it has approached Gryffindors LLP, Country X ('the Firm') for a counsel opinion for the proposed acquisition.

Additional Details:

- The scope of work for the firm shall be the following:
  - Phase I: Education & Training
  - Phase II: Acquisition Transaction
  - Phase III: Regulatory approval for the transaction.
- As part of the first phase, on education and training, the firm will provide a detailed document to Abhimanyu India on the legal framework on banking and regulatory laws in Country X. Further, apart from the document, the firm will provide presentation and discuss the various legal and regulatory requirements in Country X for setting up a bank branch or acquiring a bank in Country X.
- The presentation to be made by the firm will be to the bank officials of Abhimanyu India. The presentation will be made from the law firm's office in Country X. The purpose of the training is to ensure that if the bank sets up a branch or office in Country X, the said officials will be deputed to the Country X entity.
- The work shall be undertaken by the firm from its office in Country X and there will be no visit in India.
- As mentioned previously, the firm is a tax resident of Country X and is a fiscally transparent entity for tax purpose in Country X.
- Phase II and Phase III are subject to the conditions and legal environment being favourable, and hence, the happening of the same is not certain. However, Phase I: Education is certain and a fee of foreign currency equivalent to Rs.1,50,000 has been agreed upon by the firm to render Phase I services, which would be paid in Country X.

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

I. OBJECTIVE TYPE QUESTIONS

Write the correct answer to each of the following questions by choosing one of the four options given.

1. ABC Ltd. an Indian company paid dividend distribution tax under section 115 -O in respect of dividend distributed by it to its resident and non-resident shareholders. Mr. John, a shareholder of ABC Ltd. and a resident of Country X, has to pay tax in Country X on dividend received by him from ABC Ltd., as per the domestic tax laws of Country X. This is an example of:
   (a) Juridical double taxation
   (b) Territorial double taxation
   (c) Economic double taxation
   (d) Municipal double taxation

2. Tax treaty is part of international law; hence its interpretation should be based on a certain set of principles and rules of interpretation. Which convention is used globally for interpretation of tax treaties?

(a) The UN Model Convention
(b) The OECD Model Convention
(c) Either (a) or (b) [Except in case of USA, where US Model Convention is used]
(d) The Vienna Convention

3. In order to claim relief under the tax treaty in India, a non-resident -
   (a) should have a business presence in India
   (b) should produce his Permanent Account Number
   (c) should produce Tax Residency Certificate (TRC)
   (d) should produce his income-tax return filed in the home country.

4. When a term used in a tax treaty is not defined in the tax treaty or in the Act, but the same is defined subsequently through a notification in the Official Gazette by the Central Government, then, in such a case:
   (a) The notification shall take effect from the date of its publication in the Official Gazette
   (b) The notification shall be deemed to be effective from the date when the tax treaty came into force
   (c) The notification shall be deemed to be effective from the date when the tax treaty was last modified
   (d) The notification shall take effect from 1st April and be effective from the current assessment year.

5. In order to invoke the tax treaty for a person who is a dual resident i.e. tax resident in both the countries, which rule may be applied under the relevant article of the tax treaties to resolve the issue?
   (a) Force of Attraction
   (b) Tie-breaker
   (c) Equivalent beneficiary
   (d) Non-discrimination

II. DESCRIPTIVE QUESTIONS

1. (i) Assuming that the tax treaty benefit is available for both the foreign entities, namely, Gryffindors Y and Gryffindors Z your views are solicited as to whether Article 14 of India-Country Y and India-Country Z tax treaty can be invoked.

   (ii) The firms want clarification as to whether surcharge and education cess need to be separately added to the withholding tax rate specified in the tax treaty while invoking the tax treaty rate. Examine.

2. (i) What are the tax implications under the Income-tax Act, 1961 in respect of income earned by the firm, M/s. Gryffindors X from the proposed phase I service to be rendered by it in respect of Assignment B?

   (ii) Assuming that the above-referred income is not chargeable to tax in India in the hands of the firm as per the Indian tax laws, is it possible to bring it into tax by invoking the India-Country X DTAA provisions?

   (iii) Assuming that the tax consequences in the above case are not certain, what is the option available to M/s. Gryffindors X to ensure tax certainty.

EXHIBIT A

Extract of the relevant Articles of India - Country Y DTAA

ARTICLE 1

PERSONAL SCOPE

This Agreement shall apply to persons who are residents of one or both of the Contracting States.

ARTICLE 2

TAXES COVERED

1 *This Agreement shall apply to taxes on income and on capital imposed on behalf of a Contracting State, of a land or a political sub-division or local authority thereof, irrespective of the procedure in which they are levied.*

2 *There shall be regarded as taxes on income and on capital all taxes imposed on total income, on total capital, or on elements of income or of capital, including taxes on gains from the alienation of movable or immovable property, and the pay roll tax.*

3 *The existing taxes to which this Agreement shall apply are in particular:*

(a) *in the Federal Republic of Country Y :*

income-tax, corporation-tax, capital tax, and trade tax (hereinafter referred to as "Country Y tax");

(b) *in the Republic of India,*

the income-tax including any surcharge tax thereon, and the wealth-tax (hereinafter referred to as "Indian tax").

4 *This Agreement shall apply also to any identical or substantially similar taxes which are imposed after the date of signature of this Agreement in addition to, or in place of, the existing taxes. The competent authorities of the Contracting States shall notify each other of changes of importance which have been made in their respective taxation laws.*

ARTICLE 3 (EXTRACT)

GENERAL DEFINITIONS

1 *For the purposes of this Agreement, unless the context otherwise requires, -*
the term "person" includes an individual, a company and any other entity which is treated as a taxable unit under the taxation laws in force in the respective Contracting States ;

ARTICLE 4 (EXTRACT)

RESIDENT

1 *For the purposes of this Agreement, the term "resident of a Contracting State" means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management or any criterion of a similar nature. But this term does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein.*

ARTICLE 14

INDEPENDENT PERSONAL SERVICES

1 *Income derived by an individual who is a resident of a Contracting State from the performance of professional services or other independent activities of a similar character shall be taxable only in that State except in the following circumstances when such income may also be taxed in the other Contracting State:*

(a) *if he has a fixed base regularly available to him in the other Contracting State for the purpose of performing his activities, in that case, only so much of the income as is attributable to that fixed base may be taxed in that other State ; or*

(b) *if his stay in the other Contracting State is for a period or periods amounting to or exceeding in the aggregate 120 days in the relevant fiscal year; in that case, only so much of the income as is derived from his activities performed in that other State may be taxed in that other State.*

2 *The term "professional services" includes independent scientific, literary, artistic, educational or teaching activities, as well as the independent activities of physicians, surgeons, lawyers, engineers, architects, dentists and accountants.*

EXHIBIT B

Extract of the relevant Articles of India - Country Z DTAA

ARTICLE 1

PERSONAL SCOPE

This Agreement shall apply to persons who are residents of one or both of the Contracting States.

ARTICLE 2

TAXES COVERED

1. *The taxes to which this Agreement shall apply are:*

(a) *in the case of India :*

the Income-tax including any surcharge thereon; and

(b) *in the case of Country Z:*

the federal, cantonal and communal taxes on income (total income, earned income, income from capital, industrial and commercial profits, capital gains, and other items of income).

2. *The Agreement shall also apply to any identical or substantially similar taxes which are imposed by either Contracting State after the date of signature of the present Agreement in addition to, or in place of, the taxes referred to in paragraph 1 of this Article.*

3. *In this Agreement, the term "Indian tax" means tax imposed by India, being tax to which this Agreement applies; the term "Country Z tax" means tax imposed in Country Z, being tax to which this Agreement applies; and the term "tax" means Indian tax or Country Z tax, as the context requires; but the taxes in the preceding paragraphs of this Article do not include any penalty or interest imposed under the law in force in either Contracting State relating to the taxes to which this Agreement applies.*

4. *The competent authorities of the Contracting States shall notify to each other any significant changes which have been made in their relevant respective taxation laws.*

ARTICLE 3 (EXTRACT)

GENERAL DEFINITIONS

1. *In this Agreement, unless the context otherwise requires:*

the term "person" includes an individual, a company, a body of persons, or any other entity which is taxable under the laws in force in either Contracting State;

ARTICLE 4

FISCAL DOMICILE

1. *For the purposes of this Convention, the term "resident of a Contracting State" means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management, place of incorporation, or any other criterion of a similar nature, provided, however, that:*

   (a) this term does not include any person who is liable to tax in that State in respect only of income from sources in that State; and

   (b) in the case of income derived or paid by a partnership, estate, or trust, this term applies only to the extent that the income derived by such partnership, estate, or trust is subject to tax in that State as the income of a resident, either in its hands or in the hands of its partners or beneficiaries.

ARTICLE 14

INDEPENDENT PERSONAL SERVICES

1. *Income derived by an individual or a firm who is a resident of one of the Contracting States in respect of professional services or other independent activities of a similar character shall be taxable only in that State unless:*

   (a) the individual or firm has a fixed base regularly available to the individual or firm in the other Contracting State for the purpose of performing the individual's or the firm's activities, in which case the income may be taxed in that other State but only so much of it as is attributable to activities exercised from that fixed base; or

   (b) the stay by the individual or, in the case of a firm, by one or more members of the firm (alone or together) in the other Contracting State is for a period or periods amounting to or exceeding 183 days in a year of income, in which case only so much of the income as is derived from the activities of the individual, that member or those members, as the case may be, in that other State may be taxed in that other State.

2. *The term "professional services" includes services performed in the exercise of independent scientific, literary, artistic, educational or teaching activities as well as in the exercise of the independent activities of physicians, surgeons, lawyers, engineers, architects, dentists and accountants.*

SOLUTIONS – CASE STUDY 13

I. ANSWERS TO MCQs

MCQ No.	Answer
1.	(c)
2.	(d)
3.	(c)
4.	(b)
5.	(b)

II. ANSWERS TO DESCRIPTIVE QUESTIONS

Answer to Q. 1

(i) Article 14 of the India-Country Y and India-Country Z tax treaties deal with Independent Personal Services. Professional services rendered by independent professionals like lawyers, doctors, engineers, accountants etc. are covered by the provisions of this article.

It may be noted that the India-Country Y DTAA restricts the scope of Article 14 to income derived by an individual who is a resident of the Contracting State. Consequently, Article 14 of the DTAA with Country Y cannot be invoked in the case of income derived by a firm.

However, the India-Country Z DTAA does not restrict the scope of Article 14 to income derived by a resident individual and includes within its scope, a resident firm as well. Therefore Article 14 of the India-Country Z DTAA can be invoked in respect of income derived from such services by Gryffindors Z firm, which is resident in Country Z.

(ii) Article 2 of the DTAAs specifies the 'taxes covered' under the DTAA entered into between the Contracting States. In the DTAAs which India has entered into with Country Y and Country Z, taxes covered include income tax including any **surcharge thereon**. The issue under consideration is whether surcharge and education cess have to be added separately to the rate provided in the DTAA. In this regard, since the DTAA specifically mentions in Article 2 that taxes include surcharge, there is no requirement to include surcharge.

As per sub-section (11) and (12) of section 2 of the Finance Act, 2019, the amount of income-tax as increased by the applicable surcharge shall be further increased by an additional surcharge to be called "Education cess". Therefore, education cess are nothing but an additional surcharge. Since as per the DTAAs, taxes covered include any surcharge on income-tax, additional surcharge called as education cess are also included therein.

Therefore, if the tax treaty rate is invoked, the tax rate specified thereunder is all inclusive and there is no requirement to separately add surcharge and education cess over and above the rate prescribed in the DTAA.

Answer to Q. 2

(i) In this case, payment is to be made to the law firm in Country X in respect of income earned outside India i.e. in Country X. Considering the nature of income, it is possible to

characterise the same either as Royalty or Fees for technical services (FTS). Section 9(1)(vi)/(vii) spells out the cases where royalty and fees for technical services is deemed to accrue or arise in India as well as the exceptions thereto. The income earned by the law firm in Country X is covered under exceptions to Section 9(1)(vi)(b) and 9(1)(vii)(b). Income by way of royalty payable by a person who is a resident is deemed to accrue or arise in India, **except 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 outside India or for the purposes of making or earning any income from any source outside India**. Likewise, income by way of fees for technical services payable by a person who is resident, is deemed to accrue or arise in India except **where the fees are payable in respect of services utilized in a business or profession carried on by such person outside India or for the purposes of making or earning any income from any source outside India.**

In this case, since the payment is to be made for information used or services to be utilised for making or earning a new source of income outside India, these payments fall within the exceptions spelt out in section 9(1)(vi)/(vii). Accordingly, such income would not be deemed to accrue or arise in India in the hands of the non-resident law firm. Hence, such income earned by the law firm in Country X is not taxable in India as per the provisions of the Income-tax Act, 1961.

(ii) Since the income is not chargeable to tax in India as per the domestic tax laws, the same cannot be taxed under the DTAA. The fundamental principle of tax treaty is that it can only relieve tax burden. DTAA simply tries to eliminate double taxation. It does not grant any tax jurisdiction to any Government nor take away any jurisdiction already existing. DTAA does not create any additional tax in any state; it can only relieve tax. This is known as the principle of non-aggravation.

Further, section 90(2) of the Income-tax Act, 1961 clearly specifies that provisions of the Act shall apply to the extent they are more beneficial to the assessee. Also, the Supreme Court, in the case of *Azadi Bachao Andolan 263 ITR 706 and Ishikawajima Harima 288 ITR 408*, has held that tax treaties cannot create more onerous obligations or liabilities than provided under the Income-tax Act, 1961. Therefore, the India-Country X DTAA cannot bring into existence a new claim, if the said income is not taxable under the Income-tax Act, 1961.

(iii) The Country X firm, being a non-resident, may apply for an advance ruling under section 245N for determination of tax liability in relation to a transaction which is proposed to be undertaken by it with a view to avoiding litigation and providing certainty. Therefore, in this case, the Country X firm can make an application to the Authority of Advance Rulings in the prescribed form and manner to determine its taxability in India for the proposed Assignment C to be undertaken by it.

CASE STUDY – 14

Introduction:

Trikal Cement Ltd. (TCL) is an Indian company, having its head office at Vishakhapatnam. The company operates a SEZ unit as well as several DTA units. TCL is the flagship company in the group and the group has a foreign subsidiary D Inc.

You are the CFO with CA background, handling all taxation matters.

Meeting of the Board of Directors

An important Board meeting is scheduled on 25th May, 2020. The current date is 20th May, 2020. In this meeting, some important decisions are proposed to be taken, some of them having repercussions associated with Indian and international taxation.

Background of the business activities

TCL supplies goods to Shine Ltd. (SL), in Sri Lanka. The paid-up capital of SL in INR equivalent is Rs.50 crores. TCL holds to the tune of Rs.14 crores in the same.

TCL supplies goods to Grew Solid Ltd. (GSL), in Singapore. The paid-up capital of GSL in INR equivalent is Rs.80 crores. TCL holds to the tune of Rs.18 crores in GSL.

The voting power in both the companies is directly proportional to the number of shares held.

Royalty receipts

D Inc., is currently paying a royalty of 2 millions USD per annum (year ended 31-3-2020) to TCL for supply of know-how. For similar supply of know how to Epsilon LLC., a wholly owned Government Company in Japan, TCL receives annual royalty of USD 3 millions. (1 USD = Rs. 70)

Export sales data

Export sales are made from the SEZ unit of TCL.

Manager of Exports Division has furnished the following data pertaining to export sales of identical goods made during the year ended 31-3-2020:

Name of the party	Qty in MT	CIF Rate per MT (Rs.)
SL	8,00,000	11,800
GSL	5,00,000	12,000
XY Inc.	3,00,000	11,900
AB LLC.	2,00,000	11,700

XY Inc and AB LLC are unrelated third parties, located in notified jurisdictional areas.

External borrowings

TCL has borrowed a sum of equivalent of Rs.200 crores from Danubes Inc., Dubai on 12-4-2019. On this date, the assets position of TCL was as under:

	(In Rs. Crores)	
Type of assets	Market value	Book value
Tangible fixed assets	350	270
Intangible assets	30	25
Other assets	40	35

Danubes Inc., has charged interest at 8% and TCL has paid interest of Rs.16 crores for the year ended 31-3- 2020. Though the normal lending rate of Danubes Inc. was 7% per annum to other parties, in view of the urgent requirement of funds and pressing financial commitments, TCL decided to borrow this amount then.

I. OBJECTIVE TYPE QUESTIONS

Write the most appropriate option to each of the following questions by choosing one of the four options given.

1. Assume that TCL has entered into an Advance Pricing Agreement (APA) on 2nd Jan., 2020, covering transactions for the period starting from 1st April, 2019. The Annual Compliance Report for the assessment year 2020-21 shall be furnished within:
   (a) 60 days from 2nd Jan.,2020
   (b) 90 days from 31st March, 2020
   (c) 90 days from 2nd Jan., 2020
   (d) 30 days from 30th Nov., 2020

2. Which of the following are associated enterprises/deemed to be associated enterprises of TCL under section 92A for attracting transfer pricing provisions under the Income-tax Act, 1961?
   (i) SL
   (ii) GSL
   (iii) D Inc.
   (iv) Danubes Inc.

   The correct answer is -
   (a) (i) and (iii)
   (b) (i) and (iv)
   (c) (i), (iii) and (iv)
   (d) (i), (ii) and (iv)

3. Assume that TCL has entered into an agreement for sale of a product to Mr. Kashyap, a non-resident on 21-1-2020, who has a prior agreement with Deep Inc., of Singapore, in which TCL holds 40% of the share capital. For transfer pricing purposes, the transaction between TCL and Mr. Kashyap -
   (a) will be deemed to be an international transaction, if Mr. Kashyap is a non-resident.
   (b) will be deemed to be an international transaction, if Mr. Kashyap is a resident.
   (c) will be deemed to be an international transaction, whether Mr. Kashyap is a resident or non-resident.
   (d) will not be deemed to be international transaction at all.

4. Would transfer pricing provisions apply in respect of a transaction of TCL with XY Inc?
   (a) No; since they are unrelated parties
   (b) Yes, since the transaction is deemed to be an international transaction as per section 94A.
   (c) Yes, since the entities are deemed to be associated enterprises as per section 94A.
   (d) Yes, due to reasons stated in (b) and (c) above.

5. What is the permissible variation between the actual price charged by TCL from AB LLC in Country Q and the Arm's Length Price (ALP)?
   (a) 2%
   (b) 3%
   (c) 5%
   (d) Nil

II. DESCRIPTIVE QUESTIONS

1. "Where the total income of TCL is computed by the Assessing Officer applying the provisions of section 115JB, then, adjustments made on account of transfer pricing provisions will not have any impact while computing the book profits under section 115JB". Examine the correctness of this statement, assuming that TCL is a company which

is not required to comply with the Indian Accounting Standards.
Would your answer change if TCL is required to comply with Ind AS?

2. The Board of Directors want to know the income likely to be computed by the Assessing Officer, taking note of the adjustments under transfer pricing provisions. The profits of TCL computed without taking note of said adjustments, as per the provisions of Chapter IV-D of the Act is Rs.32.2 crores. Assume that there is no Advance Pricing Agreement and TCL has opted not to be subjected to Safe Harbour Rules. You are required to examine the various transactions entered into by TCL and determine the applicability of transfer pricing provisions for each transaction. Ignore provisions of section 94B, if applicable, in this case.

SOLUTIONS – CASE STUDY 14

I. ANSWERS TO MCQs

MCQ No.	Answer
1.	(d)
2.	(c)
3.	(c)
4.	(d)
5.	(d)

II. ANSWERS TO DESCRIPTIVE QUESTIONS

Answer to Q.1:

For the purpose of computing book profit for levy of minimum alternate tax under section 115JB, the profit shown in the statement of profit and loss prepared in accordance with the Companies Act, 1956 can be increased/decreased only by the additions and deductions specified in *Explanation* 1 to section 115JB, in case of a company which is not required to comply with Ind AS.

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

No; the answer will not change even if TCL is required to comply with Ind AS. Even then, only the adjustments listed in 115JB(2A) need to be made, and not the transfer pricing adjustment.

Answer to Q.2:

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.

The items that are to be considered for transfer pricing adjustments are as under: (a) Sales to SL, XY Inc and AB LLC;

(a) Royalty payments received from D Inc., and
(b) Interest on borrowings from Danubes Inc., Dubai.

Export sales to foreign companies Sales to SL

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 be associated enterprises.

In SL, TCL holds 14/50 i.e. 28% of the voting power.

Since TCL holds more than 26% of the voting power in SL, TCL and SL are deemed to be associated enterprises.

SL is a non-resident company. The transaction is for sale of the product. Hence, the sales made by TCL to SL are international transactions.

Sales to GSL

In GSL, TCL holds 18/80 i.e. 22.5% of the voting power

Since TCL holds less than 26% of the voting power, GSL is not an associated enterprise.

Sales to XY Inc and AB LLC

Both these companies are located in notified jurisdictional areas (NJA). As per section 94A, following are the consequences:

(i) all the parties to the transaction shall be deemed to be associated enterprises within the meaning of section 92A;
(ii) Transactions of purchase and sale shall be treated as international transactions;
(iii) Transfer pricing provisions will apply to such transactions.

Hence, the transactions in question have to be tested with reference to the ALP.

GSL is not an associated enterprise and hence the selling price of Rs.12,000 per MT to GSL can be taken as the ALP, as per CUP method.

Considering the above, the understatement of profits on account of lower selling price is:

Name of the party	Qty in MT	Rate per MT (Rs.)	ALP	Difference per MT	Total amount (Rs. In lakhs)
SL	8,00,000	11,800	12,000	200	1600
XY Inc.	3,00,000	11,900	12,000	100	300
AB LLC.	2,00,000	11,700	12,000	300	600
				Total adjustment to ALP	**2,500**

Royalty receipts

D Inc., is a wholly owned subsidiary of TCL and is a non-resident company. Hence, it is an associated enterprise.

Under CUP Method, ALP has to be taken as 3 million USD
Royalty falls within the meaning of international transaction, since it is payment for supply of know-how, being an intangible property.

D Inc., is currently paying a royalty of 2 million USD per annum (year ended 31 -3-2020) to TCL for supply of know-how. For similar supply of know how to Epsilon LLC., a wholly owned Government Company in Japan, TCL receives annual royalty of 3 million.

Understatement of royalty is 1 million USD, i.e. 1 M USD x Rs.70 =Rs.700 lakhs.

Borrowings

If one enterprise advances loan to the other enterprise of an amount of 51% or more of the book value of the total assets of such other enterprise, the two enterprises would be deemed to be associated enterprises.

As on the date of borrowing, the amount advanced is Rs.200 crores out of Rs.330 crores, which comes to 60.6%.

Hence, Danubes Inc., is deemed to be an associated enterprise of TCL. Interest payments are also covered by the term "international transaction".

Danubes Inc., has charged interest at 8% and TCL has paid interest of Rs.16 crores for the year ended 31 - 3-2020.

Interest rate charged to other parties is 7%. This has to be taken as the ALP rate.

In the light of this, the interest payment should have been 16x7/8 i.e., Rs.14 crores There has been an excess payment of Rs.2 crores w.r.t. ALP.

Total income of TCL

The total income of TCL, after considering the above adjustments will be as under:

Particulars	Amount (Rs. in cr)
Net profit as given prior to TP adjustments	32.2
Add: Difference on account of value in international transactions	
(i) Export sales	25.0
(ii) Royalty receipts	7.0
(iii) Interest payment	2.0
Total Income	**66.2**

CASE STUDY – 15

Alpha Co Ltd. (ACL), having its registered office in Delhi, is engaged in multiple businesses. It has a Knowledge Process Outsourcing (KPO) service unit at Bengaluru, trading center at Mumbai and manufacturing unit at Chennai. It has borrowed Rs. 200 crores from a leading bank in India for which 100% guarantee was given by the parent company Gama Inc. of USA. The total borrowings of ACL was Rs. 1,000 crores.

Mumbai Unit

The unit in Mumbai buys mobile handsets from Gama Inc. The handsets are branded for which royalty of Rs. 100 per handset sold is paid to Gama Inc.

Similar handsets to other customers in India are also sold by Gama Inc. The credit period offered to Alpha Co Ltd. is 2 months, whereas for the other customers, the credit period is 1 month. During the year, 15,00,000 handset were bought for an aggregate sum of Rs. 2,400 crores from Gama Inc. The purchase could be assumed as uniform throughout the financial year 2019-20. The cost of capital may be adopted as 12% per annum. Similar handset when supplied to other customers, the Gama Inc. would have billed Rs. 2,640 crores (excluding interest component for the delay beyond 1 month). It may be assumed that the entire purchase has been sold out by 31st March, 2020.

Bengaluru Unit

The KPO unit in Bengaluru has been doing services to Gama Inc. The aggregate value of international transaction during the financial year 2019-20 is Rs 180 crores.

Kolkata Liaison Office

The Gama Inc. has a liaison office at Kolkata (opened with the permission of RBI), where the orders are booked for supply of mobile handsets directly to customers in India. The liaison office has no connection with any other unit of ACL. The salary and administrative expenses of liaison office are met directly by Gama Inc. During the financial year 2019-20, the liaison office procured orders for 1,00,000 handsets from various customers and by that Gama Inc. made a profit at 20% amounting to 50 crores (rupee translated). Assume that the exchange fluctuation did not impact the profit of Gama Inc.

Chennai Unit

The manufacturing unit at Chennai is engaged in manufacture of automobile spare parts. It paid technical fee of Rs. 100 crores to Gama Inc. during the financial year 2019-20; tax was deducted at source and remitted in May, 2020. The unit also paid commission to overseas agents for booking export orders amounting to Rs. 25 crores for which no tax was deducted at source. It also employed persons for after-sales service in Europe and South Asia, for which salary was paid from India. The total salary payment to overseas employees was Rs. 40 crores and though the payments were made from Chennai, no tax was deducted at source. The payments of commission to the overseas agents were made outside India in foreign currency.

Other Information

The assessment of the assessee, i.e. ACL, for assessment year 2019-20 is pending before the Assessing Officer who referred the matter to Transfer Pricing Officer (TPO) for determination of arm's length price (ALP) in respect of the manufacturing unit at Chennai. The TPO, however, expanded the scope of his work by calling for details in respect of all other units of ACL.

Aggrieved with the expanded scope of work carried out by the TPO, ACL wants to approach the Dispute Resolution Panel (DRP), as similar issues for the assessment years 2017-18 to 2018-19

are pending before the Appellate Tribunal. The management of ACL also wants to enter into Advance Pricing Agreement (APA) with rollback mechanism.

ACL presently proposes to commence a garment manufacturing unit at Kanpur. It wants to buy raw materials from Beta Inc, Singapore. The agreement envisages a monthly supply of goods worth Rs. 30 crores for a period of 3 years. It wants to seek advance ruling in this regard.

I. OBJECTIVE TYPE QUESTIONS

Choose the most appropriate alternative for the following MCQs:

1. Alpha Co. Ltd. is required to carry out secondary adjustment if the primary adjustment exceeded:
   (a) ₹ 50 Lakhs (b) ₹ 100 Lakhs
   (c) ₹ 200 Lakhs (d) ₹ 500 Lakhs

2. Time limit available to ACL for filing modified return after advance pricing agreement (APA) is-------(where the APA) was entered into on 1-5-2020):
   (a) 31.08.2020 (b) 31.07.2020
   (c) 30.11.2020 (d) None of the above

3. The sale price of mobile handsets by Gama Inc. to ACL would have been taken as deemed ALP, if the ALP determined under section 92C by applying the most appropriate method does not exceed:
   (a) ₹ 2,520 crores (b) ₹ 2,472 crores
   (c) ₹ 2,424 crores (d) Insufficient / irrelevant data

4. ACL can seek advance ruling for the supplies made to Beta Inc, Singapore in relation to its tax liability when the said transaction value is _____ or more:
   (a) ₹ 10 crores (b) ₹ 50 crores
   (c) ₹ 100 crores (d) ₹ 500 crores

5. The time limit for AAR to pronounce its ruling from the date of receipt of application of ACL is
   (a) 12 months (b) 9 months
   (c) 6 months (d) 3 months

II. DESCRIPTIVE QUESTIONS

1. Determine the arm's length price (ALP) of the transaction of the sale of mobile handsets by Gama Inc. USA to the assessee and its impact on the assessable income for the assessment year 2020-21.

2. Explain the procedures to be followed by the Assessing Officer before making reference to TPO. State whether the TPO can enlarge his scope of work by calling for details of KPO unit, Bengaluru and trading activity at Mumbai when the Assessing Officer has made reference, only in respect of the manufacturing unit at Chennai.

3. Will the profit earned attributable to opening a liaison office at Kolkata by Gama Inc. be chargeable to tax in India?

4. Advise the company on the possibility of approaching Dispute Resolution Panel (DRP) and state how it must be carried out.

5. Advise whether the company can go for APA?

SOLUTIONS – CASE STUDY 15

I. ANSWERS TO MCQs

MCQ No.	Answer
1.	(b)
2.	(a)
3.	(d)
4.	(c)
5.	(c)

II. ANSWERS TO DESCRIPTIVE QUESTIONS

1. Alpha Co Ltd. (ACL), an Indian company and Gama Inc., a USA based company are **associated enterprises** as per section 92A**, since Gama Inc. is the parent company of ACL**. Thus, the transaction of purchase of mobile handsets by ACL from Gama Inc. would be an **international transaction**. The value of international transaction is to be worked out on the basis of Arm's Length Price (ALP).

Gama Inc. is selling mobile handsets to unrelated customers, which would be the comparable uncontrolled transaction in this case. Such purchase price to unrelated customers has to be adjusted by taking into consideration the functional differences existing between the transactions of Gama Inc. with associated enterprise (ACL) and other unrelated parties.

Accordingly, the arm's length price for purchase of mobile handsets has to be computed for working out the impact on assessable value **as per Cup method.**

Computation of Arm's Length Price

Particulars	₹in crores
Purchase price of mobile handsets by unrelated parties from Gama Inc.	2,640
Adjustments for functional differences	
Add: Royalty payable by ACL [₹100 per mobile set x 15,00,000]	15
Add: Cost of capital for 1 month credit which is not given to unrelated party [12% x ₹200 crore (monthly average sales i.e., ₹2,400 crore /12 months]	24
Arm's Length Price of 15,00,000 sets	**2679**

As per section 92(3**), transfer pricing provisions shall not apply in cases where such application results in reduction of income chargeable to tax or increase in loss of the Indian entity.** In the given case, if we consider ₹2,679 crores as purchase cost of ACL, the same would result in increase in the expenditure of ACL and consequent reduction in profits. Thus, transfer pricing provisions under the Income-tax Act, 1961 will not apply in this case. Consequently**, there would be no impact on the assessable income of ACL for the A.Y.2020-21.**

Note *– In case it is assumed that ₹15 crores is not included in the price of ₹2400* crores, the adjustment of royalty of *₹15 crores paid/payable is not required. The* ALP in such a case would be *₹2,664 crores. In such a case also, there will be no* impact on the assessable income of ACL for the A.Y.2020-21.

2. As per section 92CA(1), where the Assessing Officer considers it necessary or expedient so to do, **he may refer the computation of the arm's length price** in relation to the international transaction entered by any person, being an assessee, **to the Transfer Pricing Officer(TPO).**

   However, the Assessing Officer has to take the **prior approval of the Principal Commissioner of Income-tax (PCIT)/**Commissioner of Income-tax (CIT) before making such a reference.

   As per section 92CA(2A), **the Transfer Pricing Officer (TPO) can also determine the ALP of other international transactions which comes to his notice subsequently in the course of proceedings before him, even though the same were not referred to him by the Assessing Officer**.

   In this case, the Assessing Officer has made reference to the TPO for determination of ALP in respect of the manufacturing unit at Chennai which shall be taken as the proceedings before him (TPO). **The TPO can enlarge his scope of work during the course of proceedings before him pertaining to the Chennai unit, by calling for details of KPO Unit, Bengaluru and trading activity at Mumbai, since the same is within the powers conferred by section92CA(2A).**

3. **The term "permanent establishment" means a fixed place of business through which the business of an enterprise is wholly or partly carried on**.

   However, the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity of **a preparatory or auxiliary character would not constitute a permanent establishment.**

   In the present case, **the liaison office of Gama Inc. would constitute permanent establishment, since its activities are not of preparatory or auxiliary character but for procuring orders for supply of mobile handsets directly to customers in India.**

   In the case of *Jebon Corporation India,* the Karnataka High Court held that securing and processing orders have led to the liaison office forming a PE in India. Consequently, the **profits attributable to the PE would be chargeable to tax in India.**

4. As per section 144C(15), the **following assessees are eligible for filing their objections before the Dispute Resolution Panel(DRP):-**

   - **Any foreign Company**
   - **Any person in whose case variation arises on account of order of Transfer Pricing Officer**

   In this case, since the assessment of ACL is pending before the Assessing Officer who has referred the matter to TPO for determination of arm's length price and had not passed the draft assessment order, it cannot approach the Dispute Resolution Panel (DRP) on the ground that TPO has expanded the scope of work. **The draft order of assessment is a pre-requisite for ACL to approach the DRP with its objections.**

   If the Assessing Officer proposes to make, any variation in the income or loss returned which is prejudicial to the interest of ACL, he has to **forward a draft order of assessment to the ACL**. After receipt of the draft order containing variation in the income returned, **ACL has to file its objections against such order before the DRP and the Assessing Officer within thirty days of receipt of the draft order from the Assessing Officer.**

The **DRP has to issue directions within 9 months from the end of the month in which the draft order is forwarded to ACL**. The direction issued by the DRP would be ultimately **binding on the Assessing Officer.**

5. In the facts of the case study, it is stated that the management of ACL wants to enter into the Advance Pricing Agreement (APA) with rollback mechanism. In this background, the advice as to whether ACL can go for APA is to be given.

APA may, subject to such prescribed conditions, procedure and manner, provide for determining the ALP or for specifying the manner in which ALP is to be determined in relation to an international transaction entered into by a person during any period not exceeding four previous years preceding the first of the previous years for which the APA applies in respect of the international transaction to be under taken.

However, as per Rule 10MA, rollback provision shall not be provided in respect of an international transaction for a rollback year, if,-

(i) the determination of arm's length price of the said international transaction for the said year has been subject matter of an appeal before the Appellate Tribunal and the Appellate Tribunal has passed an order disposing of such appeal at any time before signing of the agreement; or

(ii) the application of rollback provision has the effect of reducing the total income or increasing the loss, as the case may be, of the applicant as declared in the return of income of the said year.

In case of ACL, though similar issues for A.Y. 2017-18 to A.Y. 2018-19 are pending with the Appellate Tribunal, since the Appellate Tribunal has not passed an order disposing appeal, **ACL can go for APA with roll back mechanism.**

CASE STUDY – 16

Mr. Mohan, born in India in the year 1961, left for employment in the United States in October, 1991. His family members, viz; his wife (Smt. Meera) and two sons were then residing at Chennai. He remitted US $ 50,000 to his wife's joint bank account in Chennai on 16th April, 2012. She invested in her name, Rs. 12 lakhs in the shares of domestic companies on 14th April, 2013 and Rs. 13 lakhs on 25th March, 2016. The consideration for purchase of shares on both the occasions was met in foreign exchange (USD) and the values, as translated in INR terms, have been furnished.

On 28.03.2020, the shares purchased in April, 2013 were sold for Rs. 15 lakhs and the shares purchased in March, 2016 were sold for Rs. 19 lakhs. For both purchase and sale of shares, STT of Rs. 1,200 was paid.

Date	Average of Telegraphic Transfer buying rate and selling rate of 1 US Dollar in Indian rupees.
14.03.2013	Rs. 58
25.03.2016	Rs. 62
28.03.2020	Rs. 68

Mr. Mohan owned a vacant site at Chennai which had been acquired on 14.10.2010 for Rs. 7,40,000. It was sold on 20.03.2020 for Rs. 35 lakhs to Mr. Sohan, his younger brother (a resident at Chennai). The stamp duty valuation of the property was Rs. 40 lakhs. The entire sale proceeds of vacant site and shares were used for acquiring a residential property at Malaysia. He owns only one residential house in Mumbai and a commercial apartment at Singapore, owned since October, 2011. (GAV of apartment = Rs. 5 Lacs, Income from Mumbai House Computed = Rs. 2,40,000)

Note: Cost inflation indices:

F.Y. 2010-11 = 167;	F.Y. 2012-13 = 200;	F.Y. 2013-14 = 220
F.Y. 2015-16 = 254;	F.Y. 2016-17 = 264;	F.Y. 2019-20 = 289

Smt. Meera (born and brought up in India) returned to India permanently in 2007. She has assets outside India in the form of immovable property, jewellery and bank deposits in Cayman Islands. Proceedings were initiated under Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 ("BM Act") in June 2019. She owns a residential house property at Chennai besides an apartment in the United States occupied by Mr. Mohan. She had been moving between India and USA frequently.

Mr. Mohan's first son Mr. Lava (born in India in 1986), an engineer, left India in May 2013 for permanently settling down in Australia. He acquired 50,000, 8% debentures of Rs. 100 each in a listed company in India, by remitting foreign exchange in May, 2015. He received debenture interest on 28.03.2020 for the year. He remitted Z Rs. 1 lakh by way of premium on life insurance policy taken in the year 2007 with capital sum assured of Rs. 12 lakhs. He has dividend income from listed domestic companies of Rs. 15,00,000 for the year.

Mr. Mohan's second son Mr. Kushwah (born in the year 1988 in India) is engaged in textile business at Surat. He has not filed return of income in India since assessment year 2012-13. He has a joint bank account in the United States along with Mr. Mohan, with operating rights. The Assessing Officer has issued notice under section 148 for the assessment year 2012-13 onwards on 20th March, 2020.

Mr. Mohan, his second son Mr. Kushwah and Mr. Mohan's 4 non-resident friends, formed a company by name Modi Inc. in the United Kingdom on 01.04.2017, which is engaged in trading business. The registered office of the company is in Leicester (UK). The company has a branch in India since 01.06.2017. The company is a subsidiary company of Tatla Inc., Singapore in which the 4 non-resident friends hold 100% shareholding. The entire goods traded by Modi Inc. in the UK and in India are purchased from Tatla Inc., Singapore.

The total activity profile of Modi Inc. is given below:

Financial year Particulars	2017-18	2018-19	2019-20
Average value of total assets in India (Rs. in Crores)	180	220	300
Total income of the company (Rs. in Crores)	90	100	180
Total payroll expenses incurred by the company (Rs. in Crores)	180	200	200
Average value of total assets of the company (Rs. in Crores)	400	450	500
Total average number of employees in India	1,000	1,200	1,500
Total turnover (Rs. in Crores)	1,000	1,300	1,700
Dividend from Indian companies (Rs. in Crores)	50	60	100
Payroll expenses in India (Rs. in Crores)	100	105	110
Total average number of resident employees in India	900	1,100	1,300
Turnover in India (Rs. in Crores)	400	700	900
Total average employees of the company for the year	2,000	2,200	2,200

Note: All the Board meetings of the company were held outside India during the financial year 2019-20.

Ms. Karuna Kapoor born in the USA was appointed as the CEO of Modi Inc. in India. She joined duty on 01.09.2019 at Mumbai. She was paid salary of Rs.140 lakhs upto 31.03.2020.
Ms. Karuna Kapoor was born and brought up in the USA, but her grandparents were born in Karachi before the year 1940. She has never visited in India previously.

REQUIRED
You are requested to answer the following issues arising from the above facts:

I. OBJECTIVE TYPE QUESTIONS

Choose the most appropriate alternative for the following MCQs:

1. When Smt. Meera has undisclosed asset located outside India, what is the time limit within which it is chargeable to tax under Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 ("BM Act") :
   (a) Within 16 years from the end of the financial year in which it was originally acquired.
   (b) Within 10 years from the end of the financial year in which it was originally acquired.
   (c) Within 6 years from the end of the financial year in which it was originally acquired.
   (d) No time limit and it would be chargeable to tax when it comes to the notice of the Assessing Officer.

2. When Smt. Meera owns an undisclosed asset outside India being immovable property, its value for the purpose of assessment under the BM Act, would be:
   (a) Fair market value as on 01.04.1981.
   (b) Fair market value as on 01.04.2001.
   (c) Higher of cost of acquisition or open market value on the valuation date as per valuation report from a valuer recognized by the foreign country.
   (d) Lower of cost of acquisition or open market value on the valuation date as per valuation report from a valuer recognized by the foreign country.

3. When Smt. Meera owned a property/asset outside India but has not disclosed the same for income-tax purpose, she can be prosecuted under the BM Act for:
   (a) 3 months
   (b) Not less than 6 months but which may extend to 7 years
   (c) Not less than 3 months but which may extend to 3 years
   (d) None of these

4 . The time limit for completion of assessment of Smt. Meera under the BM Act, is:
   (a) 1 year from the end of the financial year i.e. 31.03.2021
   (b) 2 year from the end of the financial year i.e. 31.03.2022
   (c) 1 year from the end of the impugned month i.e. 30.06.2020.
   (d) None of these

5. The time limit for filing appeal before the CIT (Appeals) under BM Act is_____ from the date of service of the notice of demand.
   (a) 30 days (b) 21 days
   (c) 15 days (d) 60 days

II. DESCRIPTIVE QUESTIONS

1. Mr. Mohan wants you to compute his total income and tax there on, including capital gains tax payable by him for the assessment year 2020-21.

2. Compute the total income of Mr. Lava and advise on the possibility of availing the benefits of Chapter XII-A deductions.

3. Apply POEM test on Modi Inc. for the assessment year 2020-21 and briefly discuss the consequences thereof.

SOLUTIONS – CASE STUDY 16

I. ANSWERS TO MCQs

MCQ No.	Answer
1.	(d)
2.	(c)
3.	(b)
4.	(b)
5.	(a)

II. ANSWERS TO DESCRIPTIVE QUESTIONS

1. Mr. Mohan is a **non-resident** in India during the P.Y. 2019-20 since he is residing in United States since 1991 and does **not fulfil either of the basic conditions** for being a resident.

In case of a non-resident, only the following incomes are chargeable to tax:

Income received or deemed to be received in India; and

Income accruing or arising or deemed to accrue or arise in India.

Computation of total income and tax liability of Mr. Mohan for A.Y.2020-21

Particulars	Amount in ₹	
Income from house property		
Residential house at Mumbai		2,40,000
Commercial apartment in Singapore and residential property at Malaysia [Annual value of house properties outside India is not subject to tax in India, since Mr. Mohan is a non-resident]		Nil
Capital Gains		
Long term capital gains on sale of shares of listed companies		**8,00,000**
[As per section 64(1)(iv), income arising to **Smt. Meera from transfer of listed shares i**s includible in the hands of her husband, Mr. Mohan, since there has been a transfer of money to a joint account without any consideration, out which Smt. Meera has purchased listed shares in her own name.		
However, since long-term capital gains of ₹1,00,000**[See Working Note]** on transfer of STT paid listed shares arising to Smt. Meera is exempt under section 112A,Balance includible in the hands of Mr. Mohan.		
Long term capital gain on sale of vacant site at Chennai (long term, since it is held for more than 24 months)		
Full value of consideration	40,00,000	
As per section 50C, the full value of consideration would be higher of actual consideration of ₹35,00,000 and stamp duty value of ₹40,00,000		

Less: Indexed cost of acquisition (₹7,40,000 x 289/167)	12,80,600	
Less: Exemption under section 54F [Not available since investment in residential house in India is only eligible for exemption]	-	
		27,19,400
Gross Total income/Total Income		**37,59,400**
Tax on total income		
Tax on 2,40,000		Nil
Tax@10% on LTCG of Rs.8,00,000		80,000
Tax@20% on long-term capital gains of ₹27,19,400		5,43,880
		6,23,880
Add: Education cess @4%		24,955
Tax liability		**6,48,835**
Tax liability (rounded off)		**6,48,840**

Working Note:

Computation of long-term capital gains on transfer of shares of listed companies in the hands of Smt. Meera

Particulars	Amount in ₹
Long term capital gain on transfer of shares purchased on 14.4.2013, since held for more than 12 months	
Sale Consideration	15,00,000
Less: Cost of acquisition	12,00,000
Long term capital gain	3,00,000
Long term capital gain on transfer of shares purchased on 25.3.2016, since held for more than 12 months	
Sale Consideration	19,00,000
Less: Cost of acquisition	13,00,000
Long term capital gain	6,00,000
Total Long term capital gain [3,00,000+6,00,000]	9,00,000
Taxable Long term capital gain [₹9,00,000-₹1,00,000]	8,00,000

Note – *Since long-term capital gains on transfer of listed shares has to be* computed first in the hands of Smt. Meera who is a resident, the benefit of conversion into foreign currency will not be available. Also, no benefit of indexation would be available. In any case, such long-term capital gains on sale of listed shares, **on which STT is paid at the time of acquisition and sale, is exempt under section 112A upto Rs. 1 Lakh for A.Y.2020-21**.

2. Mr. Lava is a **non-resident** in India during the P.Y. 2019-20 since he left India permanently in May, 2012. **He does not fulfil either of the basic conditions** for being a resident for the P.Y. 2019-20.

In case of a non-resident, only the following incomes are chargeable to tax:

(i) Income received or deemed to be **received in India**; and

(ii) Income accruing or arising or deemed to **accrue** or arise in **India.**

Computation of Total income of Mr. Lava for A.Y. 2020-21 under normal provisions

Particulars	Amount
Income from Other Sources	
Interest on debentures in a listed company in India [50,000x100x8%]	4,00,000
Dividend from listed domestic companies [Exempt u/s 10(34)]	-
Gross Total Income	**4,00,000**
Less: Deduction under section 80C in respect of LIC premium (since premium does not exceed 20% of actual capital sum assured)	1,00,000
Total Income	**3,00,000**

Income under Chapter XII-A

As per the provisions of Chapter XII-A, **investment income** i.e., **any income** derived (other than dividends referred to in section 115-O) **from any specified asset** in foreign currency, shall be charged to **tax at a flat rate of 20%.** Debentures of listed company in India fall under the category of "specified assets".

In computing the investment income of non-resident Indian, **no deduction** is to be allowed under any provision of the Act in respect of **any expenditure or allowance** in relation thereto. **Accordingly, no deduction under Chapter VI-A shall be allowed, where the gross total income consists only of investment income.**

In this case, total income of Mr. Lava would be ₹ 4,00,000 and it would be charged to tax at a flat rate of 20%.

Accordingly, **it is more beneficial to Mr. Lava to be governed by the regular provisions of the Act**, as per which he would be able to claim deduction of ₹1 lakh in respect of LIC premium paid under section 80C. Further, **he can avail the benefit of basic exemption limit of ₹ 2,50,000. Therefore, only ₹ 50,000 would be subject to tax @5%.**

3. For determining the POEM of a company, the important criteria is whether the company is engaged in active business outside India or not.

A company shall be engaged in "Active Business Outside India" (ABOI) for POEM, if

- the passive income is not more than 50% of its total income; and
- less than 50% of its total assets are situated in India; and
- less than 50% of total number of employees are situated in India or are resident in India; and
- the payroll expenses incurred on such employees is less than 50% of its total pay roll expenditure.

Modi Inc. shall be regarded as a company engaged in active business outside India for P.Y. 2019-20 for POEM purpose **only if it satisfies all the four conditions cumulatively.**

Condition 1: The passive income of Modi Inc. should not be more than its total Income

Total income of Modi Inc. during the P.Y. 2019-20 is ₹180 crores.

Passive income is the aggregate of, -

(i) income from the transactions where both the purchase and sale of goods is from/to its associated enterprises; and

(ii) income by way of royalty, dividend, capital gains, interest or rental income;

Passive Income of Modi Inc. is ₹100 crores, being dividend income
Percentage of passive income to total income = ₹100 crore/ ₹180 crore x 100 = 55.56%

Since passive income of Modi Inc. i.e., 55.56% is **more than 50% of its total income, the first condition is not satisfied.**

Condition 2: Modi Inc. should have less than 50% of its total assets situated in India

Value of total assets of Modi Inc. during the P.Y. 2019-20 is ₹500 crores.
Value of total assets of Modi Inc. in India during the P.Y. 2019-20 is ₹300 crores
Percentage of assets situated in India to total assets = ₹ 300 crores/₹ 500 crores x 100 = 60%
Since the value of assets of Modi Inc. situated in India is not less than 50 % of its total assets, the second condition for ABOI test is not satisfied.

Condition 3: Less than 50% of the total number of employees of Modi Inc. should be situated in India or should be resident in India

Number of employees situated in India or are resident in India is 1,500
Total number of employees of Modi Inc. is 2,200.
Percentage of employees situated in India or are resident in India to total number of employees is 1,500/2,200 x 100 = 68.18%

Since employees situated in India or are residents in India of Modi Inc. are not less than 50% of its total employees, the third condition for ABOI test is not satisfied.

Condition 4: The payroll expenses incurred on employees situated in residents in India should be less than 50% of its total payroll expenses

Payroll expenditure on employees situated in India or are residents in India is ₹110 crores
Total payroll expenditure of Modi Inc. is ₹200 crores.
Percentage of payroll expenditure on employees situated in India or are resident in India to total payroll expenditure is ₹110 crores/₹200 crores x 100 =55%
Since payroll expenditure on employees situated in India or are residents in India of Modi Inc. is not less than 50% of its total payroll expenditure, the fourth condition for ABOI test is not satisfied.

Since Modi Inc. does not satisfy all the above four conditions cumulatively, Modi Inc. has not passed the Active Business Outside India (ABOI) test.

Determination of POEM

(1) There are two-stage process for determination of POEM in case of companies not engaged in active business outside India are:

First stage: Identifying the person(s) who actually make the key management and commercial decisions for the conduct of the company as a whole.

Second stage: Determining the place where these decisions are, in fact, being made.

(2) **If the persons** who actually make the key management and commercial decisions for the conduct of the company as a **whole and the place** where these decisions are, in fact, being made **is in India, POEM of the foreign company would be considered to be in India**. In this case, **assuming** that such **decision** making power has **been delegated** by **the Board of Directors to Ms. Karuna Kapoor**, who is the CEO of Modi Inc. in India, and she actually makes such key management and commercial decisions in the P.Y.2019-20, then the **POEM of Modi Inc. would be in India during that year. Otherwise, the POEM of Modi Inc. would be considered to be outside India.**

(3) **Consequences**

As per section 6(3), a foreign company would be resident in India in any previous year, if its POEM, in that year, is in India.

If the POEM of Modi Inc. is in India in the P.Y.2019-20**, Modi Inc**. **would be resident** in India for A.Y. 2020-21 and **its global income would be taxable in India. However, the applicable rate of tax would be that rate of tax applicable to a foreign company**.

If the POEM of Modi Inc. is not in India in the P.Y.2019-20, **Modi Inc. would be non-resident in** India for A.Y. 2020-21 and **only the income attributable to its permanent establishment (PE) would be taxable in India.**

CASE STUDY – 17

ABC LLP is a firm of Chartered Accountants providing services for diversified activities in the fields of Audit, Accounts and Taxation. The International Taxation division of the firm is known for having the expertise in the issues and matters relating to International Taxation and Transfer Pricing. The firm has been contacted for seeking their expert opinion on the issues and matters relating to International Taxation and on Transfer Pricing by various constituents/entities and the professional Chartered Accountants. Some of the matters/issues referred by different entities/constituents/professionals for obtaining their expert opinion are:-

Matters referred by a small firm of Chartered Accountants

The partners of the firm have sought opinion in respect of the matters of their clients for giving reply to the tax authorities relating to the show cause notice issued to tax the income earned by each of the following clients and opinion on other matters so raised by them under the provisions of the Income-tax Act, 1961:-

(i) Techno Engineering, GMBH, a German foreign Company entered into an agreement for the execution of electrical work in India for Super Thermal Power Ltd. Separate payments were made towards drawings and designs by Super Thermal Power Ltd. to the German Company which were termed as "Engineering Fee". The German Company is not having any permanent establishment (PE) in India for doing the business and operates from Germany only.

(ii) Engineers and Engineers Pvt. Ltd. (EEPL) of the UK; a nonresident foreign company, entered into a collaboration agreement on 25.06.2019 with TMT (India) Ltd., an Indian Company. The UK Company was issued debentures by TMT (India) Ltd. for 120 lacs on 1.7.2019 bearing interest @ 10% p.a. in consideration for providing the technical know-how to TMT (India) Ltd. by the UK Company. TMT (India) Ltd. also paid the interest on the debentures EEPL which was due for the relevant period ended on 31.3.20.

(iii) XYZ Ltd. is an Indian Company located in Special Economic Zone (SEZ) in which Qilla Inc., a US Company is holding 32% shares and voting power. Following transactions were effected between these two companies during the year 2019-20 :-

(a) XYZ Ltd. sold 1,50,000 pieces of T-shirts at $ 3 per T-shirt to Qilla Inc. The identical T-shirts were sold by XYZ Ltd. to an unrelated party namely Konny Inc. at $ 4 per T-shirt.

(b) XYZ Ltd. borrowed loan of $ 5,00,000 from a foreign lender on the strength of guarantee given by Qilla Inc. and for the purpose of giving guarantee, XYZ Ltd. paid $ 20,000 as guarantee fee to Qilla Inc. However, for the same amount of loan taken by an unrelated party, Qilla Inc. had charged guarantee fees of $ 15,000.

(c) XYZ Ltd. paid $ 20,000 to Qilla Inc. for getting the details of various potential customers to improve its business outside India in global market. Qilla Inc. provided the same services and details to an unrelated party for $ 15,000.

(iv) During the previous year 2019-20, Mohammed Suleman (MS) was treated as resident in India and also in 'X', a foreign country, with which India had entered into Double Taxation Avoidance Agreement (DTAA). The particulars of assets and income of MS for the year ended 31.3.20 are:

(a) He owns immovable properties (including residential house) in both India and country 'X'.

(b) He earned business income of Rs 50 lacs from rubber estates in the foreign country 'X' during the financial year 2019-20. No business income was earned in India.

(c) He sold a house property situated in foreign country 'X' which had resulted in short-term capital gain of Rs 20 lacs during the year to him and was subject to tax in 'X' country.

(d) He has derived rental income of Rs 6 lacs from the property located in India which was let-out during the year.

(e) He was also having a residential house at Lucknow besides the let out property in India which was used by him for his stay when he was visiting India.

MS had not carried out any business in India and was also not having any permanent establishment in India during the year.

In the backdrop of the aforesaid matters referred to ABC LLP which are being entrusted by them to you, provide your expert opinion/views in the context of provisions contained under the Income-tax Act, 1961 to the following questions on the matters so referred by the firm of Chartered Accountants and by the Company:-

I. OBJECTIVE TYPE QUESTIONS

Choose the most appropriate alternative for the following MCQs:

1. Mr. A holds 40% of shareholding in XYZ Ltd., and 55% in ABC Ltd. However, XYZ Ltd., and ABC Ltd., do not have any shareholding in each other. Select which shall be treated as an associate enterprise or deemed associate enterprises, with reference to specified international transactions with Mr. A :

(a) ABC Ltd. (b) XYZ Ltd.
(c) Both ABC Ltd. and XYZ Ltd. (d) None of the above

2. The excess money determined because of primary adjustments is required to be repatriated within the stipulated time and if not done so, then the same is treated as an advance subject to change of interest; where the international transaction is denominated in foreign currency, the rate of interest to be charged on such advance amount shall be at LIBOR as on 30th September of the relevant previous year plus:-

(a) 3.25% (b) 3%
(c) 2.75% (d) 2%

3. In respect of transactions/arrangement between XYZ Ltd., and Quila Inc., if the Department wants to apply GAAR, the tax benefit arising to must be seen, the threshold limit being:

(a) XYZ Ltd. only, 3 crore
(b) Both XYZ Ltd. and Quila Inc., 2 crore
(c) Quila Inc. only, 2 crore
(d) Both XYZ Ltd. and Quila Inc, 3 crore

4. EEPL has sought to obtain an advance ruling from the Authority for Advance Ruling. Such ruling is:

(a) Applicant-specific (b) Transaction specific
(c) Both (A) and (B) (d) Neither (A), nor (B)

5. Assuming (only for this MCQ) that EEPL, for receiving trade inquiries from customers has set up a liaison office in India. Work of the liaison office is to forward the trade inquiries to them as well as to negotiate and enter into contracts on behalf of ABC LLC with customers. The existence of liaison office for the purpose of taxability of income of ABC LLC is having :

(a) Neither existence of business connection nor of PE
(b) Liaison office is having independent status
(c) Existence of business connection
(d) Services of a dependent agent

II. DESCRIPTIVE QUESTIONS

1. Will the payment made towards drawings and designs by Super Thermal Power Ltd. to Techno Engineering be subject to tax in India, and if so, why ?

2. What treatment shall be given to the debentures of Rs 120 lacs issued by TMT (India) Ltd. to Engineers and Engineers Pvt. Ltd. of UK on 1.7.2019? Will the interest earned on such debentures be taxed in India in A.Y. 2020-21 and if so, on what amount, the tax shall be charged? Answer to be based only on statutory provisions and ignoring the provisions of Double Taxation Avoidance Agreement (DTAA) between India and UK.

3. Explain the relationship of the companies XYZ Ltd. and Qilla Inc. of US and the nature of various transactions entered into between them during the year 2019-20. Compute the adjustments, if required to be made to the total Income of XYZ Ltd. under transfer pricing provisions. Take the value of one US dollar as Rs 70.

4. Examine with reasons and provide detailed opinion as to whether the business income arising in foreign country 'X' from the rubber estate and the capital gains in respect of sale of the property situated in that foreign country can be taxed in India in the hands of MS during the A.Y. 2020-21. State further as to taxability of the income derived by him in India of the let out and other house property.

SOLUTIONS – CASE STUDY 17

I. ANSWERS TO MCQs

MCQ No.	Answer
1.	(c)
2.	(b)
3.	(d)
4.	(c)
5.	(c)

II. ANSWERS TO DESCRIPTIVE QUESTIONS

1. Separate payments made towards drawings and designs (described as "engineering fee") **are in the nature of fees for technical services**. Fees for technical services payable by a resident (Super Thermal Power Ltd., an Indian company, in this case) would be deemed to accrue or arise in India under section 9(1)(vii) in the hands of the non-resident recipient (Techno Engineering GMBH, the German company).

   The payment made is not in respect of services utilized for a business or profession outside India or for the purpose of making or earning income from any source outside India and, **therefore, is deemed to accrue or arise in India as per section 9(1).**

   Further, 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, and even if such services are rendered from outside India.

   Accordingly, in this case, payments towards drawings and designs would taxable in India in the hands of Techno Engineering GMBH, the German company.

2. **Rs.120 lakhs, being the value of debentures issued by an Indian company, TMT (India) Ltd., in consideration of providing technical know-how, is in the nature of fee for technical services, deemed to accrue or arise in India to Engineers and Engineers Pvt. Ltd., a 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 in India is deemed to accrue or arise in India except if the debt incurred is used for its business purposes outside India or for making or earning any income from any source outside India.

   Therefore, in this case, **interest income from debentures of TMT (India) Ltd., an Indian company, is deemed to accrue or arise in India in the hands of Engineers and Engineers Pvt. Ltd.** by virtue of section 9(1)(v), since the debt incurred is not used for a business outside India or for earning income from a source outside India.

   Hence, interest for 9 months ₹120 lacs of ₹9 lacs shall be taxable in A.Y.2020-21.

3. XYZ Ltd, the Indian company and Qilla Inc., the US company are deemed to be **associated enterprises** as per section 92A(2)(a), since Qilla Inc. **holds shares carrying 32% of voting**

power (which is not less than 26% of the voting power) in XYZ 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 (CUP) method to be the most appropriate method.**

Particulars		₹ in lakhs
Amount by which total income of XYZ Ltd. is enhanced on account of adjustment in the value of international transactions:		
(i)	Difference in price of T -Shirt @ $ 1 each for 1,50,000 pieces sold to Qilla Inc. [$ 1 ($ 4 - $ 3) x 1,50,000 x₹70)	105.00
(ii)	Difference for excess payment of guarantee fee to Qilla Inc. for loan borrowed from foreign lender [$ 5,000 ($ 20,000 - $ 15,000) x₹70]	3.50
(iii)	Difference for excess payment for services to Qilla Inc. [$ 5,000($ 20,000 - $ 15,000) x₹70]	3.50
		112.00

XYZ Ltd. cannot claim deduction under section 10AA in respect of ₹112 lakhs, being the amount of income by which the total income is enhanced by virtue of the first proviso to section 92C(4), assuming that the above adjustments are made by the Assessing Officer to determine the arm's length price.

4. 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**. In effect, the provisions of the Income-tax Act, 1961 or the DTAA, whichever is more beneficial, would be applicable.

The DTAA with Country X provides that where an individual is a resident of both India and Country X, **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.**

MS has residential houses both in India and in Country X. Thus, he has a permanent home in both the countries. Mohd. Suleman (MS) owns rubber estates in Country X from which he derives business income. However, MS has no permanent establishment of his business in India**. Therefore, his personal and economic relations with Country X are closer,** since Country X is the place where–

(a) the property is located and

(b) the business of rubber estates is being carried on.

Therefore, he shall be deemed to be resident of Country X for A.Y. 2020-21.

The fact of the case and issues arising there from are similar to that of *CIT vs. P.V.A.L. Kulandagan 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 of the Income-tax Act, 1961 would become irrelevant, since the DTAA prevails over sections 4 and5.

However, as per section 90(4), in order to claim relief under the agreement, MS has to obtain a certificate [**Tax Residency Certificate (TRC**)] declaring that he is a resident of Country X from the Government of Country X. Further, he also has to provide such other documents and information, as may be prescribed.

Therefore, in this case, MS would not be liable to income-tax in India for assessment year 2019-20 in respect of business income and capital gains arising in Country X provided he furnishes the Tax Residency Certificate and provides such other documents and information as may be prescribed.

Rental income of ₹6 lacs from let-out property located in India would be taxable in India in the hands of MS, since it has accrued and arisen to him in India. Deduction of 30% of Net Annual Value would be allowable under section 24 in computing income from house property.

The Annual Value of residential house at Lucknow, which he uses for his stay while in India, would be Nil, assuming that the house is not let out for the rest of the year and no other benefit is derived there from by him.

CASE STUDY – 18

Good Day Inc of USA and its associates:

Good Day Inc of USA is engaged in multiple trading and manufacturing activities throughout the world. It has a liaison office at Mumbai meant for sourcing raw materials in India for the purpose of carrying out manufacturing activity at USA. It also provided plant and machinery on hire to be used for extraction of mineral oils in India. During the previous year 2019 -20, it received mobilization advance of ₹ 2 crores from an Indian company for movement of rigs from a foreign country to an offshore site at Mumbai and subsequently they were put to use (i.e.) for extraction of mineral oil. It also received ₹ 5 crores by way of hire towards provision of plant and machinery for the previous year 2019-20 in India. Good Day Inc. has a subsidiary company by name Kite Inc. at Portugal, which is engaged in supply of electronic goods worldwide.

Good Day Inc. also has another subsidiary by name Becker Inc. at Germany. On 01.04.2019, Becker Inc. advanced ₹ 2 crores to Manna Dey (P) Ltd. of Mumbai by remitting the amount directly from Germany to the bank account of Manna Dey (P) Ltd. For the previous year 2019 - 20, interest is receivable from Manna Dey (P) Ltd @ 9%. For the Assessment Year 2020 -21, Becker Inc. having significant activities in India became resident assessee because of POEM.

On 01.07.2019, Manna Dey (P) Ltd borrowed ₹ I0 crores from Jimmy Connors Ltd, United Kingdom for which interest is payable at 9% per annum. The pre-tax profit of Manna Dey (P) Ltd. was ₹ 160 lakhs before deducting depreciation of ₹ 40 lakhs and interest on moneys borrowed by it. The total borrowing of Manna Dey (P) Ltd is ₹ 12 crores, which is 80% of its total assets.

Democrat (P) Ltd, Chennai

Democrat (P) Ltd is a subsidiary of Giant Trade Ltd of UK. It is engaged in manufacturing and trading of consumer durables both by import and export. It is also engaged in executing turnkey projects. It had 4 directors viz. Ashok Chatterjee, Mithun Banerjee, Dr Deepak Mitra and Meenakshi Jain. The director, Ashok Chatterjee, sold 30% of the shares owned by him to his son, Santhosh Chatterjee, in June 2016 and resigned from the directorship of the company. The whereabouts of Ashok Chatterjee are not known to the company.

Democrat (P) Ltd. gave loan of ₹ 6 crores on 01.07.2019 to its associated concern in Australia without charging interest. For giving the said advance, Democrat (P) Ltd. mobilized funds by issuing 8% Debentures on 01.06.2019.

Kite Inc. of Portugal entered into an agreement for supply of electronic goods to Democrat (P) Ltd. of Chennai on regular basis. As per agreement, it supplied goods worth ₹ 10 crore every month from April, 2019 onwards and the supply is to be made for 42 months continuously.

Income-tax assessment of Democrat (P) Ltd.

The income-tax return of the Assessment Year 2018-19 was filed by Democrat (P) Ltd on 20.12.2019 declaring total income of ₹ 52.50 crores. The assessee obtained report in respect of international transactions from the 'Accountant' (as mentioned in the Explanation *below* section 288(2) and the report contained information about the international transactions of the assessee. The Assessing Officer referred the international transactions to Transfer Pricing Officer (TPO) for determination of arm's length price without providing an opportunity of hearing to Democrat (P) Ltd. The TPO wanted the documents and information in respect of the international transactions and the assessee could not furnish information and documents for the transactions of the value of ₹ 4.50 crores. The Assessing Officer passed the order of assessment based on the TPO report subsequently.

Activity profile of Dr. Deepak Mitra

Dr. Deepak Mitra (age 50), yet another director of Democrat (P) Ltd residing at Palghat, Kerala, earned royalty income of ₹ 50 lakhs from Gobar Gas Inc. of Canada for the year ended 31.03.2020. However, he received only ₹ 20 lakhs during the previous year 2019-20, and the balance is outstanding as on 31.03.2020. Dr. Deepak Mitra maintains cash system of accounting of royalty income and hence, admitted only ₹ 20 lakhs for the assessment year 2020-21. The DTAA between India and Canada provides for tax@15% in Canada without prejudice to taxation of the same income in India. The other income of Dr. Deepak Mitra is by way of income from house property (computed) ₹ 4.5 lakhs and dividend income from Democrat (P) Ltd of ₹ 8 lakhs. He paid premium to LIC of India of ₹ 1.5 lakhs in respect of a life insurance policy of his son who is studying in Australia.

Rajesh Mitra son of Dr. Deepak Mitra, shareholder in Democrat (P) Ltd

Rajesh Mitra son of Dr. Deepak Mitra born and brought up in India acquired 10,000 equity shares of Democrat (P) Ltd on 10.06.2011 for ₹ 9 lakhs. He left India for employment in USA in January, 2012 and settled there. He has never visited India subsequently. His entire shareholdings in Democrat (P) Ltd were sold for ₹ 28.80 lakhs on 10.01.2020. The amounts were repatriated to his bank account in USA subsequently.

The exchange rates are given below:

On 10.06.2011 1$= ₹45;

On 10.01.2020 1$ = ₹72.

Cost inflation index P.Y.2011-12 = 184; P.Y. 2019-20 = 289.

Fair Market Value (FMV) of each equity share as on 31.01.2019 = ₹300

Activity profile of director Mithun Banerjee

Director Mithun Banerjee is a renowned technocrat, and is one of the directors of the company Democrat (P) Ltd since 01.06.2015. He is a partner in Lilly LLP, New York. A notice for assessment of his income under Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 was served on 01.05.2019 for the alleged undisclosed income / assets held in USA. The initial capital contribution in the firm was made in the previous year 2006-07 was his only contribution and the accumulations are by way of profits which were not disclosed by him for income-tax assessment, in India. He has not withdrawn any amount from the firm at anytime.

The Balance Sheet of Lilly LLP is given below:

	01.04.2019	01.10.2019	31.03.2020
	In US$		
Cash on hand (as per books)	10,000	12,000	15,000
Cash at Bank (as per books)	20,000	18,000	15,000
Stock in trade (as per books)	30,000	30,000	30,000
Vacant site FMV as on 1.4.2019 $ 40,000	20,000	50,000 (FMV)	60,000 (FMV)
Plant and machinery	75,000 (As per books)	50,000 (FMV	40,000 (FMV)
Bullion FMV as on 01.04.2019 $ 25,000	15,000	30,000 (FMV)	35,000 (FMV)
	1,90,000	**1,90,000**	**1,95,000**
Liabilities			
Sundry Creditors (as per books)	50,000	55,000	60,000
Partners' Capital			

Mithun Banerjee (25%)	30,000	No fresh capital introduction.
Bimal (50%)	50,000	No fresh capital introduction.
Senthil (25%)	60,000	No fresh capital introduction.
	1,90,000	

The partnership agreement provides that in the event of dissolution, the net worth exceeding the capital of the partners is to be shared in the profit sharing ratio.

The reference rate of RBI of 1 US $ as against Indian Rupee on various dates are as under: 01.04.2019 = ₹65; 01.05.2019 =₹68; 31.03.2020 = ₹72

I. OBJECTIVE TYPE QUESTIONS

Choose the most appropriate alternative for the following MCQs:

1. What is the 'due date' within which the liaison office of Good Day Inc. has to submit the annual statement to the Income-tax authority for the year ended 31st March, 2020?
   (A) 30-05-2020
   (B) 31-07-2020
   (C) 30-09-2020
   (D) 31-03-2021

2. Compute the amount of capital gain/loss in the hands of Rajesh Mitra on sale of shares of Democrat (P) Ltd.
   (A) Long-term capital loss ₹1,20,000
   (B) Long-term capital gain ₹ 13,71,020
   (C) Long-term capital gain ₹ 19,80,000
   (D) Long-term capital gain ₹2,70,000

3. Kite Inc of Portugal in December, 2019, after the monthly supply of goods, applied for advance ruling. How much fee would it need to pay for obtaining the advance ruling?
   (A) ₹ 10 lakhs
   (B) ₹ 5 lakhs
   (C) ₹ 2 lakhs
   (D) (D) ₹ 10,000

4. How much is the penalty payable by Democrat (P) Ltd for non-maintenance of documents and information relating to international transaction?
   (A) ₹ 1,00,000
   (B) ₹ 9,00,000
   (C) ₹ 22,50,000
   (D) ₹ 1,50,000

5. How much of interest paid by Manna Dey (P) Ltd. to its associated enterprise, Jimmy Connors Ltd of United Kingdom, is liable for disallowance taking note of its income from business?
   (A) ₹108 lakhs
   (B) ₹ 90 lakhs
   (C) ₹ 31.50 lakhs
   (D) Nil

II. DESCRIPTIVE QUESTIONS

1. Compute the income of Good Day Inc. in respect of providing plant and machinery on hire for extraction of mineral oils as per the applicable presumptive provisions of the Income-tax Ac t, 1961. Will your answer be different if Good Day Inc. spent only ₹ 1.50 crore out of ₹ 2 crore mobilization advance received for movement of rigs to offshore site at Mumbai?

2. State the legal correctness of the action of the Assessing Officer as regards making reference to the Transfer Pricing Officer without providing an opportunity of hearing to the assessee i.e., Democrat (P) Ltd. Is the passing of assessment order by the Assessing Officer based on TPO's report without passing draft assessment order, tenable in law?

3. Compute the undisclosed income/asset of Mithun Banerjee under Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015. Also, compute the tax liability of Mithun Banerjee.

4. Compute the tax liability of Dr. Deepak Mitra and the amount of eligible foreign tax credit and the amount of foreign tax credit to be carried forward to future assessment years.

SOLUTIONS – CASE STUDY 18

I. ANSWERS TO MCQs

MCQ No.	Answer
1.	(a)
2.	(c)
3.	(a)
4.	(b)
5.	(d)

II. ANSWERS TO DESCRIPTIVE QUESTIONS

Answer to Q. 1

The presumptive provisions applicable in this case are those contained in section 44BB.

As per this section, the profits and gains shall be deemed to be equal to 10% of the following amounts:

- paid or payable to the taxpayer on account of the provision of such services or facilities or supply of plant & machinery for the aforesaid purposes in India; and
- received or deemed to be received in India by the assessee on account of such service or facilities or supply of plant and machinery used or to be used in prospecting for, or extraction or production of mineral oils outside India

Computation of income of Good Day Inc. as per section 44BB

Particulars	Amt (₹ in crore)
Amount received for movement of rigs from foreign country to an offshore site at Mumbai	2
Amount received by way of hire charges towards provision of plant and machinery in India	5
Amount to be considered for purposes of section 44BB	**7**

Income from business under section 44BB at 10% of ₹ 7,00,00,000 is ₹ 70,00,000, which is the income of Good day Inc. chargeable to tax in India under the head "Profits and gains of business or profession" for the A.Y. 2020-21

Note - The mobilization fee of ₹ 2 crore received by Good Day Inc. is also includible in the gross receipts for the purpose of computing the income chargeable under section 44BB [*Sedco Forex International Inc vs. CIT (2017) 399 ITR 1 (SC)].*

No, the answer would be the same. The mobilization fee received by Good Day Inc. is liable to tax under section 44BB regardless of the actual amount of expenditure incurred for movement of rigs to the offshore site.

The quantum of expenditure incurred in relation to mobilization fee is immaterial and regardless of the amount of expenditure incurred, the entire fee of ₹ 2 crore is to be included for the purposes of section 44BB. Hence, the answer will not change.

Answer to Q. 2

As per section 92CA(1), where an assessee has entered into an international transaction in any previous year, and the Assessing Officer considers it necessary or expedient so to do, then, he may refer the computation of the arm's length price in relation to the said international transaction to the Transfer Pricing Officer.

The Assessing Officer has to take the prior approval of the Principal Commissioner of Income- tax (PCIT)/Commissioner of Income-tax (CIT) before making such a reference**.**

There is no requirement under the Act to provide an opportunity of being heard to the assessee before making reference to the Transfer Pricing Officer.

Therefore, the action of Assessing Officer to refer the international transaction to Transfer Pricing Officer for determination of arm's length price without providing an opportunity of hearing to Democrat (P) Ltd. is **correct.**

As per section 144C(1), the Assessing Officer is required to forward a draft order of assessment to the eligible assessee if he proposes to make any variation in the income or loss returned which is prejudicial to the interest of such assessee.

Eligible assessee means*, inter alia*, any person in whose case variation arises on account of order of Transfer Pricing Officer.

In the present case, Democrat (P) Ltd. is an eligible assessee and the Assessing Officer is required to forward a draft assessment order to Democrat (P) Ltd.

Therefore, the action of Assessing Officer in passing an assessment order without forwarding a draft assessment order to Democrat (P) Ltd. is not tenable in law.

Answer to Q. 3

Value of interest of Mithun Banerjee in Lilly LLP is chargeable to tax in India under the Black Money Act in the A.Y.2020-21, since these assets came to the notice of the Assessing Officer in the P.Y.2019-20.

For computing the value of interest in Lilly LLP, market value as on valuation date, being value on 1st April of the previous year i.e., on 01.04.2019 is to be considered.

Computation of undisclosed income/asset of Mithun Banerjee

Particulars	Amount (In US $)
Cash in hand (as per books)	10,000
Cash at bank (as per books)	20,000
Stock-in-trade (as per books)	30,000
Plant and machinery (as per books)	75,000
Total of book value of above assets (A)	**1,35,000**
Vacant site (FMV as on 1.4.2019)	40,000
Bullion (FMV as on 1.4.2019)	25,000
Total of FMV of above assets (B)	**65,000**
Sundry creditors (as per books) (C)	50,000
Net worth of Lilly LLP (A+B – C)	**1,50,000**
Value of interest in Lilly LLP	
Net worth portion equal to capital contribution (D)	30,000
Balance Net worth portion after capital contribution as per partnership deed in profit sharing ratio [10,000 (1,50,000 – 1,40,000) x 25%] (E)	2,500

Value of interest of Mithun Banerjee in Lilly LLP (D + E)	**32,500**
Value of interest of Mithun Banerjee in Lilly LLP in ₹[32,500 x 65, being exchange rate as on 1st April of the previous year i.e., on 1.4.2019]	**21,12,500**

As per section 3(1) of Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015, every assessee would be liable to tax@30% in respect of his undisclosed foreign income and asset of the previous year.

Tax liability of Mithun Banerjee would be ₹ 6,33,750, being 30% of ₹21,12,500.

Answer to Q. 4

Since Dr. Deepak Mitra is resident in India for the P.Y.2019-20, his global income would be subject to tax in India. Therefore, income earned by him in Canada would be taxable in India. He is, however, entitled to deduction under section 90, since India has a DTAA with Canada.

Computation of tax liability of Dr. Deepak Mitra for A.Y.2020-21		
Particulars	**₹**	**₹**
Profits and gains from business or profession		
Royalty income (following cash system of accounting)		20,00,000
Income from house property (computed)		4,50,000
Income from other Sources		
Dividend income from Democrat (P) Ltd.	8,00,000	
Less: Exempt under section 10(34)	8,00,000	-
Gross Total income		**24,50,000**
Less: Deduction under Chapter VI-A		
Section 80C – LIC premium of his son		1,50,000
Total income		**23,00,000**
Computation of tax liability		
Upto ₹ 2,50,000	Nil	
₹ 2,50,001 – ₹5,00,000	12,500	
₹ 5,00,001 – ₹10,00,000	1,00,000	
₹ 10,00,001 – ₹23,00,000	3,90,000	
		5,02,500
Add: Health and education cess@4%		20,100
Tax liability		**5,22,600**
Less: Foreign tax credit [**See Working Note below]**		3,00,000
Net Tax liability		**2,22,600**

Working Note: Computation of Foreign Tax Credit		
Particulars		
Doubly taxed income	₹ 20,00,000	
Rate of tax in Canada	15%	
Average rate of tax in India [5,22,600/23,00,000 x 100]	22.72%	
Lower of Indian rate of tax and rate of tax in Canada		15%
Deduction u/s 90 = 15% x ₹20,00,000		₹ 3,00,000
Foreign tax credit allowed to be carried forward is ₹ 4,50,000 [₹ 30,00,000, being royalty income not received x 15%]		

CASE STUDY – 19

Introductory

Harivallabh Pvt. Ltd., (HPL) is a private limited company, incorporated in India in 1991. It is engaged in several activities, important one being manufacture of accessories for mobile phones.

This company is a part of a group called Dow Group. A company called DAS Martin, which is also a part of the Dow group, has acquired 10 lakh shares of ₹ 100 each in HPL, 18 years ago, for a consideration of ₹ 50.3 crores. The investment made in HPL was with the prior approval of Department of Industrial Policy & Promotion (DIPP) and RBI permission was also obtained.

About DAS Martin

DAS Martin holds 70% of the share capital of HPL.

DAS Martin does not have an office, or employee or agent in India and hence, no Permanent Establishment (PE) in India as per Article 5 of the India Nation L Double Taxation Avoidance Agreement (called India Nation L DTAA). As far as Indian taxation is concerned, it is a non-resident, as it is not covered under the provisions of section 6(3) of the Income-tax Act, 1961. DAS Martin is a resident of Nation L and is engaged in trading activities for the last two decades, with annual turnover of 2 million USD.

DAS Martin proposes to transfer in February, 2020, above 70% of the shareholding to another Singapore company called DAS Singapore, which is part of the Dow group, pursuant to Group reorganisation. Assume that this Case Study is being given to you for your opinion in January, 2020.

Objectives of transfer of shares in HPL by Dow Group

(i) Dow Group is a large and complex group having presence in several countries across the world. In order to reduce complexities, improve efficiency and reduce costs in group companies worldwide, Dow Group is transforming its holding model. The group reorganization will change the business model of the group giving the capability to support more diverse, growing business that is also expected to be more profitable in the long- term.

(ii) Prior to 2020, Dow group was divided in the following 5 areas depending on its geographical locations
- North America
- South America
- Europe
- Asia Pacific
- India, Middle East and Africa (Dow IMEA group)

(iii) In the beginning of year 2020, the IMEA group was dismantled and countries in IMEA group were realigned to other regions as per geographical convenience. The Asia pacific region now consists of countries like India, China and other South East Asian countries. The Europe region, inter alia, consists of Mauritius, United Kingdom, Germany and other European countries.

(iv) In order to achieve objective of operational excellence and administrative convenience, it became necessary for the Dow groups to re-align the holding model of HPL.

(v) It is contemplated that the holding company of HPL would be shifted to Singapore, to achieve better control. Singapore is one of the upcoming countries in the Asia Pacific region. Keeping in view the above facts, Dow group is contemplating to shift the shareholding of HPL from Nation L to Singapore.

(vi) The Group believes that such re-alignment would help the Group to focus on customer

service including support for new product launches, strong compliance culture, commitment to health, safety and the environment, and commitment to developing people that deliver strong results for the Group even as the external environment has become more demanding.

Related facts and aftermath of proposed transfer of shares

(i) Dow group proposes to achieve the above objective through its entity in Singapore i.e., DAS Singapore. DAS Singapore will be a 70% subsidiary of DAS Martin.

(ii) DAS Martin proposes to contribute shares held in HPL as its capital in DAS Singapore. By virtue of this, HPL India would become 70% subsidiary of DAS Singapore.

(iii) In view of above, DAS Martin proposes to transfer the shareholding (10 lakh shares) of HPL to DAS Singapore by way of capital contribution.

(iv) The value of DAS Singapore's shares recorded in the books of DAS Martin (equivalent amount in INR being 182.3 crores) would be considered as the sales consideration for transfer of shares of HPL.

(v) The cost at which DAS Martin has obtained the shares of HPL would be the cost of acquisition.

Payments made by HPL for advertisements

HPL has made the following payments to DAS Martin from April 2019 to December 2020:

(i) ₹ 43 lakhs for advertisements in foreign web sites;

(ii) ₹ 8 lakhs for space booking in foreign newspapers.

Exhibit

Article 13 of the India Nation L DTAA which deals with the taxation of capital gains arising to the resident of contracting state, reads thus:

"ARTICLE 13 - Capital Gains -

1. Gains from the alienation of immovable property, as defined in paragraph (2) of article 6, may be taxed in the Contracting State in which such property is situated.

2. Gains from the alienation of movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State or of movable property pertaining to a fixed base available to a resident of a Contracting State in the other Contracting State for the purpose of performing independent personal services, including such gains from the alienation of such a permanent establishment (alone or together with the whole enterprise) or of such a fixed base, may be taxed in that other State.

3. Notwithstanding the provisions of paragraph (2) of this article, gains from the alienation of ships and aircraft operated in international traffic and movable property pertaining to the operation of such ships and aircraft, shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated.

4. Gains derived by a resident of a Contracting State from the alienation of any property other than those mentioned in paragraphs (1), (2) and (3) of this article shall be taxable only in that State.

5. For the purposes of this article, the term "alienation" means the sale, exchange, transfer, or relinquishment of the property or the extinguishment of any right therein or the compulsory acquisition thereof under any law in force in the respective Contracting States."

I. OBJECTIVE TYPE QUESTIONS

Choose the most appropriate alternative for the following MCQs:

1. The provisions relating to taxation of indirect transfer of shares of an Indian company were introduced vide Finance Act, 2012, as an aftermath of the decision of the Apex Court in
   (A) McDowell & Co. Ltd. *vs.* CTO;
   (B) Union of India vs. Azadi Bachao Andolan;
   (C) Vodafone International Holdings B.V. vs. UOI;
   (D) CIT vs. Yokogawa India Ltd.

2. If, in the given Case Study, DAS Singapore happens to be a subsidiary of DSA USA (A US company), transfer of shares in HPL to DAS Singapore will be governed by the provisions of
   (A) India US DTAA;
   (B) India Nation LDTAA;
   (C) India Singapore DTAA;
   (D) USA Singapore DTAA.

3. If it is held that the transfer of shares in HPL by DAS Martin to DAS Singapore is taxable in India, ignoring the DTAA provisions, the rate of tax applicable (without surcharge or cess) is
   (A) 30%;
   (B) 10%;
   (C) 20%;
   (D) None of the above

4. Assuming that the FMV of the shareholding in HPL in the hands of DAS Martin is ₹ 192.3 crores, regardless of the taxability of the capital gain in India.
   (A) DAS Singapore alone will be liable to tax in India for ₹ 10 crore u/s 56(2) in respect of the difference between FMV and the consideration given to DAS Martin;
   (B) DAS Martin alone will be liable to tax u/s 56(2) in India for ₹ 10 crore in respect of the difference between FMV and the consideration received by DAS Martin;
   (C) DAS Singapore will not be liable to tax in India u/s 56(2) for ₹ 10 crore in respect of the difference between FMV and the consideration given to DAS Martin;
   (D) Neither DAS Martin nor DAS Singapore will be liable to tax in India u/s 56(2).

5. HPL is bound to report details with respect to transfer of shares by DAS Martin to DAS Singapore in the following Form:
   (A) Form 49D;
   (B) Form 3CT;
   (C) Form 3CTA;
   (D) There is no reporting requirement on HPL to report the transfer of the shareholding.

II. DESCRIPTIVE QUESTIONS

1. The management of DAS Martin wishes to know whether the proposed transfer of shares in HPL to Das Singapore can be regarded as a device or scheme to avoid income-tax in India and whether GAAR can be invoked.

2. Examine whether the gains arising from the transfer will be taxable in India, when the former does not have a PE in India, per Article 13 - India Nation L DTAA (Exhibit) and in light of the provisions of Article 13 of the said Treaty.

3. Examine whether the sale consideration receivable by DAS Martin should suffer any withholding tax in India as per section 195 of the Act.

4. In respect of the payments made by HPL to DAS Martin, discuss the applicability of equalization levy.

SOLUTIONS – CASE STUDY 19

I. ANSWERS TO MCQs

MCQ No.	Answer
1.	(c)
2.	(b)
3.	(b)
4.	(a)
5.	(d)

II. ANSWERS TO DESCRIPTIVE QUESTIONS

Answer to Q. 1

As per section 95, an arrangement entered into by an assessee may be declared to be an impermissible avoidance arrangement and the consequence in relation to tax arising therefrom may be determined subject to the provisions of GAAR, if the main purpose or one of the main purposes of which is to obtain a tax benefit and which satisfies any of the following tests:

- creates rights, or obligations, which are not ordinarily created between persons dealing at arm's length;
- results, directly or indirectly, in the misuse, or abuse, of the provisions of this Act;
- lacks commercial substance or is deemed to lack commercial substance under section 97, in whole or in part or
- is entered into, or carried out, by means, or in a manner, which are not ordinarily employed for bona fide purposes

In the present case, in the absence of the DTAA between India and nation L, the capital gains arising in the hands of DAS Martin would be chargeable to tax in India, since such income would be deemed to accrue or arise in India on account of capital assets (70% shares in HPL), being situated in India.

Moreover, the transfer of shares in HPL by DAS Martin to another Singapore company i.e., DAS Singapore is pursuant to group reorganisation and to achieve the objectives like reducing complexities, achieving operational excellence, etc.

The shares were acquired 18 years back for a substantial cost of about ₹ 50.3 crores. The investment made in the HPL was with the prior approval of Department of Industrial Policy & Promotion (DIPP) and RBI permission was also obtained.

From the above facts, it is evident that the arrangement of transferring the shares held in HPL, an Indian company, to DAS Singapore by way of capital contribution is not for the purpose of obtaining any tax benefit, since such capital gains are chargeable to tax in India, in the absence of beneficial provisions of the DTAA.

Further, the purpose of entering into such arrangement does not satisfy any of the objectives due to which arrangement would be deemed as impermissible avoidance arrangement.

Thus, in the present case, the proposed transfer of shares in HPL to DAS Singapore cannot be regarded as device or scheme to avoid income-tax in India and hence, GAAR cannot be invoked.

Answer to Q. 2

The capital gains arising in the hands of DAS Martin would be chargeable to tax in India, since such income would be deemed to accrue or arise in India on account of capital assets (70% shares in HPL), being situated in India.

Article 13(4) of the India-Nation L DTAA provides that gains derived by a resident of a contracting State (DAS Martin, resident of Nation L) from the alienation of any property (Shares in HPL) would be taxable only in that State i.e., Nation L.

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 other words, if the DTAA provisions are more beneficial, the same will apply.

Thus, applying Article 13(4) of the tax treaty between India and Nation L, capital gains arising in the hands of DAS Martin would be taxable only in Nation L and hence, such capital gains would not be taxable in India.

Answer to Q. 3

Under section 195(1), the obligation to deduct tax at source from interest and other payments to a non-resident, which are chargeable to tax in India, is on "any person responsible for paying to a non-resident or to a foreign company".

For section 195 to apply, there should be income chargeable to tax in India, in the given situation.

Explanation 2 to Section 195(1) clarifies that the obligation to comply with section 195(1) and to make deduction thereunder applies and shall be deemed to have always applied and extends and shall be deemed to have always extended to all persons, resident or non- resident, whether or not the non-resident has:

(a) a residence or place of business or business connection in India; or

(b) any other presence in any manner whatsoever in India.

However, by virtue of the DTAA between India and Country L, in this case, the capital gains would be chargeable to tax only in Country L. The same would not be taxable in India.

Thus, in the present case, DAS Singapore, being a non-resident foreign company is not required to withhold tax on the sale consideration payable to DAS Martin, since capital gains is not taxable in India as per the DTAA between India and Country L.

Answer to Q. 4

Chapter VIII of the Finance Act, 2016, "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: here, DAS Martin is a non-resident which does not have a PE in India;
- from a resident in India who carries out business or profession, or from a non-resident having permanent establishment in India: here, HPL is a resident in India carrying on business.

"Specified Service" means

(1) online advertisement;

(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.

Since only online advertisement or any provision for digital advertising space for the purpose of online advertisement included within the meaning of specified services, the equalisation levy @6% would be applicable only on the amount of ₹ 43,00,000, paid for advertisements in foreign websites, to DAS Martin, a non-resident not having a PE in India.

Hence, equalisation levy would not apply on the payment of ₹ 8 lakhs made by HPL to DAS Martin for space booking in foreign newspapers.

CASE STUDY – 20

FMG Associates is a firm of Chartered Accountants at Jaipur. It has received queries from its clients and for which it has to provide solutions. All the facts relate to A.Y.2020-21.

Resident Ramji with income outside India

Mr. Ramji an individual resident in India furnished details of his global income for the previous year 2019-20.

Income from business carried on in India ₹8,00,000

Agricultural income in Sri Lanka (in Sri Lanka Rupee) 1,00,000

Dividend income from a company incorporated in USA (declared on 10.1.2020) US $ 20,000

Royalty income from a detective novel published in country Sri Lanka (in Sri Lanka Rupee) 7,00,000

Income from house property in the country USA US $ 10,000

Business income from Sri Lanka (in Sri Lanka Rupee) 4,00,000

Note: All the foreign incomes were repatriated to his bank account in India in April, 2020 except business income earned outside India. Assume the accounting year is uniform for all the countries and tax payable in foreign country was paid, wherever it was taxable.

The **synopsis** of the relevant Article of the DTAA **between India and USA** regards taxation of property income and dividend income is given below:

(1) Income derived by a resident of a Contracting State from immovable property, situated in the other Contracting State may be taxed in that other State.

Assume rate of tax in USA 30% and in India at slab rate.

(2) Dividends paid by a company which is a resident of a Contracting State to a resident of the other Contracting State may be taxed in that other State. However, such dividends may also be taxed in the Contracting State of which the company paying the dividends is a resident.

Assume rate of tax in USA@25% and in India at slab rate.

The **synopsis** of the relevant Article of the **DTAA between India and Sri Lanka** as regards taxation of agricultural income, business income and royalty income are given below:

(1) Income derived by a resident of a Contracting State from immovable property (including income from agricultural land) situated in the other Contracting State may be taxed in that other Contracting State.

(2) The profits of an enterprise of a 'Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profit of the enterprise may be taxed in the other State but only so much as is attributable to that permanent establishment.

Assume rate of tax in Sri Lanka @20% and in India @ slab rate.

(3) Royalties arising in a Contracting State and paid to resident of the other Contracting State may be taxed in that other State. However, such royalties may also be taxed in the Contracting State at a rate not exceeding 10% of the gross amount of royalty.

Assume rate of tax in Sri Lanka @10% and in India @10% for non-residents and regular rate for residents.

Exchange rates

TT Buying Rate	Sri Lanka Rupee	US Dollars
31.03.2020	INR 1 = 2.54 LKR	1 US dollar = 70 INR
31.12.2019		1 US dollar = 71 INR

Ramji's son Pramod (age 23) is employed in ESS Softwares Ltd, Bengaluru. He was sent on deputation to USA on 10.01.2018 to attend to onsite duties and he returned to India on 05.01.2020. He was paid per diem allowance at USA which was adequate enough to meet his living expenses there. His salary of ₹ 27 lakhs after deducting his PF contribution of ₹ 1,80,000, was credited to his bank account at Bengaluru during the previous year 2019-20.

Non-Resident company seeking AAR

PQR Inc. of Germany is supplying technical know-how to be used by Mayur Co Ltd, Mumbai for manufacture of combustion engine at Nagpur. The agreement for supply of technical know- how is in return for royalty and was signed on 10.05.2018. The royalty exceeded ₹ 10 crore for the assessment year 2018-19. Mayur Co Ltd filed its return of income on 30th August, 2019 and approached AAR in September, 2019 as regards withholding tax on royalties paid to PQR Inc., Germany. The application of Mayur Co Ltd was admitted by AAR in November, 2019. The Assessing Officer issued a notice under section 143(2) on 10.01.2020. The foreign company PQR Inc. also applied for advance ruling on 20.01.2020 to know its tax liability in respect of its royalty income received from Mayur Co Ltd.

Mayur Co Ltd has a branch office in Sri Lanka. It exported goods worth ₹ 5 crores by raising invoice for ₹ 4.40 crores. It gave advance of ₹ 1 crore to its branch in Sri Lanka out of the loan obtained by it from State Bank of India. It did not charge any interest though the borrowing cost attributable for the advance is ascertained at ₹ 7,40,000 for the year ended 31.03.2020.

PQR Inc. has the following incomes in India for the year ended 31st March, 2020:

(i) Dividend income from Indian listed companies ₹ 12,50,000;

(ii) Royalty income from Roger Moore (P) Ltd, Cochin ₹ 8,40,000. The royalty agreement was made in accordance with the policy of the Government of India. The DTAA between India and Germany provides for taxing the royalty at 10%;

(iii) Interest ₹ 5,50,000 received on global depository receipts purchased in foreign currency from ABC Ltd; and

(iv) Interest ₹ 3,20,000 received from an infrastructure debt fund referred to in section 10(47).

Mayur Co Ltd. has 30% shareholding by way of 3 lakh equity shares of € 10 each in Botham Ltd of Spain. In December, 2018, Botham Ltd. declared dividend at 10% on the face value of shares. Mayur Co Ltd. received ₹ 22 lakhs on repatriation of the dividend amount to its bank account in India.

Mayur Co Ltd. is contemplating to transfer the shareholding in Botham Ltd. to a subsidiary company to be incorporated in yet another country and by virtue of the DTAA between that country and Spain, such dividend income will become tax-free. Presently, such dividend income is taxable in India as per DTAA between India and Spain. This plan of transferring the shares by forming the subsidiary company in foreign country is in nascent stage.

Proposal for e-sale of books in India

XY Co Publishers Ltd, United Kingdom, is a reputed scientific book publisher with global presence. The company decided to penetrate the Indian market by procuring orders online. The company anticipates the online booking to pick up in due course of time. It is planning to dispatch goods from the warehouse in Kolkata based on the orders received. There would be no direct sale to any of the

customers in India from the warehouse in Kolkata. The amounts have to be paid online by the buyers directly to the bank account of XY Co Publishers Ltd maintained in London. It is contemplating to have a website and server in India owned by it or avail the same of an outside entity for its online business in India.

Advertisement expenditure of Chetan Ltd

Chetan Ltd, Mysore is a 100% subsidiary of Beijing Ltd of Chicago, USA. It acted as the distributor of world famous mobile handsets by brand name "Chicago" manufactured by parent company viz. Beijing Ltd. During the previous year 2019-20, Chetan Ltd remitted the amounts due to Beijing Ltd in settlement of the invoices by furnishing necessary forms prescribed under Income-tax Rules, 1962. The agreement between the companies envisages that 5% of the sale consideration realized by Chetan Ltd. must be spent towards advertisement of "Chicago", being the brand name of the mobile handsets.

Each handset was invoiced @ ₹ 15,000 for Chetan Ltd. and whereas it was invoiced at ₹ 13,000 to unrelated parties. Chetan Ltd. sold 40,000 handsets in the previous year 2019- 20 at the average price of ₹ 16,000 per handset. The credit period allowed by Beijing Ltd was 3 months for Chetan Ltd and whereas for other dealers, it was given against full payment. The cost of capital may be taken as 12% per annum and the purchases as uniform throughout the year. Beijing Ltd. charged ₹ 1500 per handset as warranty charges and whereas for unrelated parties it charged ₹ 2000. The assessee selected Beijing Ltd as tested party for comparing controlled and uncontrolled transactions. Chetan Ltd spent ₹ 3 crores towards advertisement expenses in India.

BB Co Ltd. of Chennai is an associated enterprise of Chetan Ltd. It exported the semi-finished textile goods to Pick Inc, Singapore. The goods were further processed and sold to yet another 100% subsidiary of BB Co Ltd viz. Sea Ltd. at Sydney, Australia for reaching the customers therein. BB Co Ltd wants to apply for advance pricing agreement to" protect itself and its subsidiaries.

I. OBJECTIVE TYPE QUESTIONS

Choose the most appropriate alternative for the following MCQs:

1. The amount of dividend income earned by Mayur Co Ltd. from Botham Ltd. of Spain is chargeable to tax in India @_____ and it is covered by action plan of BEPS.
   (A) 10% and 4
   (B) 15% and 4
   (C) 15% and 3
   (D) 20% and not covered

2. How will DTAAs prevent treaty shopping / abuse such as the one contemplated by Mayur Co Ltd.?
   (A) Protocols in DTAA
   (B) Provision in domestic law
   (C) Limitation of Benefit clause in DTAA
   (D) Conduit rulings

3. The APA that would be applicable to BB Co Ltd for protecting itself and its two subsidiaries in Singapore and Australia for avoiding litigation in transfer pricing regulations, would be
   (A) Multi-lateral APA

(B) Bilateral APA
(C) Unilateral APA
(D) None, as it is not possible

4. What is the residential status of Pramod for the assessment year 2020-21?
   (A) Non-resident
   (B) Resident and ordinarily resident
   (C) Resident but not ordinarily resident
   (D) None of the above

5. How much is to be adjusted to the total income of the Mayur Co Ltd. by applying transfer pricing regulations for the transactions carried out with its Sri Lanka branch office?
   (A) ₹ 60,00,000
   (B) ₹ 7,40,000
   (C) ₹ 67,40,000
   (D) Nil

II. DESCRIPTIVE QUESTIONS

1. Compute the total income of resident Ramji for the assessment year 2020-21 by allowing foreign tax credit wherever applicable in the light of DTAA provisions.

2. With brief reasons for treatment of the items, you are requested to compute the tax liability of PQR Inc. for the assessment year 2020-21.

3. Advise whether XY Co Publishers Ltd should have a website and server owned by it or avail the same from an outsider in the context of Income-tax Act, 1961.

4. Compute the arm's length price adjustment for Chetan Ltd ignoring any adjustment towards advertisement expenditure.

SOLUTIONS – CASE STUDY 20

I. ANSWERS TO MCQs

MCQ No.	Answer
1.	(c)
2.	(c)
3.	(a)
4.	(b)
5.	(d)

II. ANSWERS TO DESCRIPTIVE QUESTIONS

Answer to Q. 1

Computation of total income of resident Ramji for the A.Y.2020-21		
Particulars	**₹**	**₹**
Income from house property		
Annual Value of house in USA = $ 10,000 x 70	7,00,000	
Less: Deduction@30%	2,10,000	4,90,000
Profits and gains of business or profession		
Income from business carried on in India	8,00,000	
Business income in Sri Lanka (4,00,000 LKR/2.54) [Taxable only in Sri Lanka – Hence, not included in computation of total income]	Nil	
Income chargeable under this head		8,00,000
Income from Other Sources		
Agricultural income in Sri Lanka (1,00,000 LKR/2.54)	39,370	
Dividend income from a company incorporated in the USA ($ 20,000 x 71) – Since dividend was declared on 10.1.2020, the rate as on 31.12.2019 has to be considered for conversion.	14,20,000	
Royalty income from a detective novel published in Sri Lanka (7,00,000 LKR/2.54)	2,75,591	
Income chargeable under this head		17,34,961
Gross Total Income		**30,24,961**
Less: **Deductions under Chapter VI-A**		
Section 80QQB [Royalty income from detective novel]		2,75,591
Total Income		**27,49,370**

Answer to Q. 2

Computation of tax liability of PQR Inc., a German Company, in India for A.Y.2020 -21

	Particulars of Income	Tax treatment	Tax liability (₹)

(i)	Dividend income of ₹12,50,000 from Indian listed companies	Exempt u/s 10(34), since the same is subject to dividend distribution tax u/s 115-O. Section 115BBDA is not attracted in case of a foreign company which is non-resident in India.	Nil
(ii)	Royalty of ₹ 8,40,000 from Roger Moore (P) Ltd., Cochin	Subject to tax@10% as per India-Germany DTAA (DTAA rate is inclusive of cess)	84,000
(iii)	Interest of ₹ 5,50,000 on GDRs purchased in foreign currency from ABC Ltd.	Subject to tax@10.4% [i.e., 10% as per section 115AC plus cess@4%]	57,200
(iv)	Interest of ₹ 3,20,000 received from infrastructure debt fund referred to in section 10(47)	Subject to tax@5.2% [i.e., 5% as per section 115A plus cess@4%]	16,640
		Total tax liability	**1,57,840**

Answer to Q. 3

The concept of "business connection" assumes significant importance in the context of the Income-tax Act, 1961. The scope of business connection has now been expanded to include "significant economic presence" in India.

"Significant economic presence" means systematic and continuous soliciting of business activities or engaging in interaction with such number of users in India through digital means, inter alia, through websites with the help of servers owned by the assessee or a third person. The Rules in this regard are yet to be notified.

It is possible that transacting business in India by availing the services of website and server, irrespective of its location, would fall within the meaning of "significant economic presence" and hence, constitute business connection, in which case, the income would be taxable in India. However, since the number of users in India are yet to be prescribed, business connection would be established only if users are of the prescribed number.

[Alternate Answer]: As per section 92F(iiia), "permanent establishment" includes a fixed place of business through which the business of the enterprise is wholly or partly carried on.

Existence of website by itself would not constitute a PE. Where the website is being used as a virtual office for transacting orders of purchases or sales, then, it could be regarded as a permanent establishment, if the server supporting the website is located in India.

In this case, since XY Co. Publishers Ltd., UK, wants to procure online orders from Indian customers, for which payment has to be made online by them, the website and server owned by them in India would constitute a permanent establishment. A warehouse set up in India may not constitute a PE in this case, since only delivery of goods is being effected through the warehouse and there is no direct sale of goods by the warehouse.

Therefore, XY Co. Publishers Ltd. should avail the services of website and server from an outsider.

Answer to Q. 4

Arms' length adjustment for Chetan Ltd.

Particulars	₹
Price charged by Beijing Ltd. to unrelated parties	13,000
Add: Excess billing to Chetan Ltd. attributable to 3 months credit provided [₹ 15,000 x 3/12 x12/100]	450
	13,450
Less: Difference in warranty charges [₹ 2,000 – ₹ 1,500] to be deducted, since the warranty charges were lower for Chetan Ltd.	500
Arm's length adjustment to be made in the price of each handset	12,950
Price charged from Chetan Ltd.	15,000
Arm's length adjustment for each handset	2,050

Arm's length adjustment for 40,000 handsets = 40,000 x ₹ 2,050 = ₹ 8,20,00,000

CASE STUDY – 21

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

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

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

The details of some of the assignments are as follows -

Assignment 1 [Client – Ganges Ltd.]

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

Assignment 2 [Client – Godavari Ltd.]

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

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

Assignment 3 [Client – Ms. Sheetal]

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

(i) Taxable income from a sole-proprietary concern in Baroda ₹ 80 lakhs.

(ii) Share of profit from a partnership firm in Bhopal ₹ 40 lakhs.

(iii) Agricultural Income (Gross) from coffee estate in Country G which has no DTAA with India, CGD 40000. Withholding Tax on the above income CGD 8000

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

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

Based on the above facts, answer the following questions –

MULTIPLE CHOICE QUESTIONS

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

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

   (i) the primary adjustment made was ₹ 90 lakhs;

   (ii) the said adjustment pertained to P.Y.2015-16 instead of P.Y. 2017-18? The correct answer is -

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

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

   (i) M/s. Colorado Inc. holds shares carrying 40% voting power in Godavari Ltd.

   (ii) M/s. Colorado Inc. holds shares carrying 40% voting power both in Godavari Ltd. and M/s. Amazon Inc

   (iii) M/s. Amazon Inc. guarantees the loan taken by Godavari Ltd. from M/s. Mississippi Inc.

   (iv) M/s. Colorado Inc. has deposited ₹ 80 crores with M/s. Mississippi Inc.

   The most appropriate answer is -
   (a) (i) and (iv) above
   (b) (ii) and (iii) above
   (c) (i) and (iii) above
   (d) Either (a) or (b)

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

   (i) can be set-off against her business income from sole-proprietorship in Baroda

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

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

   (iv) has to be deducted while computing doubly taxed income for the purpose of

deduction under section 91

Which of the above statements are correct?
(a) (i) and (iii)
(b) (ii) and (iii)
(c) (i) and (iv)
(d) (ii) and (iv)

4. If Ms. Sheetal derived share income from a partnership firm in Country G which is taxable under the laws of Country G, then, assuming that the shares of the partners are not specified in the instrument evidencing partnership since the same is not a requirement as per the laws of Country G, which of the following statements would be correct?

   (i) Share income of Ms. Sheetal from the partnership firm would be taxable under the Income-tax Act, 1961

   (ii) Share income of Ms. Sheetal from the partnership firm would be exempt under section 10(2A) of the Income-tax Act, 1961

   (iii) Share income of Ms. Sheetal from the partnership firm would be included in "doubly taxed income" for the purpose of deduction under section 91

   (iv) Share income of Ms. Sheetal from the partnership firm would not be included in "doubly taxed income" for the purpose of deduction under section 91

   The correct answer is –
   (a) (i) and (iii)
   (b) (i) and (iv)
   (c) (ii) and (iii)
   (d) (ii) and (iv)

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

DESCRIPTIVE QUESTIONS

1. (a) Ganges Ltd. wants to know the effect of the transaction of supply of computers to Nile Inc., in respect of which the Assessing Officer carried out primary adjustments in computing the total income for A.Y.2020-21, considering that the excess money is still lying with Nile Inc.

   (b) Is the interest payable by Godavari Ltd. to M/s. Mississippi Inc. allowable as deduction while computing the total income of Godavari Ltd.? If so, to what extent?

2. Compute the total income and tax liability of Ms. Sheetal for A.Y.2020-21.

SOLUTIONS – CASE STUDY 21

I. ANSWERS TO MCQs

MCQ No.	Answer
1.	(a)
2.	(d)
3.	(c)
4.	(a)
5.	(b)

II. ANSWERS TO DESCRIPTIVE QUESTIONS

Answer to Q.1

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

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

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

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

(1) The company has accepted the primary adjustment made by the Assessing Officer;

(2) The primary adjustment is in respect of A.Y.2018-19; and

(3) The primary adjustment exceeds ₹ 100 lakhs.

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

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

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

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

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

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

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

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

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

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

Answer to Q.2

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

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

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

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

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

(b) Agricultural income from coffee estate accrues or arises to her outside India in Country G during that previous year.

(c) Such agricultural income is not deemed to accrue or arise in India during the previous year.

(d) Such agricultural income has been subjected to income-tax in Country G in her hands and she has paid tax on such income in Country G.

(e) There is no agreement under section 90 for the relief or avoidance of double taxation between India and Country G, where the income has accrued or arisen.

CASE STUDY – 22

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

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

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

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

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

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

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

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

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

(i) no double taxation avoidance agreement with Countries W, X and Y;

(ii) a double taxation avoidance agreement with Country Z in line with OECD Model Convention, 2017

(iii) a double taxation avoidance agreement with Country U in line with UN Model Convention, 2017

(iv) India follows credit method for providing double taxation relief with respect to taxes paid in Countries Z and U.

MULTIPLE CHOICE QUESTIONS

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

1. The total income of Mr. Eashwar for the A.Y.2020-21 is –
   (a) ₹ 46,89,000
   (b) ₹ 48,19,000
   (c) ₹ 49,89,000
   (d) ₹ 51,19,000

2. For the purpose of computing deduction under section 91 for A.Y.2020-21, the "doubly taxed income" of Mr. Eashwar in respect of income earned in Country X and Country Y would be –
   (a) ₹ 15,30,000 and ₹1,59,000, respectively
   (b) ₹ 12,30,000 and ₹1,59,000, respectively
   (c) ₹ 15,30,000 and ₹ 29,000, respectively
   (d) ₹ 12,30,000 and ₹29,000, respectively

3. The rebate under section 91 available to Mr. Eashwar for A.Y.2020-21 is –
   (a) ₹ 2,53,842
   (b) ₹ 3,48,995
   (c) ₹ 3,13,842
   (d) ₹ 2,88,995

4. As per the India-Country Z DTAA and India-Country U DTAA, royalty, if any,

arising to Mr. Karan and Ms. Radha Srinivas in Country Z and Country U, respectively, would be taxable –

(a) Only in India
(b) Royalty arising to Mr. Karan may be taxed either in India or in Country Z and royalty arising to Ms. Radha Srinivas may be taxed either in India or in Country U
(c) Royalty arising to Mr. Karan would be taxable only in India; Royalty arising to Ms. Radha Srinivas may be taxed either in India or in Country U
(d) Royalty arising to Ms. Radha Srinivas would be taxable only in India; Royalty arising to Mr. Karan may be taxed either in India or in Country Z

5. Let us suppose that, as per the DTAA between India and Country U, a particular income earned by Mrs. Radha Srinivas in Country U may be taxed in Country U. While computing her total income under the Income-tax Act, 1961, the said income –

(a) should not be taken into account at all
(b) should be taken into account; thereafter, deduction is to be allowed from the tax payable in India on her total income.
(c) may be taken into account in order to compute the amount of tax on the remaining income.
(d) may be taken into account; thereafter, deduction may be allowed from the tax payable in India on her total income.

DESCRIPTIVE QUESTIONS

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

SOLUTIONS – CASE STUDY 22

I. ANSWERS TO MCQs

MCQ No.	Answer
1.	(a)
2.	(d)
3.	(a)
4.	(c)
5.	(b)

II. ANSWERS TO DESCRIPTIVE QUESTIONS

Answer to Q.1

Determination of residential status of Mr. Eashwar for A.Y.2020-21 No. of days of stay in Country X = 32 days + 49 days +19 days = 100 days No. of days of stay in Country Y = 22 days + 42 days +16 days = 80 days No. of days of stay in India = 366 days – 100 days – 80 days = 186 days

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

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

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

Since his stay in India exceeds 730 days in the last seven previous years; and his number of days of stay in India is 182 days or more in all the earlier previous years, he satisfies the condition of being resident in atleast 2 out of the 10 preceding previous years. Therefore, he is resident and ordinarily resident in India for A.Y.2020-21.

Answer to Q.2

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

Particulars	₹	₹
Profits and gains of business or profession		
From concerts held in India	10,00,000	

From royalty received from Country U [CLD 10000 x 80 (being conversion rate as on 31.3.2020 -Rule 115)]	8,00,000	
From concerts held in Country W [CWD 10145 x 69 (being conversion rate as on 31.3.2020 – Rule 115)	7,00,005	
		25,00,005
Income from Other Sources		
Income from bank fixed deposits in her name	4,00,000	
Income from savings bank account	25,000	4,25,000
Gross Total Income		**29,25,005**
Less: **Deduction under section 80C**		
Deposit in PPF	1,50,000	
Five year fixed deposit in the name of her son (does not qualify for deduction under section 80C)	-	
Under section 80D	50,000	
Medical insurance premium to insure her health and health of spouse (₹ 57,000, restricted to ₹ 50,000, being the maximum allowable for senior citizens) (See Note 1)		
Under section 80TTB	50,000	
Interest on bank FD and savings bank account restricted to		2,50,000
Total Income		**26,75,005**
Total Income (rounded off)		**26,75,010**
Tax on Total Income		
Income-tax (See Note 2)		6,12,503
Add: Health and Education Cess @4%		24,500
		6,37,003
Average rate of tax in India (i.e., ₹ 6,37,003/ ₹26,75,010 × 100)	23.813%	
Foreign Tax Credit		
Lower of tax payable under the Income-tax Act, 1961 on income from profession and foreign tax payable on such income		
Tax covered under India-Country U DTAA under section 90 [Lower of ₹ 1,90,504 (i.e., 23.813% x ₹ 8,00,000) and ₹ 78,000 (₹ 78, being the conversion rate as on 28.2.2020 as per Rule 128 x CUD 1000)]	78,000	
Income-tax referred to in section 91: Country W [Lower of ₹ 1,66,692 (i.e., 23.813% x ₹ 7,00,005) and ₹ 1,75,000 (₹ 70, being the conversion rate as on 30.9.2019 as per Rule 128 x CWD 2500)]	1,66,692	
		2,44,692
Tax payable in India (₹ 6,37,003 – ₹ 2,44,692)		**3,92,311**
Tax payable (rounded off)		**3,92,310**

Notes:

1. Section 80D allows a higher deduction of up to ₹ 50,000 in respect of the medical premium paid to insure the heath of a senior citizen. Therefore, in respect of medical insurance premium of ₹ 57,000 paid by Mrs. Radha Srinivas to insure the health of herself and her spouse, she will be allowed deduction of ₹ 50,000 under section 80D, since she and her

husband are resident Indians of the age of 60 years or more during the P.Y.2019-20.

2. The basic exemption limit for senior citizens is ₹ 3,00,000 and the age criterion for qualifying as a "senior citizen" for availing the higher basic exemption limit is 60 years. Accordingly, Mrs. Radha Srinivas is eligible for the higher basic exemption limit of ₹ 3,00,000, since she is a resident Indian of the age of 61 years.

3. As per Rule 115, for computing income from profession of Mrs. Radha Srinivas, the TT buying rate as on 31.3.2020 has to be considered. Royalty income from Country U and income from concerts in Country W constitute her income from profession, since she is a singer and a composer. However, as per Rule 128, for computing foreign tax credit, TT buying rate as on the last day of the month immediately preceding the month in which tax was deducted or paid in that country has to be considered. Foreign Tax Credit has been computed accordingly.

4. Since the DTAA with Country U is in line with UN Model Convention, as per article 12(1), royalty income arising in a Contracting State (Country U, in this case) and paid to a resident of another Contracting State (Mrs. Radha Srinivas, a resident of India, in this case) may be taxed in that other State (India, in this case). However, such royalties may also be taxed in the Source State according to its laws, but if the beneficial owner is a resident of another State, then the tax so charged shall not exceed a prescribed percentage to be established though bilateral negotiations (assumed to be 10%, as given in the question, in this case). It is presumed that the rate of 10% is as per domestic tax laws and the negotiated rate as per Article 12(2) of the DTAA of India with Country U. Credit for such tax paid by Mrs. Radha Srinivas in Source State, i.e., Country U, in this case, would be available as per Article 23B(1).

CASE STUDY – 23

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

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

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

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

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

EFG Ltd.	45	1.1.2018	₹ 2,000	15.1.2020	₹ 3,000	₹ 1,500
HIJ Ltd.	10	15.1.2018	₹ 4,000	2.3.2020	₹ 2,500	₹ 6,000

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

(i) a double taxation avoidance agreement with Country Z in line with OECD Model Convention, 2017

(ii) a double taxation avoidance agreement with Country L in line with UN Model Convention, 2017

(iii) India follows credit method for providing double taxation relief with respect to taxes paid in Countries Z and L.

MULTIPLE CHOICE QUESTIONS

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

1. For ABC Ltd., which of the following is a criterion for residency in India's DTAA with Country L but not in India's DTAA with Country Z –
   (a) Place of management
   (b) Place of incorporation
   (c) Neither (a) nor (b)
   (d) Both (a) and (b)

2. As per the DTAA entered into by India with Country Z and Country L, the assembly projects set up by EFG Ltd. in those countries would –
   (a) constitute a PE in both countries
   (b) not constitute a PE in either country Z or Country L
   (c) constitute a PE in Country Z but not constitute a PE in Country L
   (d) constitute a PE in Country L but not constitute a PE in Country Z.

3. As regards provision of technical consultancy services by HIJ Ltd. to its clients in Country Z and Country L through personnel engaged by them for such purposes, which of the following statements is correct, as per the DTAAs entered into by India with those countries?
   (a) Provision of such services would constitute a PE in both cases
   (b) Provision of such services would not constitute a PE in either case
   (c) Provision of such services would constitute a PE in Country Z but not in Country L
   (d) Provision of such services would constitute a PE in Country L but not in Country Z

4. As regards taxability of profits earned by ABC Ltd. from sale of spices to customers through its branches in Country Z and L and profit from sale of spices to customers in Country Z and L directly, which of the following statements is correct, considering the DTAA entered into by India with such countries?
   (a) ABC Ltd. will be subject to tax in Country Z and Country L, to the extent of profits earned from sales effected to customers through its branches located therein.
   (b) ABC Ltd. will be subject to tax in Country Z and Country L on entire profits earned from sales effected to customers located therein, whether through its branches or directly.
   (c) ABC Ltd. will be subject to tax in Country Z in respect of profits earned from sales effected to customers through its branch located therein and in Country L on entire profits earned from sales effected to customers located therein, whether through its branch or directly.
   (d) ABC Ltd. will be subject to tax in Country L in respect of profits earned from sales

effected to customers through its branch located therein and in Country Z on entire profits earned from sales effected to customers located therein, whether through its branch or directly.

5. As regards taxability of interest received/receivable by PQR Ltd. on loan given to L & Co. and Z & Co., which of the following statements is correct, considering the DTAA entered into by India with such countries?
   (a) Country L and Z can tax such interest in the hands of PQR Ltd. at its domestic tax rates, namely, 20% and 8%, respectively.
   (b) Country L and Z cannot tax such interest in the hands of PQR Ltd. since interest is taxable only in India, being the country of residence of PQR Ltd.
   (c) Country L and Z can tax such interest in the hands of PQR Ltd. at a rate, not exceeding the maximum rate to be established through bilateral negotiations
   (d) Country Z can tax such interest in the hands of PQR Ltd. at a rate of 8%. However, Country L can tax such interest in the hands of PQR Ltd. at a rate, not exceeding the maximum rate to be established through bilateral negotiations.

DESCRIPTIVE QUESTIONS

1. Examine whether Arjun would be treated as a resident of India or Country Z, as per the relevant article of the DTAA between India and Country Z.

2. Compute the capital gains of Arjun, assuming that the equity shares of all four companies are listed, and securities transaction tax has been paid both at the time of purchase and sale of such shares.

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

SOLUTIONS – CASE STUDY 23

I. ANSWERS TO MCQs

MCQ No.	Answer
1.	(b)
2.	(b)
3.	(b)
4.	(c)
5.	(d)

II. ANSWERS TO DESCRIPTIVE QUESTIONS

Answer to Q.1

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

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

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

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

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

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

ii) His total stay in India in last seven years preceding P.Y. 2019-20 is 730 days or more.

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

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

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

This Rule provides that where an individual is a resident of both the countries, he shall be deemed to be resident of that country in which he has a permanent home and if he has a permanent home

in both the countries, he shall be deemed to be resident of that country, which is the centre of his vital interests i.e. the country with which he has closer personal and economic relations.

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

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

(a) his residential property is located and

(b) social and cultural activities are closer

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

Answer to Q.2

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

Particulars	**₹**	**₹**
Income from house property		5,25,000
Profits and gains of business and profession		18,50,000
Capital Gains [**See Working Note below]**		2,50,000
Income from other sources		42,300
Gross Total Income		**26,67,300**
Less: Deduction under Chapter VI-A		
Under section 80C [Deposit in PPF]	1,50,000	
Under section 80D [₹ 28,000, restricted to ₹ 25,000 + ₹ 32,000 (since parents are senior citizens, and ₹ 32,000 is within the enhanced limit of ₹ 50,000)]	57,000	
Under section 80TTA	10,000	2,17,000
Total Income		**24,50,300**
Computation of tax liability		
Particulars	**₹**	**₹**
Tax@10% u/s 112A on LTCG of ₹ 1,50,000 [LTCG in excess of ₹ 1 lakh]		15,000
Tax on other income of ₹ 22,00,300		
Upto ₹ 2,50,000	Nil	
₹ 2,50,001 – ₹5,00,000@5%	12,500	
₹ 5,00,001 – ₹10,00,000@20%	1,00,000	
₹ 10,00,001 – ₹22,00,300@30%	3,60,090	
		4,72,590
		4,87,590
Add: Health and education cess@4%		19,504
Total tax liability		**5,07,094**
Total tax liability (rounded off)		5,07,090

Working Note-

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

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

CASE STUDY – 24

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

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

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

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

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

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

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

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

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

Based on the above facts, answer the following questions –

MULTIPLE CHOICE QUESTIONS

Write the most appropriate answer to each of the following questions by choosing one of the four options given.

1. India-Country B DTAA was signed on 1st July, 2017. However TDS provisions of Goods and

Service Tax Act came in force on 1st October, 2018. Whether such provisions will be covered in the India- Country B DTAA?

(a) Yes, it will be covered
(b) No, it won't be covered
(c) Will be covered if India-Vietnam enters into fresh agreement to that effect
(d) Will be covered if fresh DTAA is made.

2. Calculate the amount of penalty leviable on Ms. Diana under the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 -

(a) ₹ 25 lakhs
(b) ₹ 50 lakhs
(c) ₹ 10 lakhs
(d) ₹ 1 crore

3. In the interpretation of the treaty, the provisions shall be interpreted in such a way that it enables provisions of the treaty to work and to have their appropriate effects. Which of the following basic principle suggest the above:

(a) Purposive Interpretation
(b) The principle of effectiveness
(c) Liberal Construction
(d) Reasonableness and Consistency

4. Following details are given for Signature Ltd. in respect of Dividend received by it from Country Y:

TTBR on 30th April, 2019 – ₹ 65/ CYD
TTSR on 30th April, 2019 – ₹ 66/ CYD
TTBR on 25th May, 2019 – ₹ 65/ CYD
TTSR on 25th May, 2019 – ₹ 66/ CYD

State the specified date and rate of exchange respectively for conversion of dividend.

(a) 30th April, 65/CYD
(b) 30th April, 65.5/CYD
(c) 25th May, 65/CYD
(d) 30th April, 66/CYD

5. Holding Ltd has advanced loan to non-resident company of ₹ 60 Crores. Is the company required to furnish information in Form 15CA in respect of this transaction and if so, in which part?

(a) Part B of Form 15CA
(b) Part C of Form 15CA
(c) Part D of Form 15CA
(d) Not required to furnish Form 15CA

DESCRIPTIVE QUESTIONS

1. Calculate Holding Ltd.'s profit chargeable to tax after transfer pricing adjustments.

2. Determine residential status of Mr. Yatish for A.Y. 2020-21 and calculate Mr. Yatish's income which will be chargeable to tax in India. (Double taxation relief may be ignored)

3. Analyse the correctness of contention made by the income-tax department in the case filed by Elizabeth Ltd.

4. State whether Statue Ltd.'s office in India will constitute Permanent Establishment in India. Would your answer change if India's DTAA with Country D was in line with UN Model Convention, 2017?

SOLUTIONS – CASE STUDY 24

I. ANSWERS TO MCQs

MCQ No.	Answer
1.	(b)
2.	(c)
3.	(b)
4.	(a)
5.	(d)

II. ANSWERS TO DESCRIPTIVE QUESTIONS

Answer to Q.1

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

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

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

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

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

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

Note:

(1) Beyond Ltd offered warranty only for 3 months while unrelated party provided it for 1 year. Therefore 9 months' cost of warranty shall be adjusted. ($700 x 9/12)

(2) Beyond Ltd has provided credit for 4 months whereas unrelated party has not provided such credit. Therefore adjustment for the cost of such credit is needed to be carried out to arrive at arm's length price. ($14000 x 9 x 4/12)

Answer to Q.2

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

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

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

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

Taxability of income

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

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

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

Answer to Q.3

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

Answer to Q.4

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

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

CASE STUDY – 25

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

(1) Interest received on investment in Rupee Denominated Bonds of Cauvery Ltd., an Indian company issued in March, 2019 - ₹ 4,70,000

(2) Dividend from listed equity shares of Indian companies – ₹ 2,80,000

(3) Interest on securities – ₹ 15,48,000 (Expenses of ₹ 13,000 has been incurred to earn such income)

(4) **Income from sale of securities and shares**:

(i) Bonds of Vaigai Ltd.

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

Sale proceeds	₹ 58,00,000
Cost of purchase	₹ 29,00,000

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

(ii) Listed equity shares of Mahanadi Ltd.

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

Sale Consideration	₹ 14,50,000
Purchase cost	₹ 6,00,000

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

(iii) Unlisted equity shares of Godavari Ltd.

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

Sale Consideration	₹ 7,80,000
Purchase cost	₹ 2,65,000

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

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

Based on the above facts, answer the following questions –

MULTIPLE CHOICE QUESTIONS

Write the most appropriate answer to each of the following questions by choosing one of the four options given.

1. In respect of interest payable to Rio Grande Inc. on Rupee Denominated Bonds issued outside India by Cauvery Ltd., –
   (a) tax is deductible at source at the rates in force under section 195
   (b) tax is deductible at source@5.2%.
   (c) tax is deductible at source@20.8%
   (d) no tax is deductible at source.

2. If we assume that Rupee Denominated Bonds were issued outside India by Cauvery Ltd. in March, 2019 and Zara Ltd. has also subscribed to such bonds, then, in respect of interest payable to Zara Ltd. on such rupee denominated bonds,
   (a) tax is deductible at source at the rates in force under section 195
   (b) tax is deductible at source@5.2%.
   (c) tax is deductible at source@10.4%
   (d) no tax is deductible at source.

3. If we assume that Rio Grande Inc. had purchased listed shares of Vaigai Ltd. (STT paid) and not bonds, the date of purchase and sale remaining the same as given in respect of bonds, the entire capital gains arising on sale of such shares would be -
   (a) Exempt from tax
   (b) taxable@20% with indexation benefit.
   (c) taxable@10% without indexation benefit.
   (d) None of the above.

4. If the liaison office set up in India by Zara Ltd. does not conclude contracts in India but habitually plays the principal role leading to conclusion of service contracts, then, the activities of the liaison office -
   (a) would not constitute business connection for attracting deemed accrual provisions under section 9(1)(i), since it does not actually conclude contracts.
   (b) would not constitute business connection for attracting deemed accrual provisions under section 9(1)(i), since contract is for provision of services by Zara Ltd. and not purchase and sale of goods
   (c) would not constitute business connection due to reasons states in (a) and (b) above
   (d) constitutes business connection for attracting deemed accrual provisions under section 9(1)(i) .

5. What are the provisions which have been incorporated in Indian tax laws in line with BEPS Action 1 (The same must be relevant for A.Y. 2020-21)?
   (a) Expansion of scope of business connection to include activities of an agent who habitually plays a principal role leading to conclusion of contracts
   (b) Expansion of scope of business connection to include activities which constitute significant economic presence
   (c) Introduction of equalization levy
   (d) All the above

DESCRIPTIVE QUESTIONS

1. Compute the total income and tax liability of Rio Grande Inc. for A.Y.2020-21.

2. Would the activities carried out by the liaison office set up in India by Zara Ltd. constitute business connection to attract deemed accrual provisions under section 9(1)?

SOLUTIONS – CASE STUDY 25

I. ANSWERS TO MCQs

MCQ No.	Answer
1.	(b)
2.	(d)
3.	(d)
4.	(d)
5.	(c)

II. ANSWERS TO DESCRIPTIVE QUESTIONS

Answer to Q.1

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

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

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

Particulars	₹
Tax@5% on interest of ₹ 4,70,000 received from an Indian company on investment in rupee denominated bonds = 5% x ₹ 4,70,000	23,500
Tax@20% on interest on securities of ₹ 15,48,000 =20% x ₹ 15,48,000	3,09,600

Tax@10% on long-term capital gains on sale of bonds of Vaigai Ltd. = 10% x ₹29,00,000	2,90,000
Tax@15% on short-term capital gains on sale of listed equity shares of Mahanadi Ltd., in respect of which STT has been paid = 15% of ₹ 8,50,000	1,27,500
Tax@30% on short-term capital gains on sale of unlisted equity shares of Godavari Ltd. = 30% of ₹ 5,15,000	1,54,500
	9,05,100
Add: HEC@4%	36,204
Tax Liability	**9,41,304**
Tax Liability (rounded off)	9,41,300

Answer to Q.2

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

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

CASE STUDY – 26

Safe advisors LLP is a firm of Chartered Accountants at Mumbai. You are the tax partner of the firm. All the facts require resolution with reference to the provisions applicable for the assessment year 2020-21.

Sale of shares of foreign company outside India

Tiger Co Ltd, UK has no PE in India. It has 50% shareholding in Lion Co Ltd, UK who has branches in India. Tiger Co Ltd sold 10% of the shareholding in Lion Co Ltd to Deer Co Ltd also located in UK for ₹ 20 lakhs on 20.07.2019. The 50% shareholding in Lion Co. Ltd. acquired by Tiger Co Ltd for ₹ 50 lakhs on 27.01.2012.

The details of the assets and liabilities of Lion Co Ltd are as under:

	UK		India	
	31.03.2019	31.03.2020	31.03.2019	31.03.2020
	₹ in lakhs			
Fair market value of assets	3,000	8,000	15,000	20,000
Liabilities	2,000	5,000	6,000	8,000

There was no change in the book value of assets of Lion Co Ltd during the year 2019-20. Tiger Co Ltd adopts a year ending on 30 June of each year for the purposes of tax and financial reporting, while Lion Co Ltd adopts a period ending on 31 March.

The telegraphic transfer buying rates are as under:

27.01.2012: 1 £ = ₹ 50;	30.06.2019: 1£ =₹ 78;	20.07.2019: 1£= ₹ 80;
31.03.2019: 1 £ = 75;	31.03.2020: 1£=₹ 90	

Cost inflation index F.Y. 2011-12: 184 and F.Y. 2019-20: 289.

Advance Ruling sought by Resident as regards tax liability of itself and non-resident.

The branch of Deer Co Ltd, UK has carried out some transactions with Lotus Co Ltd, Bengaluru in the financial year 2018-19. The value of the transaction exceeds ₹ 600 crores. The branch of Deer Co Ltd. filed its return of income for the assessment year 2019-20 in September, 2019. Lotus Co Ltd. applied for advance ruling in January, 2020 to know exactly the tax consequences of its transactions with the non-resident Deer Co Ltd., UK, both for itself and on non-resident.

The branch of Deer Co Ltd was informed of the advance ruling application filed by Lotus Co Ltd for achieving clarity by both the parties. The branch of Deer Co Ltd. on its part informed the Assessing Officer the fact of the application filed by Lotus Co Ltd before the Authority for Advance Rulings (AAR). The Assessing Officer selected the return of Deer Co Ltd for scrutiny and issued a notice under section 143(2) in March, 2020. Lotus Co Ltd and Deer Co Ltd are not associated enterprises.

Lotus Co Ltd exported goods to its associated enterprise Douglas LLC of Norway during the financial year 2019-20. Lotus Co Ltd and Douglas LLC of Norway find that some of the items of income are taxed arbitrarily and wish to apply for Mutual Agreement Procedure (MAP).

Sale of goods to customers in India by foreign company.

Deer Co Ltd who has a branch in India, during the financial year 2019-20, sold 1,00,000 units of its product to its branch ₹ 5,000 per unit. The same identical units were sold to unrelated parties ₹ 6,000 per unit. From July, 2019, Deer Co Ltd also began supplying the goods directly to customers throughout the world and during the financial year 2019-20, it sold 20,000 units to customers in India at ₹ 7 ,000 per unit. The Assessing Officer wants to tax the income earned on

direct sale of goods by Deer Co Ltd in India in the assessment of its branch.

The branch of Deer Co Ltd has following incomes for the year ended 31.03.2020. (i) Commission income from head office ₹ 2,50,000; (ii) Interest paid to head· office ₹ 5,00,000 on money advanced by the head office to the branch;(iii) Royalty paid to head office, ₹ 1,10,000; (iv) Dividend from Indian companies, ₹ 1,50,000; and (v) Income from business (after deducting I including items (i) to (iv) above), ₹ 18,00,000.

Douglas LLC of Norway wishes to establish an eligible investment fund in Singapore and appoint a fund manager in India. For the year ended 31.03.2019, listed companies in India declared dividend in August, 2019 and Douglas LLC received ₹ 15,20,000 by way of dividend.

Issues in advance pricing agreement.

Lotus Co Ltd is also engaged in export of goods to its associated enterprise located in Durban, South Africa. Its turnover exceeded ₹ 200 crores in 5 years including financial year 2019-20. It anticipates that its annual turnover would exceed ₹ 500 crores for the next 5 years commencing from 01.04.2020. It proposes to apply for advance pricing agreement and avail the benefit of roll back.

Choose the correct alternative for the following MCQs:

1. What would be the total income of the Indian branch of Deer Co Ltd as per the applicable article of UN model (ignore DTAA between India and UK). Also, before considering ALP in respect of transactions with associated enterprises.
   (A) ₹ 7,90,000
   (B) ₹ 20,10,000
   (C) ₹ 13,10,000
   (D) ₹ 22,90,000

2. In determining the ALP of transactions between Lotus Co Ltd. and its associated enterprise in South Africa, which of the following comparability adjustments cannot be made?
   (A) Risk Adjustment
   (B) Accounting Adjustment
   (C) Adjustment for Control Premium
   (D) Adjustment for Capacity Utilisation

3. Mutual Agreement procedure opted/contemplated by Lotus Co Ltd and Douglas LLC of Norway is meant for providing relief -
   (A) from economic double taxation of income
   (B) from juridical double taxation of income.
   (C) from multiple interpretation of tax treaties.
   (D) from penalties in international transactions.

4. What is the minimum number of members to satisfy the condition of eligible investment fund contemplated by Douglas LLC in Singapore so that the fund management activity through the fund manager in India would not constitute business connection in India?
   (A) 200
   (B) 100
   (C) 50
   (D) 25

5. What is the tax liability on the dividend income in the case of Douglas LLC of Norway for the assessment year 2020-21 on the assumption that dividend is its only source of income in India?
   (A) ₹ 54,080
   (B) ₹ 1,58,080
   (C) Nil

(D) ₹ 6,20,160

You are required to answer the following issues:

1. Compute the capital gain taxable in the hands of Tiger Co Ltd on sale of shares of Lion Co Ltd. In case no capital gain is taxable in India, give reasons to supportyour answer.

2. Can the Assessing Officer complete the assessment of the branch of Deer Co Ltd, UK ignoring the application filed by the Lotus Co Ltd before AAR?

   What would be your advice to the Assessing Officer as regards completion of assessment of the branch of Deer Co Ltd located in India?

3. Is the action of the Assessing Officer in taxing the profits of Deer Co Ltd by direct sale of goods to customers in India, from UK, taxable along with the profits of its branch located in India valid? Note: You must decide the validity of action of the Assessing Officer as per UN Model of DTAA. [Ignore DTAA between India and UK].

4. Advise Lotus Co Ltd as regards (a) pre-filing consultation; (b) amount of fee to be paid for filing APA application; (c) time limit for filing APA application; (d) possibility of making amendments after the application has been filed; and (e) applicability of roll back provisions.

SOLUTIONS – CASE STUDY 26

I. ANSWERS TO MCQs

MCQ No.	Answer
1.	(b)
2.	(c)
3.	(a)
4.	(d)
5.	(c)

II. ANSWERS TO DESCRIPTIVE QUESTIONS

Answer to Q. 1

Capital gain arising in the hands of Tiger Co Ltd. from transfer of a capital asset situated in India is deemed to accrue in India. Shares of Lion Co Ltd., a foreign company, shall be deemed to be situated in India if the share derives directly or indirectly, its value substantially from assets located in India i.e., if on the specified date 31.3.2019, the value of Indian assets -

- exceeds ₹ 10 crore; and
- represents at least 50% of the value of all the assets owned by the company

Shares of Lion Co. Ltd. derives its value substantially from assets located in India since the value of assets located in India (without reduction of liabilities) on the specified date i.e., ₹15,000 lakhs,

- exceeds ₹10 crores and
- represents 83.33% of the value of assets of Lion Co. Ltd. [₹15,000 / ₹18,000 x 100].

Note: In the instant case, specified date would be 31.3.2019 since book value of the assets of Lion Co. Ltd. on the date of transfer i.e., 20.7.2019 is the same as the book value of the assets as on the last balance sheet date preceding the date of transfer i.e., 31.3.2019. Only if the book value of assets on the date of transfer, i.e., 20.7.2019 exceed the book value of assets as on 31.3.2019 by at least 15%, would the specified date be the date of transfer.

Computation of capital gain chargeable to tax in the hands of Tiger Co. Ltd.	
Particulars	**Amount (in Lakhs)**
Full value of consideration for transfer of shares of Lion Co. Ltd.	£ 20
Less: Cost of acquisition of shares of Lion Co. Ltd. (£ 50 lakhs/50% x 10%)	£ 10
Long term capital gains [Since the shares of Lion Co. Ltd. have been held for more than 24 months]	£ 10
Long term capital gains in Rupees [£ 10 lakhs x 78 being the TTBR on 30.06.2019 as per rule 115 – **See Note 1 below**] **[A]**	780
Fair Market value of assets of Lion Co. Ltd. located in India on 31.3.2019 **[B]**	15,000
Fair Market value of all assets of Lion Co. Ltd. on 31.3.2019 **[C]**	18,000
Long term capital gains attributed to assets located in India [A x B/C]	**650**

Notes –

(1) Rule 115(1)(f) states that in respect of income chargeable under the head "Capital gains", the last day of the month immediately preceding the month in which the capital asset was transferred

is the 'specified date' for adoption of TT buying rate. Hence, the TT buying rate on the specified date i.e. 30.06.2019 is 1 £ = ₹ 78 is adopted.

(2) In the question, it is mentioned that Tiger Co Ltd sold 10% of the shareholding in Lion Co Ltd**.** It may be interpreted to mean that Tiger Co. Ltd has sold 10% shareholding of Lion Co Ltd or 10% of its shareholding which is 50%, in which case it would be 5% shareholding. The above solution has been worked out on the assumption that it has sold 10% shareholding of Lion Co Ltd.

However, it is possible to take a view that Tiger Co. Ltd. has sold 10% of its shareholding. In such a case, cost of acquisition of shares would be £ 5 lakhs being, 10% of £ 50 lakhs. Accordingly, long term capital gain would be £ 15 lakhs [i.e., ₹ 1,170 lakhs (£ 15 lakhs x ₹ 78) in Indian Rupees]. In such a case, long term capital gains attributed to assets located in India would be ₹ 975 lakhs (₹ 1,170 lakhs x 15,000/18,000).

Answer to Q. 2

Section 245RR provides that where a resident applicant has made an application to AAR and referred issues therein for decision of AAR, then, any Income-tax Authority or Tribunal should not take any decision in respect of such issues.

Since Lotus Co Ltd had made the application for advance ruling in respect of tax consequences of transaction between Lotus Co Ltd and branch of Deer Co Ltd, the Assessing Officer cannot take any decision in respect of such issues, even if it relates to the assessment of the branch of Deer Co Ltd (foreign company).

This is because the advance ruling is also binding in respect of the transaction in relation to which the ruling had been sought. Further, it is also binding on the Principal Commissioner or Commissioner and the income-tax authorities subordinate to him, in respect of, inter alia, the transaction.

As per section 245R(6), the Authority for Advance Ruling shall pronounce its advance ruling within 6 months of the receipt of application. The application was filed by Lotus Co Ltd in January, 2020 and the time limit of 6 months would expire in July, 2020.

The time limit for completion of assessment of Deer Co Ltd for the A.Y. 2019-20 (F.Y. 2018-19) under section 143(3) is 30.9.2021. The time limit for completion of assessment would get further extended by the period commencing on the date on which application is made for advance ruling and ending with the date on which the advance ruling is pronounced.

Therefore, the Assessing Officer is advised to wait for the Authority for Advance Ruling to pronounce its ruling and then complete the assessment of branch of Deer Co Ltd. based on the said Ruling.

Answer to Q. 3

The term "permanent establishment" means a fixed place of business through which the business of an enterprise is wholly or partly carried on.

Since Deer Co Ltd has a set up a branch in India, such branch would constitute permanent establishment.

Article 7(1) of UN Model DTAA contains Force of Attraction rule which implies that when a foreign enterprise i.e., Deer Co Ltd sets up a PE in the State of Source i.e., a branch in India, it brings itself within the fiscal jurisdiction of Source State i.e., India, profits which are attributable to -

- that Permanent Establishment
- sale in India of goods of the same or similar kind as those sold through permanent establishment
- other business activities carried on in India of the same or similar kind as those effected through that permanent establishment.

Therefore, the entire profits derived by Deer Co Ltd from sale of its products in India, whether through the PE or not, may be taxed in India. Hence, the action of the Assessing Officer to tax the profits earned on direct sale of goods by Deer Co Ltd in India is **valid**.

Answer to Q. 4

(a) Pre-filing consultation

Lotus Co Ltd has option to make a request, by an application in writing, for a pre - filing consultation in the prescribed form to the Director General of Income-tax (International Taxation).

The pre-filing consultation shall, among other things,-

(i) determine the scope of the agreement;
(ii) identify transfer pricing issues;
(iii) determine the suitability of international transaction for the agreement;
(iv) discuss broad terms of the agreement.

(b) Amount of fee to be paid for filing APA application

Amount of international transaction entered into or proposed to be undertaken in respect of which APA is proposed during the proposed period of APA	**Fee (₹)**
Amount not exceeding ₹ 100 crores	10 lakhs
Amount not exceeding ₹ 200 crores	15 lakhs
Amount exceeding ₹ 200 crores	20 lakhs

(c) Time limit for filing APA application

The application may be filed at any time -

(i) before the first day of the previous year relevant to the first assessment year for which the application is made, in respect of transactions which are of a continuing nature from dealings that are already occurring; or

(ii) before undertaking the transaction in respect of remaining transactions. Accordingly, in this case, the application may be filed before 1.4.2019.

(d) Possibility of making amendments after the application has been filed

An applicant may request in writing for an amendment to an application at any stage, before the finalization of the terms of the agreement.

The amendment would be given effect only if it is accompanied by the additional fees, if any, necessitated by such amendment.

(e) Applicability of roll back provisions

Lotus Co Ltd can apply for rollback provisions for determining the ALP in relation to an international transaction entered into by it for any previous year, falling within the period not exceeding four previous years preceding the first of the five consecutive previous years for which the APA applies in respect of the international transaction to be undertaken provided other conditions are satisfied.

In this case, the roll-back application can be made for the four immediately preceding previous years, P.Y. 2016-17 to P.Y. 2019-20.

CASE STUDY – 27

Ram Process Ltd.

Ram Process Ltd., Chennai, manufactured textile goods and sold the same with brand name 'Vela'. It also manufactured on contract basis for Taylor Inc. of Singapore being its associate enterprise (holding company). Taylor Inc. marketed the goods so manufactured by Ram Process Ltd in its brand name 'Crowe'. The total borrowing of Ram Process Ltd as on 31.03.2019 stood at ₹ 50 crores. Ram Process Ltd entered into a business agreement with Jim Laker LLP of UK in April, 2020 for export of goods to various countries as directed by Jim Laker LLP. The amount of transaction between Ram Process Ltd and Jim Laker LLP by way of sale of goods would be ₹ 180 crores spread over 3 financial years commencing from 01.04.2020. The parties (i.e., both Ram Process Ltd and Jim Laker LLP) apprehend some ambiguity as regards the income chargeable to tax in the hands of Jim Laker LLP in India and Ram Process Ltd. It is decided by the parties that Ram Process Ltd would seek advance ruling to overcome the uncertainty in taxation of its income vis a vis Jim Laker LLP in respect of the transaction contemplated by the parties.

The income-tax assessment of Ram Process Ltd for the assessment year 2019-20 is pending under section 143(3). The Assessing Officer made reference to Transfer Pricing Officer (TPO) in December, 2019. Ram Process Ltd did not furnish information or documents sought by the TPO in respect of the international transactions of the value of ₹ 3.50 crores. Ram Process Ltd has done export turnover exceeding ₹ 100 crores to its associate enterprise in the financial years 2016-17 to 2019-20. The Assessing Officer made reference to TPO for the assessment years 2017-18 and 2018-19. There was upward revision of income by 5% of the sale price for the assessment years 2017-18 and 2018-19 in accordance with the ALP determined by the TPO. The assessee, Ram Process Ltd., is willing to accept the addition of 5% for the assessment year 2019-20 also as there is no change in nature of business or terms of trade made by it with its associate enterprises.

The Assessing Officer has completed the assessment of assessment year 2019-20 by making identical addition of 5% of the export turnover made to associate enterprises as in the preceding assessment years.

Ram Process Ltd. has agricultural land in Country N. There is a DTAA between India and Country N. As per the DTAA, agricultural income earned by any person in India would be exempt from tax in India and whereas Country N may or may not levy tax on agricultural income earned therein based on its domestic law. The agricultural income of Ram Process Ltd. would be dealt with accordingly in Country N.

Botham (P) Ltd.

Botham (P) Ltd of Bengaluru is yet another subsidiary company of Taylor Inc. of Singapore since 2007. From 1st April, 2019 Botham (P) Ltd did back office support service to Taylor Inc. which is engaged in multifarious manufacturing and trading activities. The aggregate international transactions of Botham (P) Ltd always exceeded ₹ 50 crores since the financial year 2015-16. It may be noted that both Botham (P) Ltd and Taylor Inc. were also trading goods by purchasing them from Ram Process Ltd, Chennai.

On 01.10.2019, Botham (P) Ltd entered into an agreement with Somatsu LLC of Tokyo, Japan who is engaged in providing online advertisement service. As per the agreement, Botham (P) Ltd has to pay ₹ 90,000 per month to Somatsu LLC for online advertisement facility after deducting the amounts as per the applicable legal provisions. It paid the monthly fee up to January, 2020 in one lump sum on 05.02.2020. The balance monthly amounts were credited to Somatsu LLC and

debited to expenditure on 31.03.2020 with equalization levy payable shown as liability. The entire amount payable by way of equalization levy was remitted on 10.11.2020.

Botham (P) Ltd borrowed ₹ 60 crores from its associate enterprise Arnold Ltd of Switzerland on 01.05.2019. Interest is payable on such loan @ 9% per annum. The total income of Botham (P) Ltd for the financial year 2019-20 was ₹ 305 lakhs after deduction of interest payable to Arnold Ltd but before deducting depreciation and taxes. The above said borrowing is the only borrowing of Botham (P) Ltd. Tax was deducted at source on the interest paid I payable within the prescribed time.

Gopal Shanna

Shri. Gopal Sharma a software engineer born and brought up in India went to United States on 10th April, 2001 for the purpose of employment. He acquired a property in USA in July, 1999. He commenced business in USA in April, 2006. He closed his business in USA and returned to India permanently on 10th April, 2016 and became Managing Director of Ram Process Ltd at Chennai. He never visited India from April, 2001 to March, 2017. The property in USA was let out by Gopal Sharma fetching rental income of US $ 30,000 per annum from 1st April, 2017. The entire annual rent was received in advance in April, 2017 and April, 2018 respectively. He has not disclosed the rental income in his Income-tax returns of the assessment years 2018-19 and 2019-20. The Deputy Director of Income tax launched prosecution proceedings against Gopal Sharma under the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015. The exchange rates are given below:

Date	Exchange rate of Rupee per US Dollar
31.03.2017	60
31.03.2018	66
31.12.2018	67
31.03.2019	68
31.12.2019	69
31.03.2020	70

Choose the correct alternative for the following MCQs:

1. Which method would be the most appropriate method for determination of arm's length price for contract manufacturing carried out by Ram Process Ltd for Taylor Inc.?
   (A) Transactional Net Margin Method
   (B) Profit Split Method
   (C) Cost Plus Method
   (D) Comparable Uncontrolled Price Method

2. What is the latest date for Botham (P) Ltd to remit equalization levy for allowance of deduction of the amount paid and I or payable to Somatsu LLC?
   (A) Latest date 31.03.2020
   (B) Latest date 31.07.2020
   (C) Latest date 30.09.2020
   (D) Latest date 30.11.2020

3. How much of the amount of interest paid by Botham (P) Ltd to Arnold Ltd is liable for disallowance for the assessment year 2020-21?
   (A) Nil
   (B) ₹ 4.95 crores
   (C) ₹ 2.55 crores
   (D) ₹ 4.035 crores

4. The DTAA provisions providing exemption for agricultural income in one country and providing option to the other State for taxing or exempting the same such as Ram Process Ltd having agricultural income in Country 'N' being taxable or exempt in that State is known as -
   (A) Mutual agreement procedure
   (B) Anti-fragmentation rule
   (C) Distributive rule
   (D) Limitation of Benefit Clause

5. What must be the minimum value of the transaction between Ram Process Ltd and Jim Laker LLP in order to allow the resident taxpayer to seek advance ruling in respect of its tax liability? How much is the amount of fee to be paid for seeking advance ruling?
   (A) It cannot seek AAR as regards the liability of non-resident taxpayer. The question of paying fees does not arise.
   (B) Minimum value of transaction ₹ 100 crores/amount of fee ₹ 5,00,000
   (C) Minimum value of transaction ₹ 200 crores/amount of fee ₹ 10,00,000
   (D) Minimum value of transaction exceeding ₹ 500 crores/amount of fee ₹ 25,00,000.

You are required to answer the following issues:

1. What are the tax implications of Ram Process Ltd. agreeing to accept the adjustment made by the Assessing Officer to the transaction price? Are there any penalty implications on Ram Process Ltd.? Is there any way for Ram Process Ltd. to avoid repetitive transfer pricing litigation in respect of its transactions with AEs?

2. What would be the tax consequence in the case of Botham (P) Ltd for the payments made to Somatsu LLC, if there is a branch of Somatsu LLC at Delhi?

3. Compute income from property of Shri. Gopal Sharma for the assessment years 2018-19 and 2019-20 and decide the validity of the initiation prosecution proceedings against him under the Black Money Act, 2015 by the Deputy Director of Income-tax. Will it make any difference as regards prosecution proceedings if the assessee Shri Gopal Sharma had filed revised returns voluntarily?

SOLUTIONS – CASE STUDY 27

I. ANSWERS TO MCQs

MCQ No.	Answer
1.	(a) or (c)
2.	(d)
3.	(c)
4.	(c)
5.	(b)

II. ANSWERS TO DESCRIPTIVE QUESTIONS

Answer to Q. 1

In this case, the primary adjustment is to the tune of ₹ 5 crores or more (i.e., 5% of ₹ 100 crores or more). Since the primary adjustment exceeds ₹ 1 crore and it relates to A.Y. 2019-20, Ram Process Ltd. has to make a secondary adjustment in its books of account. The secondary adjustment is required to be made for A.Y. 2018-19 also. However, no such adjustment is required for A.Y. 2017-18.

The excess money of ₹ 5 crores or more has to be repatriated within 90 days from the date of order of the Assessing Officer, since the adjustment was made by the Assessing Officer and accepted by the company.

If it is not so repatriated within the above time limit, the excess money would be deemed as advance to the associated enterprise and interest would be computed at the one year marginal cost of fund lending rate of SBI as on 1st April of the relevant previous year + 3.25%, since the international transaction is denominated in Indian rupee.

Penalty@2% of the value of the international transaction would be attracted under section 271G for failure to furnish information and document as required by the TPO. The amount of penalty would be ₹ 7 lakhs (2% of ₹3.5 crores)

In order to avoid repetitive transfer pricing litigation in respect of its transaction with Associated Enterprises, Ram Process Ltd. can apply for unilateral or bilateral advance pricing agreement by paying the requisite fee.

Note - In this case, the Assessing Officer has made a reference to the TPO in December, 2019. However, he has completed the assessment adding 5% (based on the revision made by TPO in the earlier assessment years), without waiting for the order of the TPO for the current year. The Assessing Officer's action is not correct since section 92CA(4) requires that the total income of the assessee has to be computed in conformity with the ALP determined by the TPO.

Answer to Q. 2

If Somatsu LLC has a branch at Delhi, equalization levy@6% would not be attracted on the amount paid or credited by Botham (P) Ltd. to Somatsu LLC for online advertisement service, since such levy is attracted only where such payment is made to a non-resident not having a permanent establishment in India.

A branch at Delhi constitutes a permanent establishment in India, and it is assumed that the

services are effectively connected with the permanent establishment.

Therefore, Botham (P) Ltd. would not be required to deduct equalization levy at the time of credit or payment to Somatsu LLC for online advertisement service, if Somatsu LLC had a branch in Delhi.

However, tax has to be deducted by Botham (P) Ltd. at the rates in force under section 195 at the time of credit of ₹ 90,000 per month to the account of Somatsu LLC or at the time of payment, whichever is earlier.

The rate of tax deduction shall be @40% (plus surcharge, as applicable, and HEC@4%) on the payments made or amounts credited to Somatsu LLC (as per Part II of The First Schedule to the Finance Act, 2019)

Non-deduction of tax at source under section 195 would attract disallowance under section 40(a)(i) of 100% of amount credited/paid while computing income under the head "Profits and gains of business or profession".

However, if Botham Ltd has deducted tax at source on or before 31.03.2020, it has time limit for remitting the tax deducted at source up to the 'due date' (i.e. 30.11.2020) for filing the return specified in section 139(1), for not attracting disallowance under section 40(a)(i).

Answer to Q. 3

Mr. Gopal Sharma returned to India on 10.4.2017. The question states that he never visited India from April, 2001 to March, 2017.

Mr. Gopal Sharma is resident for A.Y.2018-19 and A.Y. 2019-20, since his stay in India in the P.Y. 2017-18 and P.Y.2018-19 is 182 days or more [356 days in the P.Y. 2017-18 and 365 days in the P.Y. 2018-19].

For being resident and ordinarily resident in any previous year, he would have to satisfy both the following conditions -

(i) He should be resident in any 2 out of 10 preceding previous years; and
(ii) His total stay in the last 7 years preceding the relevant previous year is 730 days or more.

Mr. Gopal Sharma has been non-resident from A.Y. 2002-03 to A.Y. 2017-18, since he has not visited India during the previous years 2001-02 to 2016-17. Hence, he does not satisfy condition (i) [i.e., being resident in India in 2 out of 10 preceding years], for either A.Y. 2018-19 or A.Y. 2019-20. Therefore, he would be resident but not ordinarily resident for both A.Y. 2018-19 and A.Y. 2019-20.

In case of a resident but not ordinarily resident, income from a source outside India would not be taxable in India except where it is derived from a business controlled in or profession set up in India.

Accordingly, income from house property in USA would not be taxable in India in the hands of Mr. Gopal Sharma for A.Y. 2018-19 and A.Y. 2019-20. Since the income is denominated in foreign currency, it is logical to assume that the same is received outside India.

Therefore, the prosecution proceedings initiated against Gopal Sharma for non-disclosure of rental income in the income-tax returns of A.Y. 2018-19 and A.Y. 2019-20 are not valid, since such income is not taxable in his hands in India. Furthermore, Gopal Sharma is a resident but not ordinarily resident in India for A.Y. 2018-19 and A.Y. 2019-20, and hence, prosecution proceedings under the Black Money Act cannot be launched against him, even if he has any undisclosed income for those years.

There is no need to file revised returns, as Gopal Sharma has not made any mistake in his original return.

CASE STUDY – 28

Ratan Co Ltd.

Ratan Co Ltd., Mumbai is engaged in manufacture of medicines, textiles and automobile parts. It has total borrowing of ₹ 50 crores by way of loan as on 31.03.2020. It entered into .an agreement with Tikosha LLC of Japan for digital advertising space for online advertisement of its products. The amount payable to Tikosha LLC as per agreement is ₹ 2,12,000 and it was paid on 10.03.2020. In yet another transaction with Geneva LLC, UK, Ratan Co Ltd did not depos it equalization levy amount of ₹ 36,000 before the prescribed date and the delay was of 30 days.

Ratan Co Ltd has a subsidiary by name Knowledge Source (P) Ltd at Chennai which provided predominantly knowledge process outsourcing services (KPO) to its associate enterprise Walters Inc. of USA. For the year ended 31.03.2020, it declared operating profit of ₹ 33 crores out of aggregate gross receipts of ₹ 183 crores and operating expense of ₹ 150 crores. It incurred expenditure towards employees as under: (i) Salaries ₹ 50 crores; (ii) Bonus ₹ 12 crores; (iii) staff welfare expenses ₹ 2 crores; and (iv) staff training expenses ₹ 1 crore.

Clinch Inc. advanced USD 10 million on 1.06.2019 to Knowledge Source (P) Ltd in foreign currency. Knowledge Source (P) Ltd accepted the loan amount after taking permission from appropriate government authorities in India. The loan is eligible for interest@9% per annum payable in foreign currency. For the financial year 2019-20, Knowledge Source (P) Ltd paid interest after deducting income-tax on 31.03.2020. The TT buying rates on various dates are 01.06.2019 one USD= ₹ 69; on 31.03.2020 one USD = ₹ 70.

Shri Anand Bhargava having 15% shareholding in Knowledge Source (P) Ltd is employed as a crew in an Indian ship as per section 3(18) of the Merchant Shipping Act, 1958. His voyage details show that the date of joining the ship was entered in the Continuous Discharge Certificate (CDC) as 1.11.2018 and the date of signing off in the CDC as 03.05.2019. He remained in India before he flew by air to Colombo, Sri Lanka on 31.10.2019 and joined as crew of the ship again on 02.12.2019 at Colombo port which was the date of entry recorded in the CDC. He received salary income of ₹ 15 lakhs for the financial year 2019-20. He has remained in India for more than 500 days in 4 previous years preceding the previous year 2019-20. Assume that he was on 'eligible voyage' during the previous year 2019-20.

Mary Mark LLP

Mary Mark LLP of Singapore imported textile goods from Ratan Co. Ltd. in the form of finished goods and acted as distributor in Singapore. Ratan Co. Ltd. sold 10 lakh units @ ₹ 1000 per unit to Mary Mark LLP and sold similar goods to other dealers in Singapore @ ₹ 1,100 per unit. Ratan Co. Ltd. received bank guarantee on 01.04.2019 for availing cash credit limit of ₹ 8 crores for which Mary Mark LLP was the guarantor. The proposal helped Ratan Co Ltd to avail bank facility with interest@7.5% per annum which otherwise would have cost@10% per annum. The terms of trade for other dealers was to make payment within 1 month from the date of sale of goods by Ratan Co Ltd and whereas for Mary Mark LLP, the credit period allowed was 3 months from the date of sale of goods. The cost of capital may be taken as 12% per annum and supply of goods as uniform throughout the year.

Proceedings against non-resident under Black Money Act

Ravinder, an ex-director of Ratan Co Ltd was doing individually some business at Delhi. He left India and settled in United Kingdom from 10.04.2015. He had never left India previously since April, 2007. He acquired a property in his name in the financial year 2012-13 at Malaysia by

under-invoicing his export sale bills for ₹ 200 lakhs. The Assessing Officer came to know of this in March, 2020 based on the investigation made by Enforcement Directorate in some other person's case.

The Assessing Officer having received some concrete evidences against Ravinder issued a notice under section 10 of the Black Money and Imposition Act of 2015 on 27.03.2020. The assessee's counsel contended that since the assessee is not a resident in the financial year 2019-20, a notice under section 10 could not be issued to him.

Zing Zong LLC, Japan

Zing Zong LLC, Japan entered into an agreement for executing a turnkey project for setting up a power plant in India for Ratan Co Ltd. The consideration was US dollar 150 million which could be proceeded with through a term loan given by SBI. The payment was split as per separate agreements in the following manner:

(i) US dollar 15 million for design of power plant outside India (which is taxable as per applicable presumptive provision)

(ii) US dollar 100 million for offshore supplies of equipments and spares. (No role was played by the PE in India of Zing Zong LLC).

(iii) US dollar 35 million for local supplies to be sourced in India and towards installation charges in India, for the project. Assume it is taxable on net income basis.

The fair market value of offshore design is US dollar 25 million. The offshore supplies were over-invoiced by equal amount.

Zing Zong LLC has a branch in India from 01.01.2018. It follows calendar year as accounting year. The annual turnover of the Indian branch always exceeded ₹ 100 crores. The consolidated group revenue of Zing Zong LLC on the various dates are (i) 31.12.2018 US dollar 7000 million; (ii) 31.03.2019 US dollar 7700 million; (iii) 31.12.2019 US dollar 12000 million; (iv) 31.03.2020 US dollar 12200 million. The Telegraphic Transfer (TT) buying rates are 31.03.2018 $ 66; 31.12.2018 $ 67; 31.03.2019 $ 68; 31.12.2019 $ 69; and 31.03.2020 $ 70. The Indian branch is the alternate reporting entity of the international group.

Choose the correct alternative for the following MCQs:

1. When does the consolidated group revenue of Zing Zong LLC exceed the threshold limit for CBC reporting and state the 'due date' for filing such report?
   (A) 31.03.2019 I group revenue ₹ 5,236 crores I CbC reporting not required,
   (B) 31.12.2018 I group revenue ₹ 4,690 crores I CbC reporting not required.
   (C) 31.12.2019 I group revenue ₹ 8,280 crores I CbC report due date 31.12.2020.
   (D) 31.03.2020 I group revenue ₹ 8,296 crores I CbC report due date 31.03.2021.

2. What is the income-tax liability of Clinch Inc. in India for the assessment year 2020-21 in respect of interest income earned in foreign currency from Knowledge Source (P) Ltd?
   (A) Nil, exempt income
   (B) ₹ 109.7928 lakhs
   (C) ₹ 111.384 lakhs
   (D) ₹ 222.768 lakhs

3. How much Ratan Co Ltd must pay towards equalization levy for the online advertisement space provided by Tikosha LLC, Japan and what is the 'due date' for payment of equalization levy?
   (A) ₹ 12,000 I 07.04.2020
   (B) ₹ 12,720 I 07.04.2020
   (C) ₹ 63,600 I 30.09.2020

(D) ₹ 21,200 I 31.07.2020

4. How much is the amount of penalty payable by Ratan Co Ltd for the delayed remittance of equalization levy in respect of the transaction with Geneva LLC and how much of the expenditure would be disallowed for non-remittance?
   (A) Penalty₹ 30,000 I Disallowance₹ 6,00,000
   (B) Penalty₹ 30,000 I Disallowance 'Nil'
   (C) Penalty ₹ 30,000 I Disallowance ₹ 1,80,000
   (D) Penalty ₹ 36,000 I Disallowance ₹ 6,00,000

5. Decide whether Knowledge Source (P) Ltd can opt for safe harbour rules based on any of the reasons given below -
   (A) Can claim the benefit of safe harbour rules as the aggregate value of international transaction does not exceed ₹ 200 crores.
   (B) Ineligible as the operating profit margin is less than 24% and employee cost is less than 60% of operating expense.
   (C) Eligible as the operating profit margin is more than 18% of the operating expenses and employee cost is less than 60%.
   (D) Eligible as the operating profit is more than 21% and employee cost is more than 40% but less than 60% of the operating expenses.

You are required to answer the following issues:

1. Determine if Ratan Co. Ltd. and Mary Mark LLP are associated enterprises. I f they are associated enterprises, compute the ALP of the transaction between them and quantify the amount to be added to the income of Ratan Co. Ltd, if any, by way of an ALP adjustment.

2. Determine the residential status of Shri Anand Bhargava and the taxability of his salary income earned in the previous year 2019-20.

3. Is the issue of notice on Ravinder under section 10 of the Black Money Act, 2015 tenable in law?

4. Does the arrangement between Zing Zong LLC, Japan and Ratan Co Ltd, Mumbai attract GAAR provisions? If not, will the ·provisions of transfer pricing apply for determination of arm's length price?

SOLUTIONS – CASE STUDY 28

I. ANSWERS TO MCQs

MCQ No.	Answer
1.	
2.	(c)
3.	(b)
4.	(b)
5.	(a) or (d)

II. ANSWERS TO DESCRIPTIVE QUESTIONS

Answer to Q. 1

Ratan Co. Ltd. received bank guarantee from Mary Mark LLP for availing cash credit of ₹ 8 crores. Ratan Co. Ltd. has total borrowings of ₹ 50 crores. Since Mary Mark LLC guarantees 16% (8/50 crores) of the total borrowings of Ratan Co. Ltd., which is 10% or more of the total borrowings, Ratan Co. Ltd. and Mary Mark LLP would be deemed as associated enterprise by virtue of the section 92A(2)(d).

Computation of Arm's Length Price

Particulars	₹
Sale price charged to other dealers in Singapore (per unit)	1,100
Add: Cost of credit for 2 months which is not included in the price charged to other dealers [₹1100 x 12% x 2/12]	22
Arm's length price	**1,122**
Less: Actual sale price to Mary Mark LLP	1,000
Difference per unit	**122**
No. of units sold to Mary Mark LLP 10,00,000	
Addition required to be made in the computation of total income of Ratan Co. Ltd. [10,00,000 x ₹122]	12,20,00,000

Note - Bank guarantee given by the non-resident associated enterprise has no bearing on determination of ALP. Hence, the same is not to be considered for determination of arm's length price**.**

Answer to Q. 2

An Indian citizen, who leaves India during the previous year as a member of the crew of an Indian ship, will be treated as resident in India only if the period of his stay during the relevant previous year is 182 days or more.

In case of an individual, being a citizen of India and a member of the crew of a ship, period of stay in India, in respect of an eligible voyage, shall **not** include the period commencing from the date of entry into the Continuous Discharge Certificate in respect of joining the ship by the said individual for the eligible voyage and ending on the date entered into the Continuous Discharge Certificate in respect of signing off by that individual from the ship in respect of such voyage.

In the present case, Shri Anand Bhargava stayed in India for 181 days i.e., from 4.5.2019 to 31.10.2019 (period from 1.4.2019 to 3.5.2019 and period from 1.11.2019 to 31.3.2020 are to be excluded) during the previous year 2019-20. He has stayed for 181 days during the previous year 2019-20 i.e., 28+30+31+31+30+31 = 181 days.

Thus, he would be non-resident in India for the previous year 2019-20.

By virtue of section 5(2), in case of a non-resident, income received or deemed to be received in India and income which accrues or arises or is deemed to accrue or arise in India would be chargeable to tax in India.

Accordingly, if salary income of ₹ 15,00,000 is received in India, the same would be chargeable to tax in India in his hands for A.Y. 2020-21. If the same is received outside India, it would not be subjected to tax in his hands in India.

Answer to Q. 3

Every assessee would be liable to tax@30% in respect of his undisclosed foreign income and asset of the previous year. Undisclosed foreign asset would be liable to tax in the previous year in which such asset comes to the notice of the Assessing Officer.

Section 2(2) of the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 defines "assessee" as a person, being a resident other than not ordinarily resident in India within the meaning of section 6(6) of the Income-tax Act, 1961, by whom tax in respect of undisclosed foreign income and assets, or any other sum of money, is payable under this Act.

Since Mr. Ravinder left India and settled in United Kingdom from 10.4.2015 and not visited India at any time thereafter, he would be non-resident in India in the previous year 2019-20 in which notice is issued.

The Finance (No. 2) Act, 2019 has amended the definition of 'assessee' under section 2(2) with retrospective effect from 01.07.2015, to include a person -

(a) being a resident in India within the meaning of section 6 of the Income-tax Act, 1961 in the previous year; or

(b) being a non-resident or not ordinarily resident in India within the meaning of section 6(6) of the Income-tax Act, 1961 in the previous year, who was resident in India either in the previous year to which the income referred to in section 4 relates; or in the previous year in which the undisclosed asset located outside India was acquired.

Accordingly, the issue of notice on Mr. Ravinder under section 10 of the Black Money Act, 2015, is tenable in law, since in the financial year 2012-13 when the property was acquired at Malaysia, he was resident and ordinarily resident in India by virtue of section 6(6) of the Income-tax Act, 1961.

Answer to Q. 4

In the present case, design of power plant outside India would be chargeable to tax as per the applicable presumptive provision i.e., section 44BBB. The price of this component is under invoiced by US dollar 10 million [i.e., US dollar 25 million, being the fair market value - US dollar 15 million, being the payment as per the agreement]. To the same extent, the price of offshore supplies for equipments and spares, which is not chargeable to tax in India, is over-priced by US dollar 10 million [i.e., US dollar 100 million (-) US dollar 90 million].

The allocation of price to different parts of the contract has been decided in such a manner as to reduce tax liability of Zing Zong LLC in India. Both conditions for declaring an arrangement as impermissible are satisfied.

(1) The main purpose of this arrangement is to obtain tax benefit; and

(2) The transactions are not at arm's length.

Consequently, GAAR may be invoked and prices would be reallocated.

Transfer pricing provisions for determination of ALP would not be applicable, since Zing Zong LLC and Ratan Co. Ltd. are not associated enterprises, even in case it is assumed that GAAR cannot be invoked.

CASE STUDY – 29

Sprint Group Inc

Sprint Group Inc ('SOI') is a diversified US based multinational enterprise, operating worldwide through various subsidiaries and joint ventures, engaged in variety of businesses and ventures, having consolidated turnover exceeding INR 5,500 crores in recent past three years. For FY 2019-20, corresponding to AY 2020-21, some of the entities within Sprint Group had the following transactions having potential income tax implications:

1. Product Distribution transactions of UK Ltd.

UK Ltd, a subsidiary of SOI, incorporated and tax resident of UK, manufactures and sells engineering machines. These machines are sold in UK by UK Ltd and outside UK through its Associate Enterprises who act as distributors of UK Ltd. UK Ltd. designs and manufactures its machines country-wise. Machines designed for Country X are different from machines designed for Country Y.

INITO Private Limited ('INITO) is another subsidiary of SOI incorporated in and tax resident of India; functioning in India as the distributor of the machines of UK Ltd. INITO promotes and sells UK Ltd.'s machines in India. INITO purchases machines from UK Ltd and resells them to unrelated customers in India. INITO has adequate financial and operating resources of its own to undertake such distribution and sales activities and has been doing these activities for past 10 years not only for UK Ltd but also for other unrelated international engineering machines manufacturers.

In FY 2019-20, the purchases and sales of INITO are tabulated below:

Sr. No.	Particulars	Qty	Price/unit (INR)	Value (INR in crores)
	Purchase Details			
(i)	Machine purchases from UK Ltd.	5,000	40,000	20.00
(ii)	Machine purchases from unrelated manufacturer 'A Inc.' of USA	4,000	25,000	10.00
(iii)	Machine purchases from unrelated manufacturer 'B Ltd' based in Japan	2,000	30,000	6.00
	Sales Details:			
(i)	Sales of machines purchased from UK Ltd.	5,000	46,000	23.00
(ii)	Sales of machines purchased from 'A Inc.'	4,000	27,500	11.00
(iii)	Sales of machines purchased from 'B' Ltd.'	2,000	36,000	7.20

UK Ltd sells similar machines to its associate enterprise 'SL Ltd' in Srilanka at the per unit price of INR 35,000 for distribution and· resale in the Sri Lankan market. Other terms and conditions of sale of machines by UK Ltd to INITO and SL Ltd are same.

An overview of the Functions, Assets and Risk ('FAR') analysis of INITO's transactions with UK Ltd, A Inc., and B Ltd (the manufacturers) is tabulated below:

FAR of INITO

Type of entity	Functions	Assets	Risks

Distributor	- Budgeting - Administration - Purchasing - Inventory management - Logistics - Marketing - Sales - Customer support	- Storage/ Warehouse - Office equipment· - Land & Building - Vehicles	- Business risk - Inventory risk - Credit & collection risk - Foreign exchange fluctuation risk

FAR of UK Ltd, A Inc., and B Ltd -

Type of entity	Functions	Assets	Risks
Manufacturer	- Budgeting - Administration - Product strategy & design - R&D - Procurement of raw materials - Product manufacturing - Quality control - Inventory management - Logistics - Sales &. Marketing - Customer support	- Intangibles - Patents, technical knowhow, trademarks, etc. - Plant & Machine - Storage/ Warehouse - Office equipment - Land & Building - Vehicles	- Business risk - Inventory risk - Scheduling risk - Product liability risk - credit and collection risk - Foreign exchange fluctuation risk

In respect of similar machine purchase transactions with UK Ltd, Transfer Pricing Officer ('TPO') has made transfer pricing adjustment of INR 2.5 crores for AY 2015-16, in the hands of INITO by determining the ALP purchase price of machine at lower price of INR 35,000 per machine.

2. External Commercial Borrowing Transaction :

For selling UK Ltd.'s machines in neighbouring Country 'X', INITO established a branch office in Country X, following the due procedure under FEMA, 1999. INITO purchases machines meant for Country X from UK Ltd and transfers such machines to its Country X branch office for sale to unrelated customers in Country X.

Country X branch office maintains its own books of accounts and pays due Income tax in Country X as per tax laws of Country X. Country X and India do not have a Double Taxation Avoidance Agreement.

For financing the Country X branch operations, INITO borrowed INR 10 crores from SOI, USA at 9% p.a. An interest of INR 90 lacs is required to be paid to SOI, USA by INITO in this respect. The loan amount was remitted by SGI, USA to INITO, who in tum, immediately transferred the money to bank account of Country X branch office outside India.

3. Allegation of UK Ltd.'s Permanent Establishment in India.

In the course of assessment for AY 2015-16 of INITO, the Assessing Officer also issued a show cause notice to INITO alleging that INITO's arrangement with UK Ltd for distribution of machines creates a permanent establishment of UK Ltd in India in terms of India -UK DTAA and thus, why

the consequential Income tax consequence arising out of that shall not follow.

Choose the correct alternative from the following MCQs:

1. In respect of its transactions with UK Ltd, which of the compliances INITO is required to do under Indian Transfer Pricing Regulations of the Act :
   (A) Obtaining Accountants report in the prescribed Form and furnishing such report on or before the due date.
   (B) Keeping and maintaining such information and document as are prescribed in Rule 100.
   (C) Furnishing of report to and/or filing the notification to prescribed Income Tax Authority u/s 286 of the Act.
   (D) All.

2. Arm's length price is required to be computed by any of the prescribed transfer 'pricing method. Which of the prescribed transfer pricing method is not a profit-based method?
   (A) Resale Price Method
   (B) Comparable Uncontrolled Price Method
   (C) Cost Plus Method
   (D) Transactional Net Margin Method

3. As per section 92 of the Act, transfer of goods by INITO to its branch in Country X is :
   (A) A specified domestic transaction (SOT)
   (B) An International transaction
   (C) Neither an SOT nor an International Transaction
   (D) Both an SOT arid an International Transaction

4. In respect of payment of interest by INITO to SOI USA, INITO is required to deduct tax at source under the Act at the rate of :
   (A) Nil.
   (B) 10%
   (C) 20%
   (D) 40%

5. The residential status of Country X branch of INITO for the purpose of the Act is:
   (A) Resident of India
   (B) Non-resident of India
   (C) Foreign Company
   (D) None

You are required to answer the following issues:

1. In the context of UK Ltd.' s transactions with INITO, answer the following :

   (i) Discuss and determine "the most appropriate method" which INITO may apply to determine the ALP of machine purchase transaction by it from UK Ltd, based on the facts and information set out in the case study.

   (ii) In respect of the transfer pricing adjustment of INR 2.5 crore made by TPO in India in the hands of INITO for AY 2015-16, can UK Ltd seek corresponding adjustment in UK to adjust its reported UK taxable income, assuming that the text of India-UK DTAA is identical to UN Model Tax Convention 2017?

   (iii) Assuming that both NITO and UK Ltd are not agreeable to the transfer pricing adjustment of INR 2.5 crore made by the TPO, can UK Ltd invoke the Mutual Agreement Procedure to seek appropriate relief in the matter? For this purpose,

assume that the text of India-UK DTAA is identical to UN Model Tax Convention 2017.

2. Discuss and determine the taxability of profits of Country X branch under the Act in the hands of INITO, including following:

   (a) Entitlement of INITO to claim tax credit in India for the income taxes paid in Country X on Country X branch profits.

   (b) Entitlement of INITO to claim deduction for interest paid to SGI, USA.

3. Examine and discuss the validity of the Assessing Officer's claim, that the business arrangement between INITO and UK Ltd creates UK Ltd.'s permanent establishment in India. For this purpose, assume that the text of the India-UK DTAA is identical to UN Model Tax Convention 2017.

SOLUTIONS – CASE STUDY 29

I. ANSWERS TO MCQs

MCQ No.	Answer
1.	(d)
2.	(b)
3.	(c)
4.	(a) or (c)
5.	(a)

II. ANSWERS TO DESCRIPTIVE QUESTIONS

Answer to Q. 1

(i) Resale Price Method is the most appropriate method which can be applied to determine the ALP of machine purchase transaction by INITO from UK Ltd. as the assessee purchases goods from related party and resells the same to unrelated parties and does not add substantially to the value of the product sold.

The resale price method (RPM) is a method which compares the gross margins (i.e. gross profit over sales) earned in transactions between related and unrelated parties for the determination of the ALP.

Machinery purchased from UK Ltd. at ₹ 40,000 has been sold to unrelated customers in India at ₹ 46,000. The gross profit margin is 13.04% of sales.

The assessee has uncontrolled transaction with unrelated machine manufacturers viz. A Inc. and B Ltd. for comparison for satisfying the condition of availability, coverage and reliability of data necessary for application of resale price method to determine ALP.

ALP could be determined by making adjustment for functional and other differences, if any, including differences in accounting practices which could materially affect the gross profit margin in the open market.

Machinery purchased from unrelated manufacturer, A Inc. of USA for ₹ 25,000 has been sold to unrelated customers in India at a gross profit margin of 9.09% on sales. Machinery purchased from unrelated manufacturer, B Ltd. of Japan, has been sold to unrelated customers in India at a gross profit margin of 16.67% on sales.

Therefore, based on these information, ALP of the purchase transaction with UK Ltd. can be computed applying Resale Price Method.

Notes

- In this case, interest is not deemed to accrue or arise to SGI USA in India, since the interest is paid by a resident, INITO, for the purpose of carrying on business outside India (for its branch operations in Country X). Hence, the same is not taxable in India, consequent to which there is no liability to deduct tax at source. The answer would, accordingly, be A.
- On a plain reading, the question has been drafted in a manner that appears to test the rate of TDS rather than the taxability or otherwise of interest in the hands of SGI USA in

India. Therefore, without going into the taxability of such interest in India, if only the rate of TDS has to be examined on the presumption that such interest is actually taxable in India, the alternate answer possible in such a case would be C, assuming that the loan is in foreign currency.

(ii) As per Article 9(2) of the UN Model Convention, 2017, if the profits of INITO are included in computation of total income under the Income-tax Act, 1961 and the said profits have also been included in the income of UK Ltd. and charged to tax in UK, and the profits so included are profits which would have accrued to the INITO if the conditions made between the two enterprises had been those which would have been made between independent enterprises, then, UK shall make an appropriate adjustment to the amount of the tax charged therein on those profits.

Accordingly, UK Ltd. can seek corresponding adjustment in UK to adjust its reported UK taxable income in respect of the transfer pricing adjustment of INR 2.5 crore made by the Transfer Pricing Officer in India in the hands of INITO for A.Y.2015-16.

(iii) Article 25 of the UN Model Convention, 2017 enables competent authorities of the Contracting States, India and UK, to endeavour to resolve by mutual agreement, not only problems of juridical double taxation but also of economic double taxation arising from transfer pricing adjustments.

When a person considers the actions of one or both of the Contracting States result for him in taxation not in accordance with the provisions of DTAA between the Contracting States, he can opt for MAP.

Accordingly, UK Ltd. can invoke MAP to seek appropriate relief, where both INITO and UK Ltd. are not agreeable to the transfer pricing adjustment of INR 2.5 crore made by the Transfer Pricing Officer.

Answer to Q. 2

(a) Rule 128 allows a resident to claim credit of foreign taxes paid in the year in which the income corresponding to such tax has been assessed to tax in India.

For this purpose, foreign tax includes, in the case of a country with which India does not have a DTAA, tax payable in the nature of income tax referred to in clause (iv) of Explanation to section 91.

As per clause (iv) of Explanation to section 91, the expression "income-tax" in relation to any country includes, inter alia, business profits tax charged on the profits by the Government of that country.

Since tax on branch profits is levied by Country X (being a country which does not have a DTAA with India) is essentially a business profit tax, credit for the same is allowable as per Section 91 read with Rule 128, from the tax payable by INITO in India.

(b) INITO Ltd. is entitled to claim deduction for interest paid to SGI USA for financing branch operations under section 36(1)(iii).

Limitation of interest deduction under section 94B would not be attracted in this case, even though loan is borrowed from a non-resident associated enterprise, since the interest amount of ₹ 90 lakhs does not exceed the threshold of ₹ 1 crore.

Answer to Q. 3

As per Article 5(5) of the UN Model Convention, a foreign enterprise may be treated as having an Agency PE in Source State even though it may not satisfy all the tests in Article 5(1) (such as not having a fixed place of business at its disposal in State of Source within the meaning of Article 5(1) and 5(2), or not satisfying the time threshold of six or twelve months, as the case may be).

The transactions between INITO and UK Ltd. are on principal to principal basis. INITO is purchasing machines from UK Ltd. and reselling them on its own account and not as agent of UK Ltd. Hence, an agency PE is not constituted in this case.

Therefore, the Assessing Officer's claim that the business arrangement between INITO and UK Ltd. creates UK Ltd.'s permanent establishment in India is **not** valid.

Note – Alternatively, in case it is assumed that INITO does act as agent of UK Ltd., due to the fact that it promotes and sells UK Ltd.'s machines in India, then, it needs to be examined whether it is an independent agent or not. Article 5(7) provides that if the agent is an independent agent, then, agency PE will not be constituted.

An agent is independent if it acts for the enterprise in its ordinary course of business. A person is not considered to be an independent agent where the person acts exclusively or almost exclusively for one or more enterprises to which it is closely related.

INITO purchases machines from UK Ltd. and sells them to unrelated customers in India. INITO has adequate financial and operating resources of its own to undertake such distribution and sales activities. Also, it has been doing these activities for past ten years not only for UK Ltd. but also for other unrelated international engineering machine manufacturers. From the details of purchases given for F.Y. 2019-20, INITO has purchased 5000 machines from UK Ltd. and 6000 (total) machines from A Inc and B Ltd., being other unrelated international engineering machine manufacturers. Therefore, it is clear that INITO does not act exclusively or almost exclusively for UK Ltd. Hence, INITO Ltd. is an independent agent and acts for UK Ltd. in the ordinary course of its business.

Hence, the Assessing Officer's claim that the business arrangement between INITO and UK Ltd. creates UK Ltd.'s permanent establishment in India is **not** valid.

CASE STUDY – 30

Bellisimo Group Ltd. ('BGL') is a transnational conglomerate incorporated, registered and head quartered in a low tax country, having worldwide operations through subsidiaries, joint ventures and branches, including India. You are Head of Taxation, India. The Global Head - Taxation of BGL has referred to you the following cases related to the Indian taxation of some of BGL Group's entities for AY 2020-21.

Part A: H Ltd.'s Indian operations:

H Ltd, a Hungarian wholly owned subsidiary of BGL, is engaged in the manufacture and sale of power transformers worldwide. H Ltd has manufacturing operations in Hungary only. I Co. Ltd., an Indian company and tax resident of India, is also engaged in the manufacture and sale of power plant equipment. H Ltd holds 40% shareholding in I Co Ltd and the remaining 60% shareholding is held by an unrelated Indian group.

P Ltd, an Indian public sector company, invited tenders/ bid proposals on turnkey basis from power plant equipment manufacturers either singly or in consortium provided they meet the financial and technical qualification criteria. The scope of this turnkey project involved "design, engineering, test, manufacture, supply, installation and commissioning of 10 transformers and 5 switches"

H Ltd and I Co. Ltd, both meeting the qualification criteria, decided to bid for this tender of P Ltd, on a consortium basis. Further, as per the terms of tender, H Ltd and I Co Ltd also executed a consortium agreement between themselves providing that:

(i) Both H Ltd and I Co Ltd will be jointly and severally responsible to P Ltd for any default and/or damages payable to P Ltd.

(ii) H Ltd and I Co. Ltd., inter se, will be responsible for executing their respective scope of work as set out in the Annexure to the consortium agreement and receive the sale consideration thereof.

Moreover, as per the terms of the tender, I Co. Ltd was designated as the lead consortium member who would be responsible for liaisoning and co-ordinating with P Ltd in respect of this project. For the purpose of communication between P Ltd and the consortium, the registered office of I Co Ltd was designated as the office address of the consortium.

P Ltd awarded & executed three separate contracts to the consortium of H Ltd & I Co Ltd as follows:

(i) Contract I for design, engineering, manufacture and supply of 10 transformers to be made by H Ltd on FOB Hungarian port basis, for the lumpsum contract price of INR 250 crores (converted amount). Out of INR 250 crores, INR 200 crores was directly remitted by P Ltd to H Ltd outside India on supply of transformers from time to time over 4 years. H Ltd. authorised I Co Ltd to receive mobilisation advance of INR 50 crores in India from P Ltd and remit the same to H Ltd outside India.

(ii) Contract II for design, engineering, manufacture and supply of 5 switches to be made by I Co. Ltd. in India on ex-works basis, for lumpsum consideration of INR 100 crores.

(iii) Contract Ill for handling, installation and commissioning of imported transformers and domestically supplied switches. Contract III is a service contract and all the services are to be performed in India by I Co Ltd. The lumpsum consideration under Contract III is INR 50 crores and it was directly paid to I Co Ltd by P Ltd.

H Ltd manufactured all transformers in its manufacturing facility in Hungary and supplied them to

P Ltd on FOB Hungarian port of shipment. These transformer were supplied with post sales warranty period of 5 years. Transformers were imported into India in the name of P Ltd and it also paid custom duty thereon. Except for a period of 5 days in each year for meeting with P Ltd, none of the employees of H Ltd visited India during the project duration of 4 years.

The supply of transformers and payment thereof received by H Ltd over 4 years period is as follows:

Assessment Year	Particulars	No. of transformers supplied	Value (INR)
2017-18	Receipt of mobilisation advance (through I Co Ltd)	-	50 crores
2018-19	Receipt of sale consideration	3	60 crores
2019-20	Receipt of sale consideration	3	60 crores
2020-21	Receipt of sale consideration	4	80 crores

H Ltd did not maintain separate books of accounts for its Indian sales. Neither it is possible to separately identify the specific profits/income earned from sale of transformers to P Ltd. However, H Ltd does maintain its global financial statements which shows its global profit margin of 6% of sales for AY 2020~21.

P Ltd applied to the prescribed tax authorities for determination of appropriate rate of deduction of Income tax at source for payments, to be made to H Ltd. Prescribed tax authorities directed it to deduct tax at source at 1% of contract value.

H Ltd has also been advised to consider applying for Advance Ruling in India. ·

Part B: Financing transactions of FCO, USA.

I Co 2 Pvt Ltd ('I Co. 2'), an Indian company, is a subsidiary of Company F Co. (non-resident) from USA. F Co. is a wholly owned subsidiary of BGL. The capital structure of I Co. 2 is as follows:

Equity Capital: INR 500 Million contributed by Company F Co Debt: INR 800 Million
The nature of loan and expenditure incurred by way of interest or of similar nature on these loans during the year by I Co. 2 are as follows:

Loan No.	Nature of Loan	Interest or expenditure of similar nature (INR millions)
1	Loan from non-resident AE, Company F Co.	Interest = 30.00
2	Loan from Independent Third Party in India	Interest = 11.00
3	Loan from Mumbai branch of an Indian bank on the strength of Letter of Comfort issued by resident AE; Company R Co.	Interest = 5.50
4	Loan from Indian branch of a foreign bank on the strength of guarantee of non-resident AE, Company F Co.	Interest = 9.00 Guarantee Fees = 1.00
5	Loan from Delhi branch of an Indian bank on the strength of Letter of Comfort issued by Company F Co	Interest = 6.00
6	Loan from outside India branch of a foreign bank on the strength of guarantee issued by resident AE; Company R Co.	Interest = 5.40 Guarantee Fees = 0.60
7	Foreign Currency Loan of USD 2 Million from outside India branch of foreign bank for which there is back to back deposit kept by its non-resident AE; Company F Co	Interest = 3.25

TOTAL	Interest = 70.15 Guarantee Fees = 1.60

Company I Co. 2's EBITDA for the current year is INR 200 Million.

Part C: Shipping Operations:

S. Co. Ltd. ('SCL'), a company incorporated in and tax resident of country X, is engaged in shipping operations. SCL owns various vessels which it operates for carrying goods cargoes from one country to another. Vessels of SCL regularly calls on Indian ports twice a week. In addition to the aforesaid container line business, break bulk vessels of SCL also occasionally call on Indian ports.

To promote and administer its business in India, SCL has appointed Q Ltd. as its shipping agent in India. Q Ltd. is an Indian company and is an exclusive agent of SCL for booking the export cargoes and import cargoes; handling of work at ports when SCL vessels calls on Indian port, issuing invoices to India shippers and collecting the freight and other charges on behalf of SCL. For all these activities, SCL pays agency commission to Q Ltd. All the amounts collected by Q Ltd. on behalf of SCL are deposited into a separate bank account maintained by Q Ltd. and then remitted to SCL. Thus, entire Indian operation of SCL are effectively managed by Q Ltd., whereas overseas and other countries operations are managed by SCL.

For F.Y. 2019-20, the receipts of SCL are as follows, in so far it concerns its India operations:

Sr. No.	Nature of Receipt	Amount (INR in Crores)	Place of Collection
1.	Export Freight for cargoes loaded from Indian ports	7.5 1.5	In India by Q Ltd Outside India by SCL
2.	Import Freight for cargoes loaded from a port outside India for destination port in India	10 2.5	Outside India by SCL In India by Q Ltd
3.	Terminal handling charges for handling Export and Import cargoes at Indian port	5	In India by Q Ltd
4.	Interest paid by Indian bank on balances lying in Indian bank account	1.75	Credited to Indian bank account

Against the aforesaid receipt, SCL has following expenses for its Indian operations:

(i) Agency commission paid to Q Ltd.: INR 3 Cr.

(ii) Port dues and other incidental expenses: INR 1.25 Cr.

India has DTAA with Country X identical to text of UN Model Tax Convention 2017. Article 8 of said DTAA is based on Alternative A Text of Article 8 of UN Model Tax Convention 2017.

Choose the correct alternative from the following MCQs:

1. H Ltd. is considering applying for an advance ruling to determine its taxability in India and is seeking your advice on the nature of such a ruling. An Advance Ruling pronounced by the Authority for Advance Rulings is binding on:
   (A) The applicant who had sought it
   (B) High Court
   (C) Income Tax Appellate Tribunal
   (D) All

2. If a resident and ordinarily resident individual having substantial equity shareholding in a foreign company, fails to furnish his income tax return before the end of relevant assessment year, he/she would attract penalty of INR …… under the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015.

(A) INR 5,000
(B) INR 5,00,000
(C) INR 10,00,000
(D) INR 1,50,000

3. H Ltd will not be able to rely on a DTAA (based on the UN/OECD Model Tax Convention) for:
   (A) Determination of tax residency
   (B) Providing relief from double taxation
   (C) Protection of investment from appropriation
   (D) Allocation of taxing rights

4. The basic rules of interpretation of any international agreement (including a DTAA) are provided in:
   (A) OECD Model
   (B) UN Model
   (C) US Model
   (D) Vienna Convention on the Law of Treaties

5. In order to protect against the un-intended use of a DTAA or the benefits provided under DTAA, which measures/ rules have been recommended by BEPS Action Plans?
   (A) Advance Pricing Agreement (APA)
   (B) Safe Harbour Rules
   (C) Limitation of Benefits (LOB) Rule and Principal Purpose Test (PPT)
   (D) Allocation of taxing rights

You are required to answer the following issues:

1. Examine and discuss the Indian income-tax liability of H Ltd in respect of its income from supply of transformers to P Ltd. Examine and answer the following questions in particular:
   (i) Can the income arising from the turnkey project executed by H Ltd. and I Co. Ltd. be assessed as income of an Association of Persons (AOP)?
   (ii) Whether H Ltd.'s income from sale of transformers to P Ltd. is chargeable to tax in India considering the provisions of the Act and India-Hungary DTAA? (Relevant extracts of the DTAA are set out as Exhibits).
   (iii) Assuming that H Ltd is chargeable to income-tax in India in respect of sale made to P Ltd and given that H Ltd cannot separately identify its income from such sale made to P Ltd, what are the options available to the Assessing Officer under the Act/Rules to ascertain and quantify the amount of income chargeable to income tax in India.

2. In the context of financing transactions of F Co, USA with I Co. 2, compute the total amount of excess interest which shall not be deductible under the head 'Profit and gains of business or profession' of Company I Co.2 applying section 94B of the Act.

3. In respect of Indian shipping operations of SCL:
   (i) Compute the taxable income of SCL under the Act (ignoring DTAA)
   (ii) Compute the taxable income of SCL considering the provisions of DTAA which are identical to the text of Article 8 (Alternative A) of UN Model Tax Convention 2017.

Reference Material

Exhibit I: Article 5 Permanent Establishment (India - Hungary DTAA)

1. For the purposes of this Convention, the term ''permanent establishment" means a fixed place

of business through which the business of an enterprise is wholly or partly carried on.

2. *The term ''permanent establishment" includes especially:*

   (a) *a place of management;*

   (b) *a branch;*

   (c) *an office,·*

   (d) *a factory;*

   (e) *a workshop; and*

   (f) *a mine, an oil or gas well, a quarry or any other place of extraction of natural resources.*

3. *A building site or construction, installation or assembly project or supervisory activities in connection therewith constitute a permanent establishment only if such site, project or activity lasts more than nine months.*

4. *Notwithstanding the preceding provisions of this Article, the term ''permanent establishment" shall be deemed not to include :*

   (a) *the use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise;*

   (b) *the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery;*

   (c) *the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;*

   (d) *the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of collecting information, for the enterprise;*

   (e) *the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity of a preparatory or auxiliary character;*

   (f) *the maintenance of a fixed place of business solely for any combination of activities mentioned in sub-paragraphs (a) to (e), provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character.*

5. *Notwithstanding the provisions of paragraphs 1 and 2, where a person - other than an agent of an independent status to whom paragraph 6 applies - is acting on behalf of an enterprise of the other Contracting State, that enterprise shall be deemed to have a permanent establishment in the first-mentioned Contracting State in respect of any activities which that person undertakes for the enterprise, if such a person:*

   (a) *has and habitually exercises in that State an authority to conclude contracts in the name of the enterprise, unless the activities of such person are limited to those mentioned in paragraph 4 which, if exercised through a fixed place of business, would not make this fixed place of business a permanent establishment under the provisions of that paragraph; or*

   (b) *has no such authority, but habitually maintains in the first-mentioned State a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the enterprise;*

   (c) *habitually secures orders in the first-mentioned State, wholly or almost wholly for the enterprise itself or for the enterprise and other enterprises controlling, controlled by, or subject to the same control, as that enterprise.*

6. *An enterprise shall not be deemed to have a permanent establishment in a Contracting State merely because it carries on business in that State through a broker, general commission*

agent or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business. However, when the activities of such an agent are devoted wholly or almost wholly on behalf of that enterprise, he will not be considered an agent of an independent status within the meaning of this paragraph.

7. *The fact that a company which is a resident of a Contracting State controls or is controlled by a company which is a resident of the other Contracting State, or which carries on business in that other State (whether through a permanent establishment or otherwise), shall not of itself constitute either company permanent establishment of the other.*

Exhibit II: Relevant extracts of protocol to India - Hungary DTAA relevant for Article 7.

With reference to Article 7:

(a) *In the determination of the profits of a building site or construction, assembly or installation project there shall be attributed to that permanent establishment in the Contracting State in which the permanent establishment is situated only the profits resulting from the activities of the permanent establishment as such. If machinery or equipment is delivered from the head office or another permanent establishment of the enterprise (situated outside that Contracting State) or a third person (situated outside that Contracting State) in connection with those activities or independently therefrom there shall not be attributed to the profits of the building site or construction, assembly or installation project the value of such deliveries.*

(b) *With respect to paragraph 3 it is understood that the administrative and general expenses incurred outside India will be allowed as a deduction in accordance with the provisions of section 44C of the Income-tax Act, 1961, as effective on the date of the signing of this Convention.*

SOLUTIONS – CASE STUDY 30

I. ANSWERS TO MCQs

MCQ No.	Answer
1.	(a)
2.	(c)
3.	(c)
4.	(d)
5.	(c)

II. ANSWERS TO DESCRIPTIVE QUESTIONS

Answer to Q. 1

(i) As per the Circular F.No.225/2/2016/ITA.II dated 7.3.2016 issued by the CBDT, it has been clarified that consortium arrangement for executing Turnkey project which has the following attributes may not be treated as an AOP –

1. Each member is independently responsible for executing its part of work through its own resources and also bear the risk of its scope of work.
2. Each member earns profits or incurs losses, based on performance of the contract falling strictly within its scope of work.
3. The control and management of the consortium is not unified and common management is only for the inter se coordination between the consortium and members for administrative convenience.

However, the benefit of this Circular would not be available if the consortium members are associated enterprises under section 92A.

In the present case, H Ltd. and I Co Ltd. form a joint venture for turnkey project. They entered into an agreement to specifically allot the scope of work between them and receive the sale consideration thereof, respectively. However, they are deemed to be associated enterprises since H Ltd holds 40% voting power in I Co Ltd (i.e., not less than 26% voting power).

Hence, the benefit of this Circular would not be available and in such a case, Assessing Officer will decide whether an AOP is formed or not keeping in view the relevant provisions of the Act and judicial jurisprudence on this issue. In this consortium arrangement, the scope of work of H Ltd. and I Co Ltd. are separately defined, Contract I is to be executed solely by H Ltd. and Contracts II and III solely by I Co Ltd. Consideration has also been fixed separately for these three contracts. The Indian consortium member, I Co. Ltd., is operationally capable of independently performing the work. Taking into consideration these facts, the Assessing Officer may come to a conclusion that joint venture between H Ltd and I Ltd. would not be treated as an AOP.

(ii) In the case of sale of goods, the income accrues or arises at the place where the property in goods is transferred by the seller to the buyer. In the present case, H Ltd. has supplied the transformers on FOB, Hungarian port of shipment. These transformers are manufactured in Hungary and thereafter, supplied to P Ltd. at the Hungarian Port (i.e., outside India). Consequently, the income actually accrues or arises to H Ltd. outside India

i.e., in Hungary. Except for the initial mobilization advance of ₹ 50 crores (in the assessment year 2017-18) out of contract price of ₹ 250 crores, the receipts were outside India.

Further, section 9(1)(i) provides that all income accruing or arising, directly or indirectly, through or from any business connection in India is deemed to accrue or arise in India. Clause (a) of Explanation 1 to section 9(1)(i) provides that in case of a business of which all the operations are not carried out in India, only such part of the income as is reasonably attributable to the operations carried out in India shall be deemed to accrue or arise in India.

In this case, since no part of the operations is carried out in India, no income is deemed to accrue or arise in India from Contract-I. Hence, H Ltd.'s income from sale of transformers to P Ltd. is not chargeable to tax in India.

As per India-Hungary DTAA, profit of an enterprise would also be taxable in the other contracting State if such enterprise has a Permanent establishment in other Contracting State.

An installation or assembly project would constitute Permanent establishment only if such site, project or activity lasts more than nine months. In the instant case, since the installation or project activity is not done by H Ltd., it does not have a PE in India.

H Ltd. manufactures and supplies transformers to P Ltd. outside India. Its employees also visit India only for 5 days for meeting with P Ltd. Hence, there is no PE of H Ltd. in India. Hence, H Ltd.'s income from sale of transformer to P Ltd would not be chargeable to tax as per India-Hungary DTAA.

(iii) If H Ltd is chargeable to tax in India in respect of sale made to P Ltd. and H Ltd cannot separately identify its income from such sale made to P Ltd., the Assessing Officer can take H Ltd.'s global profit margin for A.Y.2020-21 as a base to compute profit chargeable to tax income in India.

The amount chargeable to tax in India for A.Y.2020-21 on such basis would be ₹ 4.80 crore, being 6% of ₹ 80 crores

Answer to Q. 2

Computation of excess interest not deductible under the head "Profits and gains of business or profession" of Company I Co. 2

Particulars	Amount (in INR millions)
Interest on loan from non-resident AE, Company F Co.	30
Interest on loan from independent third party in India [Not considered since interest is not paid in respect of loan issued by non-resident AE]	-
Interest on loan from Mumbai branch of an Indian bank on the strength of Letter of Comfort issued by resident AE, Company R Co. [Not considered, since letter of comfort is issued by resident AE]	-
Interest on loan from Indian branch of foreign bank on strength of guarantee on non- resident AE, company F [Since F Co. provided guarantee to foreign bank, such debt would be deemed to have been issued by non-resident AE]	9
Guarantee fees in respect of loan from Indian branch of foreign bank on strength of guarantee on non-resident AE, company F [Since, interest includes other charge in respect of the moneys borrowed, guarantee fee can be classified as interest]	1

Interest on loan from Delhi branch of an Indian bank on the strength of Letter of Comfort issued by Company F Co. [Since F Co. issued letter of comfort to Indian bank, such debt would be deemed to have been issued by non-resident AE]		6
Guarantee fee and interest on loan from outside India branch of a foreign bank on the strength of guarantee issued by resident AE, Company R Co. [Not considered since, letter of comfort is not issued by non-resident AE]		-
Interest on foreign currency loan from outside India branch of foreign bank [Considered, since back to back deposit is provided by the non-resident AE]		3.25
Interest paid or payable to non-resident AE		**49.25**
EBIDTA		200
Excess Interest: Lower of the following would be disallowed -		**Nil**
- Interest paid or payable to non-resident AE in excess of 30% of EBIDTA [₹ 49.25 million minus ₹60.00 million]	Nil	
- Interest paid or payable to non-resident AE	49.25	

Note – Section 94B(1) provides that where an Indian company, being the borrower, incurs expenditure by way of interest or similar nature exceeding Rs.1 crore, which is deductible in computing income chargeable under the head "Profits and gains of business or profession" in respect of any debt issued by a non-resident, being an associated enterprise of the borrower, the interest shall not be deductible in computation of income under the said head to the extent that it arises from excess interest.

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

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

whichever is less.

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

Answer to Q. 3

(i) Section 44B of the Income-tax Act, 1961 provides for determination of income of taxpayer, being a non-resident engaged in the business of operating of ships.

In such case, the profits and gains shall be deemed to be equal to 7.5% of specified sum. The specified sum is the aggregate of amounts:

- paid or payable to the taxpayer or to any person on his behalf on account of the carriage of passenger, livestock, mail or goods shipped at any port in India; and
- received or deemed to be received in India by the assessee or on behalf of the assessee on account of the carriage of passenger, livestock, mail or goods shipped at any port outside India

Computation of total income of SCL as per section 44B of the Income-tax Act, 1961

Particulars	₹
Income computed under section 44B [7.5% of specified sum of ₹ 16.50 crores **(See Working Note below)]**	1,23,75,000
Bank interest	1,75,00,000
Total Income	**2,98,75,000**

Working Note - Computation of specified sum

Particulars	Amount (₹ in crore)
Export freight for cargoes loaded from Indian ports and received in India by Q Ltd.	7.50
Export freight for cargoes loaded from Indian ports and received outside India by SCL	1.50
Import Freight for cargoes loaded from a port outside India for destination port in India and received in India by Q Ltd.	2.50
Terminal handling charges for handling export and import cargoes at Indian port and received in India	5.00
	16.50

Note - Agency commission paid and port dues and incidental expenses incurred by SCL are not deductible expenditures since the income is computed on presumptive basis.

(ii) Paragraph 1 of Article 8 (Alternative A) of the UN Model Tax Convention, 2017 provides that profits of an enterprise of a Contracting State from the operation of ships or aircraft in international traffic shall be taxable only in the State of which the assessee is a tax resident. Since SCL is a company incorporated in and tax resident of country X, its profits from the operation of ships shall be taxable only in Country X. Hence, there would be no taxable income of SCL in India.

CASE STUDY – 31

You are practicing in the field of International Taxation. Horse Racing World Championship and Payer Ltd. Are two of your clients, who have approached you for your opinion on certain issues.

Horse Racing World Championship

Horse Racing World Championship ('HRWC'), a company incorporated under the laws of the United Kingdom, wishes to enter into an agreement with Horse Racing India Ltd. ('HRIL'). HRWC and HRIL are associate enterprises. By way of the agreement, HRIL will license all the commercial rights in the Championships for a period of 100 years to HRWC. A Concorde Agreement will also be entered into between HRWC and the participating teams through which HRWC will be given the exclusive commercial rights in relation to the Horse Racing Championship which it could exploit directly or through its affiliates. As per this Agreement, HRWC had the right to include the race courses in which races would take place. For the purpose of conducting the Horse Racing Event in India, HRWC will also enter into a Race Promotion Contract with Race Contractor International Ltd ('RCIL'), an Indian contractor, granting it the right to host, stage and promote the Horse Racing event in Mahalaxmi Race Course in India for a consideration of USD 40 million for a period of 5 years. HRWC and its employees will have full access to the Mahalaxmi Race Course and HRWC will be granted access for a period of 6 weeks at a time during each race and that the access will be for a period of 5 years. The duration of the Race Promotion Contract and RCIL's capacity to act will be extremely limited.

The Agreement, *inter alia*, included that the Circuit is required to be constructed in the form and manner prescribed by the HRWC. Further, HRWC shall be responsible for the inclusion of the Event in the Championship. Also, HRWC shall have full access to the pit, padlock buildings, etc. during the Access Period. The passes issued by the HRWC shall not be questioned by RCIL. RCIL shall not permit any recording of footage of the Event in the confines of the circuit or the land over which it has control. All intellectual property relating to the Event shall be irrevocable and unconditionally assigned to the HRWC. RCIL shall be mandated to engage a third party approved by the HRWC to carry out all service relating to the origination of international television feed.

In client's view, the duration of the event will only be 3 days, there will be limited grant of access which may not be sufficient to constitute the degree of permanence necessary to establish a PE. Also in client's opinion, construction of the track will be done by RCIL and hence HRWC will not have disposal over the track.

Payer Ltd.

Pride Inc, a company incorporated under the laws of USA. The value of its global assets are Rs.50 crores. The value of assets in India are Rs.25 crores. Its turnover during the P.Y. 2019-20 is US $ equivalent to INR 90 crores. Out of 10 board meetings held during the F.Y.2019-20, only 4 meetings are held in India. The key management and commercial decisions for conduct of the company's business as a whole are, however, made by the directors located in India at the meetings held in India. Your client, Payer Ltd, an Indian company, wishes to remit an amount towards professional fees to Pride Inc. on which tax is required to be deducted in India.

Note: Assume that India-UK DTAA is in line with UN Model Convention, 2017

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

MULTIPLE CHOICE QUESTIONS

Write the most appropriate answer to each of the following questions by choosing one of the four options given.

1. In the given case, subject matter is to decide which type of following PE under the India - UK DTAA:
   (a) Fixed Place PE
   (b) Construction PE
   (c) Service PE
   (d) All of the above

2. Is RCIL liable to deduct tax on payments to HRWC and, if so, under which section:
   (a) Yes; under section 194BB
   (b) Yes; under section 195
   (c) Yes; under section 194J
   (d) No; not liable to deduct tax at source

3. For A.Y.2020-21, under the provisions of the Income-tax Act, 1961,Pride Inc shall be:
   (a) Resident in India
   (b) Non-resident in India, since it is said to be engaged in active business outside India
   (c) Non-resident in India, since majority board meetings are held outside India
   (d) Non-resident in India, due to reasons stated in both (b) and (c) above.

4. Assuming that HRWC does not have a fixed place PE in India, it may constitute PE, if it sends its employees to India for rendering consultancy services in the P.Y.2019-20 for:
   (a) 182 days
   (b) 183 days
   (c) 184 days
   (d) No PE is constituted irrespective of the number of days of stay of personnel in India.

5. Which of the following statements is true in the context of satisfaction or otherwise of the disposition test by HRWC?
   (a) Disposition test fails since HRWC has limited access to the race horses; the access is available only for 6 weeks' period each time the race is conducted.
   (b) Disposition test fails, since construction of the track is by an Indian contractor, RCIL.
   (c) Disposition test is satisfied, since HRWC had taken over and exercised control over the entire event.
   (d) Disposition test is satisfied, only because HRWC and HRIL are AEs.

DESCRIPTIVE QUESTIONS

1. From the facts of the case, you are required to advise whether the agreement entered into by HRWC and its activities pursuant thereto constitute a permanent establishment (PE) in India. Justify your answer with reasoning and decided case law, if any.

2. Advise RCIL whether it is required to withhold any tax on payments to HRWC. State reasons for your answer.

3. Determine the residential status of Pride Inc. for A.Y.2020-21 under the Income-tax Act, 1961. Advise Payer Ltd as to whether tax on fees for professional services paid to Pride Inc. has to be deducted under section 194J or section 195.

SOLUTIONS – CASE STUDY 31

I. ANSWERS TO MCQs

MCQ No.	Answer
1.	(a)
2.	(b)
3.	(a)
4.	(c)
5.	(c)

II. ANSWERS TO DESCRIPTIVE QUESTIONS

Answer to Q.1:

The facts of the case are similar to the decision of Supreme Court in the case of *Formula One World Championship Ltd. v. Commissioner of Income-tax (International Taxation) 394 ITR 80*. In this case, Supreme Court held that the race circuit constituted fixed place PE of the assessee. The Supreme Court observed that the essential conditions which need to be satisfied for the existence of a fixed place PE under Article 5(1) of the India UK DTAA are:

(a) existence of a fixed place of business; and

(b) the business of the enterprise is wholly or partly carried out through that fixed place.

A major contention put forward on behalf of the assessee was the fact that any access to the assessee was only given during the period of 6 weeks ("Access Period") and that the Circuit was built by Indian Contractor using its own engineers and architects and was at the disposal of Indian Contractor as the promoter of the Event.

The Supreme Court considered the manner in which commercial rights were enjoyed by the assessee and its affiliates to determine who was in actual control of the Event. The facts clearly highlighted that though Indian Contractor was designated as the promoter of the Event, in reality, its authority to act as promoter was severely restricted. These clauses clearly highlighted that:

- The Circuit is required to be constructed in the form and manner prescribed by the assessee;
- The assessee is responsible for the inclusion of the Event in the F1 Championship;
- The assessee had full access to the pit, padlock buildings, etc. during the Access Period;
- The passes issued by the assessee could not be questioned by Indian Contractor;
- Indian Contractor could not permit any recording of footage of the Event in the confines of the circuit or the land over which it had control;
- All intellectual property relating to the Event had been irrevocable and unconditionally assigned to the assessee; and
- Indian Contractor was mandated to engage a third party approved by the assessee to carry out all service relating to the origination of international television feed.

Consequently, Court held that the Circuit constituted assessee's fixed place PE in India since the assessee and its employees had full access to the Circuit and the assessee was granted access for a period of 6 weeks at a time during each race and that the access was for a period of 5 years i.e.,

the duration of the Race Promotion Contract and Indian Contractor's capacity to act was extremely limited. Accordingly, it held that assessee carried on business in India within the meaning of expression under Article 5(1) of the DTAA. The Apex Court observed that the arrangement clearly demonstrated that the entire event was taken over and controlled by the assessee and its affiliates and accordingly, rejected the assessee's stand that since the duration of the event was only 3 days, there was limited access granted which was not sufficient to constitute the degree of permanence necessary to establish a fixed place PE since for the entire period of race, the control was with the assessee. Further, it held that mere construction of the track by Indian Contractor was of no consequence while determining whether assessee had disposal over the track. Accordingly, it upheld that the tests laid down for constitution of a PE *viz*. stability, productivity and dependence were satisfied. It concluded that the taxable event i.e. earnings from the grand prix had taken place in India and, therefore, assessee was liable to pay tax in India on such income earned by it.

Applying the ratio of above judgement of the Supreme Court, the agreement entered into by HRWC and its activities pursuant thereto constitute Fixed Place PE in India.

Answer to Q.2:

The Supreme Court in the case of *Formula One World Championship Ltd. v. Commissioner of Income-tax (International Taxation) 394 ITR 80* clarified that TDS obligation of Indian Contractor u/s 195 on the payments made to assessee was limited to the appropriate portion of income which is chargeable to tax in India and directed the Assessing Officer to compute the same.

The Supreme Court held that since it had been established that the payments being made by Indian Contractor was in the nature of business income earned by the assessee through its fixed place PE in India, i.e., the Circuit, Indian Contractor was under an obligation to withhold taxes on such payment. Reference was made to the landmark judgement of the Supreme Court in *GE India Technology Centre Private Limited v. Commissioner of Income Tax & Anr.,(2010) 327 ITR 456 i*n this regard. However, the Supreme Court partially agreed with the submission of Indian Contractor that this liability to withhold taxes could only arise for that portion of the income which was chargeable to tax in India on account of the existence of the PE.

Applying the ratio of above judgement of the Supreme Court, RCIL is required to withhold taxes on payments to be made to HRWC on the portion of income which is chargeable to tax in India.

Answer to Q.3:

In the given case, Pride Inc. is a company incorporated under the laws of USA and hence, resident of USA. It is a foreign company under the Income-tax Act, 1961. However, the said company shall be considered to be resident in India if its place of effective management is in India. In this case, the company does not satisfy the active business test outside India since 50% of its assets are located in India. Therefore, since it has failed the active business test outside India on account of 50% of its assets being located in India, the persons who take key management and commercial decisions for conduct of the company's business as a whole and the place where the decisions are made are the key factors in determining whether the POEM of the company is in India. The facts of the case clearly state that the key management decisions and commercial decisions for conduct of the company's business as a whole are made by the directors located in India and at the meetings held in India. Therefore, the POEM of Pride Inc. is in India in the P.Y.2019-20, irrespective of the fact that majority of the board meetings are held outside India.

Section 194J applies when professional fees are being paid to a resident, whereas section 195 applies when payments are made to a non-corporate non-resident or a foreign company. Section 194J is income specific and section 195 is payee specific. CBDT *vide Notification No. 29/2018 date 22nd June 2018* has clarified that the foreign company shall continue to be treated as a foreign company even if it is said to be resident in India on account of its POEM being in India, and all the provisions of the Act shall apply accordingly. Where more than one provision of Chapter XVII-B of the Act applies to the foreign company as resident as well as a foreign company, the provision applicable to the foreign company alone shall apply. Further, in case of conflict between the provision applicable to the foreign company as resident and the provision applicable to it as foreign company, the latter shall generally prevail. Therefore, the rate of tax in case of foreign company shall remain the same, i.e., rate of income-tax applicable to the foreign company even though residential status of the foreign company changes from non-resident to resident on the basis of POEM.

Hence, Payer Ltd shall deduct tax under section 195 while making payment of fees for professional services to Pride Inc., a foreign company resident in India.

CASE STUDY – 32

Mr. Investor, an Indian citizen, aged 46 years, has passive incomes in India. He habitually resides in Canada but visits India every year. He stays in five star rated hotels in spite of owning a residential house in Mumbai, as the same is let out to Mr. Tenant for a yearly rent of Rs. 3,10,000. During the F.Y.2019-20, Mr. Investor repaid EMI of housing loan from HDFC amounting to Rs. 30,000, out of which Rs. 10,000 was towards interest. Mr. Investor paid Rs. 10,000 towards municipal taxes of the said let out property in March, 2020 during his stay in India from 2nd Feb 2020 to 31st May 2020.

Details of his other Incomes and Payments are as below:

1. Mr. Investor received dividend from Indian companies amounting to Rs.10,10,000.

2. Mr. Investor sold STT paid listed shares on 28.2.2020 amounting to Rs.3,00,000. The same were subscribed in convertible US $ on 15.5.2009 for Rs. 2,00,000 on which STT was paid. The broker's ledger reflected a debit of Rs. 10,000 towards brokerage. Fair market value of these shares on 31.1.2018 was Rs. 1,80,000.

   Cost Inflation Index: F.Y.2009-10 = 148 F.Y.2019-20 = 289

   The telegraphic transfer buying and selling rate of US dollars adopted by the State Bank of India is as follows:

Date	Buying Rate (1 US $)	Selling Rate (1 US $)
15.5.2009	63	65
31.1.2018	68	70
28.2.2020	74	76

3. Mr. Investor had invested in debentures of an Indian Company amounting to Rs.6,25,000. Such investment was done out of remittances in convertible foreign exchange. Interest Income on the same was 12% p.a. Interest paid on money borrowed in India for investment in the debentures amounted to Rs. 25,000.

4. Mr. Investor received equivalent to Rs. 60,000 from his friend, a resident Indian in October, 2019. The same was paid by such resident from his bank account in Canada and was received by Mr. Investor in his bank account in Canada. The friend also gifted a Work of Art to Mr. Investor in Canada. Fair Market Value of Work of Art on the date of gift was Rs. 2,00,000.

5. Mr. Investor paid Rs. 5,000 by way of donation by A/c payee cheque to the Prime Minister's National Relief Fund and Rs. 10,000 by way of donation to PM's Drought Relief fund by crossed cheque.

6. Total tax deducted during F.Y.2019-20 was Rs. 20,000. Assume that all tax deductable at source has been duly deducted and remitted to the credit of Central Government on time.

Mr. Investor holds 26% of voting power in Canada Supply Inc, a company incorporated under the laws of Canada. For the purpose of expansion of business, the said company enters into an agreement with Bombay Buying Ltd., a company incorporated under the Indian laws. As per one of the clauses of the agreement, Canada Supply Inc has the power to appoint five directors of Bombay Buying Ltd. The Indian company has ten directors on the board. Further, total purchases by Bombay Buying Ltd. for the F.Y. 2019 -20 is estimated to be Rs. 500 crores, out of which, Bombay Buying Ltd shall source purchases of Rs. 48 crores locally and the balance shall be supplied by Canada Supply Inc. The price for entire purchase has been agreed in the agreement and the conditions for supply are determined by Canada Supply Inc.

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

MULTIPLE CHOICE QUESTIONS

Write the most appropriate answer to each of the following questions by choosing one of the four options given.

1. For Assessment Year 2020-21, Mr. Investor shall be:
   (a) Resident and Ordinarily Resident in India
   (b) Resident but not Ordinarily Resident in India
   (c) Non-resident in India
   (d) Resident in India; not possible to determine whether ordinarily resident or not-ordinarily resident in India with the given information.

2. Dividend income received by Mr. Investor from Indian company would be:
   (a) Taxable @20% due to special provisions being applicable to him.
   (b) Rs. 10,000 is taxable @10% under section 115BBDA
   (c) Either (a) or (b) at the option of Mr. Investor
   (d) Exempt from income-tax

3. The taxability of capital gains on sale of shares by Mr. Investor during the F.Y. 2019 -20, under the regular provisions of the Income-tax Act, 1961 is:
   (a) Entire capital gains taxable @10%, without indexation benefit; brokerage allowable as deduction
   (b) Entire capital gains taxable @10%, with indexation benefit; brokerage allowable as deduction
   (c) Entire capital gains taxable at normal rates, without indexation benefit; brokerage allowable as deduction
   (d) None of the above

4. With respect to donation to Prime Minister Relief Fund & Prime Minister Drought relief fund, Mr. Investor:
   (a) Is not entitled to any deduction under the Income-tax Act, 1961.
   (b) Is entitled to deduction of Rs. 5,000 under section 80G
   (c) Is entitled to deduction of Rs. 10,000 under section 80G
   (d) Is entitled to deduction of Rs. 15,000 under section 80G

5. Are the gifts received by Mr. Investor taxable in his hands under the Income-tax Act, 1961?
   (a) Yes; Rs. 2,60,000 would be taxable as Income from other sources.
   (b) Partially; Rs. 60,000 received from resident would be taxable as Income from other sources.
   (c) Partially; only Rs. 10,000 received from resident would be taxable as Income from other sources.
   (d) No; such gifts are not taxable in the hands of Mr. Investor under the Income-tax Act, 1961.

DESCRIPTIVE QUESTIONS

1. You are required to compute tax liability of Mr. Investor for Assessment Year 2020-21 under the regular provisions of the Income-tax Act, 1961 and the special provisions, if any, applicable to him under the said Act and advise him whether or not to opt for special provisions of the Act.

2. Advise Mr. Investor as to whether Canada Supply Inc and Bombay Buying Ltd are Associated Enterprises, on the basis of the provisions of the Income-tax Act, 1961.

SOLUTIONS – CASE STUDY 32

I. ANSWERS TO MCQs

MCQ No.	Answer
1.	(c)
2.	(d)
3.	(d)
4.	(c)
5.	(b)

II. ANSWERS TO DESCRIPTIVE QUESTIONS

Answer to Q.1:

Stay of Mr. Investor in India during F.Y. 2019-20 is 59 days and hence, he will be considered as non- resident in India for Assessment Year 2020-21.

Comparison of Tax Liability under the regular provisions and special provisions of the Act

As per special provisions under Chapter XII-A of the Income-tax Act, 1961, Mr. Investor is liable to pay tax of Rs. 1,310.	Rs.1,310
As per regular provisions of the Income-tax Act, 1961, Mr. Investor is entitled to a refund of Rs.18,440.	(Rs.18,440)

Since the regular provisions of the Act are more beneficial to Mr. Investor, he should compute his total income and pay tax under the regular provisions of the Act.

Computation of total income and tax liability of Mr. Investor for A.Y.2020-21 under Chapter XII-A

Particulars	Amount (Rs)	Amount (Rs)	Amount (Rs)
Income from House Property			
Gross Annual Value		3,10,000	
Less: Municipal taxes paid and borne by the owner		(10,000)	
Net Annual Value		3,00,000	
Less: Deductions u/s 24			
(a) 30% of NAV	90,000		
(b) Interest on loan	10,000	1,00,000	2,00,000
Capital Gains			
Period of holding of shares – F.Y.2009-10 to F.Y. 2019-20			
Long-term capital gains			
Full Value of Consideration [Rs.3,00,000/75]		$ 4,000	
Less: Expenditure on Transfer			
Brokerage [Rs. 10,000/75]		$ 133.33	
Net Consideration		$ 3,866.67	
Less: Cost of Acquisition [Rs.2,00,000/64]		$ 3,125.00	

		$ 741.67	
TTBR as on 28.2.2020		74	
Long term capital gains [$ 741.67 x 74]			54,884
Income from Other Sources			
Dividend Income	10,10,000		
Less: Exempt under section 10(34)	10,10,000	Nil	
Interest income on debentures (Gross)		75,000	
Sum of money received from friend		60,000	1,35,000
Gross Total Income			**3,89,884**
Less: **Deductions under Chapter VI-A**			
Under section 80C - Loan repayment to HDFC		20,000	
Under section 80G - Prime Minister's National Relief Fund and Drought Relief Fund 100% of Rs. 5,000 = Rs. 5,000 50% of Rs.10,000 = Rs.5000 [allowable since payment is made by a mode other than cash]		10,000	30,000
Total Income			**3,59,884**
Tax Liability:			
Income tax payable on interest income@20%		15,000	
Income tax payable on long-term capital gains@10%		5,488	
Income tax payable on other incomes of Rs.2,30,000		Nil	20,488
Add: Health & Education Cess@4%			820
Total Tax Liability			**21,308**
Less: TDS			20,000
Net Tax Payable			**1,308**
Net Tax Payable (Rounded off)			**1,310**

Computation of total income & tax liability under the regular provisions of the Act for A.Y. 2020-21

Particulars	Amount (Rs)	Amount (Rs)	Amount (Rs)
Income from House Property			
Gross Annual Value		3,10,000	
Less: Municipal Taxes paid and borne by the owner		10,000	
Net Annual Value		3,00,000	
Less: Deductions under section 24			
(a) 30% of NAV	90,000		
(b) Interest on Loan	10,000	1,00,000	2,00,000
Capital Gains			
Period of holding of shares – FY 2009-10 to 2019-20			
Long-term capital gains			
Full Value of Consideration		3,00,000	
Less: Expenditure on Transfer			

Brokerage		10,000	
Net Consideration		2,90,000	
Less: Cost of acquisition		2,00,000	90,000
Higher of the following			
Original cost of acquisition	2,00,000		
Lower of fair market value as on 31.1.2018 and Full value of consideration (i.e., lower of Rs. 1,80,000 and Rs. 3,00,000)	1,80,000		
[Indexation and currency fluctuation benefit not allowable on capital gain chargeable under section 112A]			
Income from Other Sources			
Dividend Income	10,10,000		
Less: Exempt U/s 10(34)	10,10,000	Nil	
Interest Income on Debentures (Gross)	75,000		
Less: Interest Paid	25,000	50,000	
Sum of money received from friend		60,000	1,10,000
Gross Total Income			**4,00,000**
Less: **Deductions under Chapter VI-A**			
Under section 80C- Loan repayment to HDFC		20,000	
Under section 80G - Prime Minister's National Relief Fund and Drought Relief Fund 100% of Rs. 5,000 = Rs. 5,000 50% of Rs.10,000 = Rs.5000 [allowable since payment is made by a mode other than cash]		10,000	30,000
Total Income			**3,70,000**
Tax Liability:			
Income tax payable on long term capital gains [Since10% tax is attracted under section 112A, in excess of Rs.1,00,000]		Nil	
Income tax payable on other incomes of Rs.2,80,000		1,500	1,500
Add: Health & Education Cess@4%			60
Total tax liability			1,560
Less: TDS			20,000
Net Refund Due			**(18,440)**

Notes:

#1 Capital gains on transfer of STT paid shares are covered by section 112A. Consequently, no tax is payable upto gains of Rs.1,00,000.

#2 Indexation and currency fluctuation benefit is not available under the regular provisions of the Act in respect of capital gains chargeable under section 112A.

Indexation benefit is not available under special provisions of the Act.

#3 As per newly inserted clause (viii) in section 9(1), "income arising outside India, being any sum of money referred to in sub-clause (xviia) of clause (24) of section 2, paid on or after the 5th day of July, 2019 by a person resident in India to a non-resident, not being a company, or to a foreign company would be deemed to accrue or arise in India."

Consequently, sum of money received from friend Rs.60,000/- is taxable in India. However, Work of Art shall not be deemed to accrue in India as only "Sum of Money" shall be deemed to accrue in India.

#4 Section 115BBDA is applicable only in case of Residents. Hence, Dividend Income in the hands of Non-resident shall not be taxable. Thus, entire dividend would be fully exempted under section 10(34)

#5 Rebate under section 87A is not available to non-resident individual.

Answer to Q.2:

Two enterprises shall be deemed to be associated enterprises if, at any time during the previous year, more than half of the board of directors or members of the governing board, or one member executive directors or executive members of the governing board of one enterprise, are appointed by the other enterprise.

In the present case, the power to appoint is only for half the number and not more than half. Hence, they are not associated enterprises under this criteria.

Two enterprises shall be deemed to be associated enterprises, if 90% or more of the raw materials and consumables required for the manufacture or processing of goods or article carried out by one enterprise, are supplied by the other enterprise, or by persons specified by the other enterprise, and the prices and other conditions relating to the supply are influenced by such other enterprise.

Here, Canada Supply Inc supplies more than 90% of the requirements of purchases of Bombay Buying Ltd. Further, the price is controlled by the former by way of written agreement. Also, the conditions for supply are determined by Canada Supply Inc., the two entities would be deemed to be associated enterprises under this criterion.