PREFACE

It is my great pleasure to present this super small summary containing all list of Sections, Rules, Articles, Circulars and other relevant factors for Elective Paper 6C-International Taxation.

The most salient feature of this summary is mention of precise Page numbers of every provision as per STUDY MATERIAL OF ICAI which may help a student to save his/her valuable time during the exam.

This is something which was there in my mind since day one when Elective Paper was announced by ICAI and I have tried my best to make it as useful as possible for all my dearest students.

WE ARE FIRST IN INDIA TO INNOVATE SUCH THINGS FOR ELECTIVE PAPER NOV 2018 AND CONTINUING IT FOR MAY/NOV 2019 & NOW FOR MAY/NOV 2020. YOU WILL FIND THAT SUMMARY IN BOOK 2.

I hope this may help you all. Kindly share your feedback.

In case of any errors or omission kindly forgive for the same.

ALL THE BEST,

GOD BLESS YOU ALL.

CA AARISH KHAN.

ALL THE BEST TO THE STUDENTS
Elective Paper 6C
International Taxation

(Relevant for May, 2020 and November, 2020 examinations)
This study material has been prepared by the faculty of the Board of Studies. The objective of the study material is to provide teaching material to the students to enable them to obtain knowledge in the subject. In case students need any clarifications or have any suggestions for further improvement of the material contained herein, they may write to the Director of Studies.

All care has been taken to provide interpretations and discussions in a manner useful for the students. However, the study material has not been specifically discussed by the Council of the Institute or any of its Committees and the views expressed herein may not be taken to necessarily represent the views of the Council or any of its Committees.

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BEFORE WE BEGIN ...

Revised Scheme of Education and Training: Bridging the competence gap

The role of a chartered accountant is evolving continually to assume newer responsibilities in a dynamic environment. There has been a notable shift towards strategic decision making and entrepreneurial roles that add value beyond traditional accounting and auditing. The causative factors for the change include globalisation leading to increase in cross border transactions and consequent business complexities, significant developments in information and technology and financial scams underlining the need for a stringent regulatory set up. These factors necessitate an increase in the competence level of chartered accountants to bridge the gap between competence acquired and competence expected from stakeholders. Towards this end, the scheme of education and training is being continuously reviewed so that it is in sync with the requisites of the dynamic global business environment; the competence requirements are being stepped up to enable aspiring chartered accountants to acquire the requisite professional competence to take on new roles.

In the Revised Scheme of Education and Training, the concept of electives has been introduced at the Final level in line with the school of thought that specialisation is the key to developing professionally competent chartered accountants. As per this school of thought, an emerging chartered accountant has to be geared up to assume new roles as consultants and advisors, necessitated on account of growing business complexities, dynamic changes in legislations and regulatory requirements and client expectations.

Elective Paper on International Taxation: Paving way for specialization in this key concern area of businesses engaged in cross border transactions and tax administrations

Consequent to borderless economies, it has become imperative that subjects which transcend borders be added in the curriculum, for instance, Global Financial Reporting Standards and International Taxation. In fact, globalisation, capital mobility and increased trade and services have resulted in the whole world virtually becoming one market and consequently, international taxation has become a key concern area both for business enterprises engaged in cross border transactions as well as for tax administrations of the concerned States. In a highly advanced IT enabled business scenario where an entity operates from many establishments spread throughout the globe, chartered accountants have to be well versed with the nuances of international taxation to be able to give an informed and correct advice and ensure compliance with tax laws. With this objective, International Taxation has been introduced as an elective paper in the Final Course. In fact,
the core paper on Direct Tax Laws and International Taxation [Paper 7] in the Final Course, in which there is a dedicated part on International Taxation for 30 marks, lays the foundation for further specialisation in the area of International Taxation by opting for the Elective Paper [Paper 6C] on International Taxation.

**Syllabus of International Taxation: Division into two parts**

The syllabus of this elective paper on International Taxation is divided into two parts: Part I comprises of "Taxation of International Transactions and Non-resident Taxation in India" covering Transfer Pricing provisions under the Income-tax Act, 1961, Non-resident Taxation, Double Taxation Relief, Advance Rulings as well as an Overview of the Law and Procedures under the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015. Part II comprises of “Other aspects of International Taxation” covering Taxation of E-Commerce Transactions, Overview, Features, Application and Interpretation of Tax Treaties, Anti Avoidance Measures and Overview of Model Tax Conventions.

**Elective Paper on International Taxation: Building on the knowledge base of the Core Paper on Direct Taxes and International Taxation**

Part I of the syllabus of this paper comprises of five chapters and Part II comprises of four chapters. In this Study Material, the contents of Part I on Taxation of International Transactions and Non-resident Taxation in India are based on the provisions of income-tax law, as amended by the Finance (No. 2) Act, 2019. The relevant assessment year is A.Y.2020-21.

Students may note that in the chapters comprised in Part I of the Syllabus of this Elective Paper, the special provisions relating to non-resident taxation, transfer pricing, double taxation relief and advance rulings under the Income-tax Act, 1961 are dealt with in detail in this Study Material. Also, certain general provisions of the Income-tax Act, 1961 which would apply in the same or modified form to non-residents have been discussed at some length. Since these general provisions and other general provisions of the income-tax law are dealt with in detail in the core paper on Direct Tax Laws and International Taxation [Final Paper 7], students are expected to integrate and apply the provisions of income-tax law (dealt with in Final Paper 7: Direct Tax Laws and International Taxation and in the Elective Paper 6C: International Taxation) in making computations and addressing relevant issues in case study based questions raised in the Elective Paper on International Taxation.

**Enhance your knowledge through the webpages on international taxation and non-resident taxation and relevant Acts and Rules available at the Income-tax Department website**

Along with the Study Material, students are also advised to read the relevant provisions of the Income-tax Act, 1961 [as amended by the Finance (No.2) Act, 2019], the updated edition of the Income-tax Rules, 1962, Black Money (Undisclosed Foreign Income and Assets) and Imposition of

The double taxation avoidance agreements (DTAAs) entered into by India with different countries are available on this website, and it is important that students read and appreciate the different articles forming part of the DTAAs. Furthermore, the webpage on international taxation https://www.incometaxindia.gov.in/pages/international-taxation.aspx contains useful compilation on various topics relating to international taxation, like, advance ruling, transfer pricing, withholding tax, DTAAs etc and the webpage on non-resident taxation https://www.incometaxindia.gov.in/pages/non-resident-specific-content.aspx details the specific provisions relating to non-residents. Students are advised to go through the contents of these webpages and enhance their knowledge on international taxation. This would help them to solve the case study based questions in a more effective manner. Students may note that case studies on international taxation are being hosted at the BoS Knowledge Portal on the Institute’s website www.icai.org from time to time.

**Happy Reading and Best Wishes!**
ELECTIVE PAPER – 6 C: INTERNATIONAL TAXATION

(One paper – Three hours – 100 Marks)

Objective:
To develop an understanding of the concepts, principles and provisions relevant to international taxation and acquire the ability to apply such knowledge to make computations and address issues in practical case scenarios.

Content:

Part I - Taxation of International Transactions and Non-resident Taxation in India

1. Transfer Pricing provisions under the Income-tax Act, 1961, including
   (i) Arm’s Length Price
   (ii) International Transactions
   (iii) Most Appropriate Method
   (iv) Functions, Assets and Risk Analysis
   (v) Documentation & Compliances
   (vi) Specific Reporting Regime in respect of Country by Country reporting and master file
   (vii) Advance Pricing Agreements

2. Other Provisions relating to taxation of international transactions and non-resident taxation under the Income-tax Act, 1961
   (i) Non-resident Taxation (including Source Rule of Taxation)
   (ii) Double Taxation Relief
   (iii) Advance Rulings

3. Law and Procedures under the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 – An Overview.
Part II – Other aspects of International Taxation

1. Overview of Model Tax Conventions
   (i) OECD Model Tax Convention
   (ii) UN Model Tax Convention
   (iii) US Model Tax Convention*

2. Tax treaties, Application and Interpretation
   (i) Features of Tax treaties
   (ii) Overview of Tax Information Exchange Agreements
   (iii) Commentaries and their importance
   (iv) Role of Vienna Convention in application and interpretation of tax treaties

3. Anti Avoidance Measures
   (i) Controlled Foreign Corporations
   (ii) Base Erosion and Profit Shifting
   (iii) Other Anti Avoidance Measures

4. Taxation of E-Commerce Transactions
   (i) Introduction
   (ii) Emerging issues
   (iii) Equalisation levy

Note – If any new legislation(s) are enacted in place of an existing legislation(s), the syllabus will accordingly include the corresponding provisions of such new legislation(s) in the place of the existing legislation(s) with effect from the date to be notified by the Institute. Similarly, if any existing legislation(s) on direct tax laws ceases to be in force, the syllabus will accordingly exclude such legislation(s) with effect from the date to be notified by the Institute.

The specific inclusions/ exclusions in any topic covered in the syllabus will be effected by way of Study Guideline every year, if required. Specific inclusions/ exclusions in a topic may also arise due to additions/ deletions made every year by the Annual Finance Act.

* Excluded from Syllabus by way of Study Guidelines

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After studying this chapter, you would be able to -

- **appreciate** the need for incorporation of transfer pricing provisions in the Income-tax Act, 1961;
- **examine** the meaning and significance of arm’s length principle and the practical difficulties in application of arm’s length principle;
- **appreciate** the meaning and significance of the terms “associated enterprise”, “international transaction”;
- **analyze** the functions performed, assets used and risks assumed to determine the arm’s length price of an international transaction;
- **determine** the arm’s length price of an international transaction using the most appropriate method;
- **pinpoint** the responsibilities of a person entering into an international transaction to keep and maintain prescribed information and documents;
- **examine** the country-by-country reporting requirements and related matters incorporated in the income-tax law in compliance with BEPS Action Plan 13;
identify the circumstances when the Assessing Officer can invoke the power to determine the arm’s length price;

identify the cases where secondary adjustments have to be made;

appreciate the mechanisms for dispute resolution in transfer pricing cases, including filing of objections before Dispute Resolution Panel, filing of appeal, adoption of safe harbour and entering into advance pricing agreements;

appreciate the specific anti-avoidance measures incorporated in the Income-tax Act, 1961 in respect of transactions with persons located in notified jurisdictional areas;

appreciate the provisions incorporated in the Income-tax Act, 1961 restricting interest deduction claimed by an entity in respect of borrowings from an associated enterprise in line with BEPS Action Plan 4;

integrate, analyse and apply the relevant provisions to make computations and address issues relating to transfer pricing.
1.1 INTRODUCTION

Transactions between related entities may have inherent advantage as compared to transactions between unrelated entities. Such advantage may be by means of price concessions, extended credit period, reduced interest rates, lower logistics expenses, etc. With the advent of globalization, multinational companies (MNCs) have established presence in all parts of the world and are conducting business seamlessly. They can enjoy the privileges of doing business with related parties whereas companies which deal with unrelated parties in an open market are not able to exploit such benefits. Therefore, in order to ensure safe and fair dealing among all companies and markets, the need to introduce regulations for transfer pricing was felt.

In addition to price related benefits, MNCs may also bear in mind the goal of minimizing tax burden and maximizing profits but the two tax jurisdictions/countries also need to ensure that they are not losing their fair share of tax revenue in such cases. This has given rise to an internationally accepted practice that such ‘transfer pricing’ should be governed by the Arm’s Length Principle (ALP) and the transfer price should be the price applicable in case of a transaction of arm’s length. In other words, the transaction between associates should be priced in the same way as a transaction between independent enterprises. Today, transfer pricing is one of the most important issues faced by MNCs as they attempt to fairly distribute their profits amongst the companies within the group. While on the other hand, the tax authorities implement transfer pricing regulations and strengthen the enforcement in order to prevent a loss of revenue for each regime where these companies are incorporated. The net result of this dichotomy is that transfer pricing has become a major tax issue for the companies.

The principles governing the taxation of MNCs are embodied in the OECD Model Tax Convention of Income and Capital (OECD Model Convention), which serves as the basis for the bilateral income-tax treaties between Organization of Economic Cooperation and Development (OECD) member countries and between OECD member and non-OECD member countries. According to these guidelines, “Transfer prices” are the prices at which an enterprise transfers physical goods and intangible property or provides services to associated enterprises. Two enterprises are “associated enterprises” if one of the enterprises participates directly or indirectly in the management, control or capital of the other or if both enterprises are under common control. Since international transfer pricing involves more than one tax jurisdiction, any adjustment to the transfer price in one jurisdiction requires a corresponding adjustment in the other jurisdiction. If a corresponding adjustment is not made, double taxation will result.
1.2 WHAT IS TRANSFER PRICING?

Transfer pricing as a concept traditionally began with the amount charged by one segment of an enterprise for a product or service that it supplied to another segment of the same enterprise. With the evolution of MNC concept, segments of the enterprise started spreading as independent entities operating in various parts of the globe. Accordingly, the term has evolved to mean *price which is charged between two or more entities of a MNC [associated enterprises (AEs)] operating in different countries.*

For example, common business transactions between the AEs are in the nature of purchase and sale of assets, raw materials, finished goods and provision of services. Due to the lack of a natural conflict between the parties involved in commercial transactions in a group scenario, most MNCs, given their wide geographical presence, have a possibility to use their position to arrange business transaction to favourably exploit tax positions. By structuring transactions in a way which is most beneficial to the MNC from a tax perspective, the MNC is basically able to steer and manage where it books its profits and therefore also can influence actively the tax burden.

This, the tax administrators believe is unjust. Thus, to protect each country’s fair share in an MNC’s total profit, the tax authorities have established principles under which it can be assumed that related parties deal with each other as if they were independent and this principle is called the arm’s length principle.

Example:

*X Limited, a trader of goods, purchases and sells goods as below:*

<table>
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<tr>
<th>Particulars</th>
<th>Related parties</th>
<th>Unrelated parties</th>
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<tr>
<td>Purchases</td>
<td>8,00,000</td>
<td>5,00,000</td>
</tr>
<tr>
<td>Sales</td>
<td>10,00,000</td>
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<tr>
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<td>2,00,000</td>
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By increasing the costs of purchases from related parties, X Ltd has reduced its taxable profits in said jurisdiction.

1.3 MEANING OF THE TERM “ARM’S LENGTH PRINCIPLE”

The Arm’s Length Price (ALP) of a transaction between two associated enterprises is the price that would be paid if the transaction had taken place between two comparable independent and unrelated parties, where the consideration is only commercial.

The Arm’s Length Principle, in the context of taxation, is explained in the OECD Model Tax Convention as under:

“Where conditions are made or imposed between two associated enterprises in their commercial
or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly."

The OECD transfer pricing guidelines provides guidance on the application of the arm’s length principle in order to arrive at the proper transfer pricing range between associated enterprises. Market forces determine business relations between independent parties. The arm’s length principle seeks to adjust the profits between two associated enterprises by comparing the same as if the transaction is carried out between two independent enterprises. It treats each enterprise as a separate independent entity rather than as inseparable parts of a single unified business.

1.4 SIGNIFICANCE OF ARM’S LENGTH PRINCIPLE

There are several reasons as to why the OECD member countries and other countries have adopted the arm’s length principle.

Parity between MNCs and independent enterprises – A major reason is that the ALP provides broad parity of tax treatment for MNCs and independent enterprises. Since the ALP puts associated and independent enterprises on a more equal footing for tax purposes, it avoids the creation of tax advantages and disadvantages that would otherwise distort the relative competitive positions of these entities. The ALP, thus promotes the growth of international trade and investment by removing these tax considerations from economic decisions.

Determines real taxable profits - The transfer price adopted by a multinational has a direct bearing on the proportional profit it derives in each country in which it operates. If inadequate or excessive consideration is paid for the transfer of goods, services or intangible property between the members of an MNC group, the income calculated for each of those members will be inconsistent with their relative economic contributions. An ‘arm’s length’ price – a price two independent firms operating at arm’s length would agree on – is needed to determine taxable profits earned in each country. The arm’s length doctrine permits the taxing authorities to rectify the accounts of the enterprise so as to reflect correctly the income that the establishment would have earned if it were an independent enterprise.

Reduction of artificial price distortion - If the ALP is not followed, an MNC will sell goods/provide services to a controlled entity in a high tax regime at a high price (which exceeds the market price) and to an entity in a low-tax regime or a tax haven at a low price (which is lower than the market price). This would result in extreme price distortion of goods and services in the international market.

Minimization of double taxation – The ALP is an international concept and it represents the international norm. The potential for double taxation is minimized, since in international transfer pricing, adjustment to the transfer price in one tax jurisdiction requires a corresponding adjustment in the other tax jurisdiction.
**Accurate measurement of economic contribution** – The ALP provides accurate measurement of the fair market value of the economic contribution units of an MNC. The focus of the ALP is to ensure that the proper amount of income is attributed to where it is earned. This result in each unit of the MNC earning a return commensurate with its economic contribution and risk assumed.

### 1.5 PRACTICAL DIFFICULTIES IN APPLICATION OF ALP

There are, however, certain practical difficulties in applying the ALP, which are described hereunder:

**True comparison difficult in certain cases** – The commercial and financial conditions governing a transaction between independent enterprises are, by and large, never similar to those existing between associated enterprises. As a result, there cannot be a true comparison. The economies of scale and integration of various business activities of the associated enterprise may not be truly appreciated by arm’s length principle. Further, associated enterprises may enter into transactions which independent enterprises may not enter into, like say, licensing of valuable intangible or sharing the benefits of research. The owner of an intangible may be hesitant to enter into licensing arrangements with independent enterprises for fear of the value of the intangible being degraded. In contrast, he may be prepared to offer terms that are less restrictive to associated enterprises because the use of the intangible can be closely monitored. Further, there is no risk to the overall group’s profit from a transaction of this kind between members of an MNC group. In such situations, where independent enterprises seldom undertake transactions of the type entered into by associated enterprises, the ALP is difficult to apply because there is little or no direct evidence of what conditions would have been established by independent enterprises.

**Availability of data and reliability of available data** – There may be difficulty in getting adequate and reliable information and data in order to apply arm’s length principle. The comparison of controlled and uncontrolled transactions between associated and independent enterprises usually requires a large quantum of data. Easily accessible information may be incomplete and difficult to interpret while the relevant and required information may be difficult to obtain due to geographical constraints or secrecy and confidentiality aspects. In other cases, information about an independent enterprise which could be relevant may not exist at all. Due to these difficulties, the tax administration and tax payers may have to exercise reason and judgment when applying the ALP.

**Absence of market price** - There must be a reasonably reliable and comparable uncontrolled market price. The ALP does not meet this condition because of the nature of the market place. A market price is an outcome of unique negotiations. It may be possible to know the price range, but it is very difficult to know the actual market price unless a market transaction actually takes place.

**Absence of comparable market price for “intangible” transactions** - The ALP reaches a comparable uncontrolled market price that is reasonably reliable for standard transactions where the price range is narrow and market price is certain. However, the ALP generally fails to achieve a comparable market price for transactions involving intangibles because they are unique. The unique nature of these transactions creates a very wide price range.
Administrative burden - In certain cases, the arm’s length principle may result in an administrative burden for both the taxpayer and the tax administrations of evaluating significant numbers and types of cross-border transactions.

Time lag - Although an associated enterprise normally establishes the conditions for a transaction at the time it is undertaken, at some point the enterprise may be required to demonstrate that these are consistent with the arm’s length principle. The tax administration may also have to engage in the verification process perhaps some years after the transactions have taken place. It may result in substantial cost being incurred by the tax payer and the tax administration. It is also difficult to appreciate the business realities which prevailed at the time when the transactions were entered into. This may lead to bias against the tax payer.

In spite of the practical difficulties listed above, OECD member countries are of the view that the ALP does provide a sound basis to appreciate the transfer pricing between associated enterprises. It has so far provided acceptable solutions to both taxpayers and the tax administrations. The experience gained so far should be effectively used to remove the practical difficulties and improve the administration.

1.6 EVOLUTION OF TRANSFER PRICING IN INDIA

Post the globalization / liberalization in 1991, the enhanced presence of MNCs in India and their ability to allocate profits in different jurisdictions by controlling prices in intra-group transactions, made the issue of transfer pricing a matter of serious concern for the Indian exchequer. Just like their global counterparts, the Indian tax authorities presumed the ability/intention of the MNCs to resort to transfer pricing as tool to shift profits and thereby erode the Indian tax base. This presumption ultimately laid to the evolution of the transfer pricing regulations in India.

Pre 2001 scenario: Prior to the introduction of comprehensive transfer pricing regulations by the Finance Act, 2001, certain basic provisions existed under the income-tax and the customs and excise legislation. While provisions like erstwhile Section 92 and Rule 10 did exist in law (which empowered the Assessing Officers to examine inter-company transactions of MNC group), however, given their restricted scope/ methodology, it was felt over a period of time that the same were not sufficient enough to prevent the erosion of the Indian tax base on account of inter-company transactions undertaken by MNC members. There was no detailed statute on transfer pricing. Further, the term “related parties” found mention under the company law and the anti-trust legislation.

In Mazagaon Dock Ltd v. CIT, the concept of transfer pricing was considered by the Supreme Court with reference to section 42 of the Indian Income-tax Act, 1922, when the law relating to transfer pricing was in its rudimentary stage. The question before the Supreme Court was whether the transaction between the non-resident British companies and the Indian company were at arm’s length. If not, whether it is covered within the scope set out under section 42(2) of the Indian Income-tax Act, 1922. It was observed that section 42 states that it is not the question of the non-residents carrying on business in the abstract but of their carrying on business with the resident. The arrangement has to be looked into and decided on the taxability.
The Apex court rejected the contentions of the Indian company and held that profits, if any foregone, must be taxed. The court expressed the view that the fact, that the dealings were such as to yield no profit, was immaterial.

Section 42(2) in the Indian Income-tax Act, 1922 dealt with the situation concerning ‘Transfer pricing’. On the enactment of the Income-tax Act, 1961 (the Act), the provisions of section 42(2) were incorporated in this Act in the form of section 92 with minor changes to bring out the purport of the section more clearly. Section 92 was backed by Rule 10 and 11 of the Income-tax Rules, 1962.

For invoking section 92, certain requisite conditions had to exist. These were:

(i) The business was transacted between a resident and a non-resident.
(ii) There was a close connection between the two.
(iii) On the account, the course of business was so arranged that the business produces either no profit or less than normal profit to the resident.

If the conditions at (i) to (iii) were found to exist, the Assessing Officer was empowered under the Act to:

• determine the amount of profits, which may reasonably be deemed to have been derived from such business; and
• include such amount in the total income of the resident.

Rules 10 and 11 provided the methodology for working out the normal profit to be included in the income of the resident assessee in the circumstances mentioned earlier. The normal profit could be calculated:

(i) at such percentage of the turnover so accruing or arising as the Assessing Officer may consider to be reasonable, or
(ii) on any amount which bears the same proportion to the total profits and gains of the business of such person, as the receipts so accruing or arising bear to the total receipts of the business, or
(iii) in such other manner as the Assessing Officer may deem suitable.

Section 92 as it existed prior to its amendment, was not sufficient to deal with complex cases of transfer pricing. Its primary shortcomings were:

• The section applied only to ‘businesses’ between a resident and a non-resident. Since business demands a continuity of relationship, isolated transactions were outside its purview.
• The section was not wide enough in its scope to cover cases of transfer of services or intangibles.
• The section was not applicable in the case where a non-resident entered into a transaction with another non-resident. Therefore, business transactions between a permanent
establishment of a non-resident company and a non-resident were not covered.

- The section provided for adjustment of profits instead of adjustment of prices and the rules prescribed for estimating profits were not scientific.
- The concept of ‘close connection’ was not defined, leading to arbitrariness in applying the said provisions.
- No detailed rules for necessary documentation were prescribed to defend actions by the Revenue authorities.

In March 1999, the Standing Committee on Finance realised that the existing transfer pricing policy framework may not be effective to curb transfer pricing abuse in India. In view of the above, the Central Board of Direct Taxes (CBDT) set up an Expert Group on Transfer Pricing in November, 1999 to determine whether any amendments were necessary in the Act and if so to suggest a regulatory framework for the same.


**Post 2001 scenario:** The Finance Act, 2001 introduced Transfer Pricing Regulations for curbing tax avoidance and manipulation of intra-group transactions by abusing transfer pricing. Specifically, the memorandum to the Finance Act, 2001 stated that:

“The increasing participation of multinational groups in economic activities in the country has given rise to new and complex issues emerging from transactions entered into between two or more enterprises belonging to the same multinational group. The profits derived by such enterprises carrying on business in India can be controlled by the multinational group, by manipulating the prices charged and paid in such intra-group transactions, thereby, leading to erosion of tax revenues. With a view to provide a statutory framework which can lead to computation of reasonable, fair and equitable profits and tax in India, in the case of such multinational enterprises, new provisions are proposed to be introduced in the Income-tax Act.”

Accordingly, sections 92 to 92F had been included in Chapter X of the Income-tax Act, 1961, through the Finance Act, 2001, providing for a transfer pricing mechanism based on computation of income from cross-border transactions. The following conditions must be satisfied in order to attract the special provisions of Chapter X relating to avoidance of tax:

(i) There must be an international transaction;
(ii) Such international transaction should be between two or more associated enterprises either or both of whom are non-residents;
(iii) Such international transaction should be in the nature of:
    (a) purchase, sale or lease of tangible or intangible property; or
(b) provision of service; or
(c) lending or borrowing money; or
(d) any other transaction having a bearing on the profits, income, losses or assets of such enterprise.

(iv) Further, such transaction may also involve allocation or apportionment of, or any contribution to any cost or expenses incurred or to be incurred in connection with a benefit, service or facility provided or to be provided to any one or more of the associated enterprises on the basis of mutual agreement or arrangement between such associated enterprises.

(v) Such international transaction must be done at arm’s length price and if such international transaction has been done at less than the arm’s length price, it shall require determination of income or apportionment of cost or expense on the basis of arm’s length price.

(vi) The above adjustment should either result in an increase of income or decrease of loss returned by the assessee. In other words, the adjustment should not have the effect of reducing the income chargeable to tax or increasing the loss.

The provisions of Chapter X apply to international transactions entered into with effect from 1st April, 2001. Rules 10A to 10E have been inserted in the Income-tax Rules, 1962 by a notification dated 21st August, 2001. These sections and rules of the Income-tax Act, 1961 and the Income-tax Rules, 1962 respectively, will affect all non-corporate and corporate assessee who have dealings with non-residents for import or export of goods, properties or services. In other words, price paid for import of goods, properties or services and price received for export of goods, properties or services will be subject to scrutiny by the Assessing Officer. Therefore, it is necessary to make a detailed study of these provisions. All assesses who have such dealings with non-residents will have to keep detailed records as prescribed under the Rules and will have to furnish audit report every year with the return of income about their international transactions.

1.7 COMPUTATION OF INCOME FROM TRANSACTION WITH NON-RESIDENT [SECTION 92]

Section 92 provides that any income arising from an “international transaction” shall be computed having regard to “the arm’s length price”. For this purpose, the allowance for any expense or interest shall be determined on the basis of arm’s length price. The section further provides that in an international transaction between two or more ‘associated enterprises” when there is a mutual agreement or arrangement for the allocation or apportionment of, or any contribution to, any cost or expenses in connection with a benefit, service or facility provided to any one or more of such enterprises, the allocation of cost, expenses etc. shall be determined having regard to arm’s length price of such benefit, service or facility. Similarly, the price received for exports and amounts received for services rendered to associated enterprise will be determined on the basis of arm’s
length price. It will be noticed that in the international transaction, the income or expense will have to be at arm’s length price, if the transaction is between associated enterprises.

The objective of transfer pricing provisions is to protect the tax base of India and to ensure that due to inter-company transactions, there is no reduction in the taxable profits or the taxes paid by the Indian taxpayer. The reverse, however, does not hold true.

Section 92(3) provides that the transfer pricing provisions contained in Section 92 shall not apply if the same has the effect of reducing the income chargeable to tax or increasing the loss of the assessee for the year under consideration.

The same can be understood with the help of the following example:

**Example:**

<table>
<thead>
<tr>
<th>Case</th>
<th>Income as determined by assessee</th>
<th>Income as per ALP</th>
<th>Expenses claimed by assessee</th>
<th>Expenses as per ALP</th>
<th>Profit/Loss as per assessee</th>
<th>Profit/Loss after applying TP provisions</th>
<th>Has TP resulted in reduction of taxable income/increase of losses?</th>
<th>Will TP provisions apply?</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>100</td>
<td>150</td>
<td>70</td>
<td>70</td>
<td>30</td>
<td>80</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>2</td>
<td>100</td>
<td>90</td>
<td>70</td>
<td>70</td>
<td>30</td>
<td>20</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>3</td>
<td>100</td>
<td>90</td>
<td>110</td>
<td>110</td>
<td>(10)</td>
<td>(20)</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>4</td>
<td>100</td>
<td>100</td>
<td>70</td>
<td>110</td>
<td>30</td>
<td>(10)</td>
<td>Yes</td>
<td>No</td>
</tr>
</tbody>
</table>

**1.8 ASSOCIATED ENTERPRISES**

Associated enterprises are those which are owned or controlled by the same or common entity/person. Section 92A of the Act defines the term ‘Associated Enterprises’ for the purpose of provisions relating to Transfer Pricing. As per Section 92A(1) of the Act, associated enterprise refers to:

a) an enterprise which participates, directly or indirectly, or through one or more intermediaries, in:
   - management of the other enterprise, or
   - control of the other enterprise, or
   - capital of the other enterprise.
Example: A Ltd. directly participates in management of B Ltd.

Therefore, both A Ltd. & B Ltd. are associated enterprises.

Now, consider a situation where A Ltd. directly participates in management of B Ltd. and B Ltd. directly participates in management of C Ltd. In such situation, A Ltd. has direct participation in management of B Ltd. but has an indirect participation in management of C Ltd.

Therefore, in such scenario, C Ltd. is also an associated enterprise of A Ltd.

b) If one or more persons participates, directly or indirectly, or through one or more intermediaries in:

- management of the two different enterprises
- control of two different enterprises
- capital of two different enterprises

Then, those two enterprises are associated enterprises.
**Example:** Mr. A directly has control in A Ltd. and B Ltd. In such a scenario, both A Ltd. & B Ltd. are associated enterprises since they have a common person i.e. Mr. A, who controls both entities A Ltd. & B Ltd.

**Deemed Associated Enterprises**

Two enterprises are deemed to be associated enterprises if they fall under any one or more of the situations contained in section 92A(2). This section provides 13 such situations during which associated enterprise relationship is deemed to be established. Two enterprises are deemed to be associated enterprise if:

(i) **Enterprise ownership** - One enterprise holds 26% or more of the voting power, directly or indirectly, in the other enterprise.

*Example:* A Ltd. holds 33% of voting power in B Ltd. and B Ltd. holds 40% voting power in C Ltd.

![Diagram](https://via.placeholder.com/150)

In above situation, A Ltd. holds 33% of voting power in B Ltd. directly and 40% of voting power in C Ltd. indirectly (i.e. through B Ltd.). Therefore, both B Ltd. & C Ltd. are deemed associated enterprises of A Ltd.

(ii) **Voting power by common person** - Any person or enterprise holds 26% or more of the voting power, directly or indirectly, in each of two different enterprises.

*Example:* Mr. A holds 40% of voting power in both X Ltd. and Y Ltd. where neither X Ltd. has any holding in Y Ltd. nor Y Ltd. has any holding in X Ltd.

![Diagram](https://via.placeholder.com/150)

In this situation, since Mr. A directly holds 40% of voting power in both X Ltd. and Y Ltd., X Ltd. & Y Ltd. will be deemed associated enterprises.

(iii) **Lender** - 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.

*Example:* Book value of total assets of Y Ltd. is ₹100 crores. X Ltd. advances loan of ₹60 crores to Y Ltd.
Since, in this case, X Ltd. advances loan of ₹ 60 Crores to Y Ltd, which is 60% of the book value of total assets of Y Ltd. Hence, X Ltd. & Y Ltd. are deemed associated enterprises.

(iv) **Guarantor** - One enterprise guarantees 10% or more of the total borrowings of the other enterprise.

*Example:* P Inc. has total loan of 1 million dollars from XYZ Bank of America. Out of that, A Ltd., an India company, guarantees 20% of total borrowings in case of any default made by P Inc.

*In such scenario, since, A Ltd. guarantees 20% of total borrowings of P Inc., P Inc. and A Ltd. are deemed associated enterprises.*

(v) **Appointment of Board by other enterprise** - One Enterprise appoints more than half of the board of directors or members of the governing board, or one or more executive directors or executive members of the governing board of another enterprise, or

*Example:* X Ltd. has 15 directors on its Board. Out of that, Y Ltd. has appointed 8 directors. In such case, X Ltd. and Y Ltd. are deemed associated enterprises.

(vi) **Appointment of Board of two different enterprises by same person(s)** - More than half of the directors or members of the governing board, or one or more of the executive directors or members of the governing board, of each of the two enterprises are appointed by the same person or persons.

*Example:* Mr. A appointed 9 directors out of 15 directors of X Ltd. and appointed 2 executive directors on the board of Y Ltd. In such case, since a common person i.e. Mr. A appointed more than half of the directors in X Ltd. and appointed 2 executive directors in Y Ltd., both X Ltd. and Y Ltd. are deemed associated enterprises.

(vii) **Dependence on intangibles** - The manufacture or processing of goods or articles or business carried out by one enterprise is wholly dependent (i.e. 100%) on the know-how, patents, copyrights, trade-marks, licenses, franchises or any other business or commercial rights of similar nature, or any data, documentation, drawing or specification relating to any patent, invention, model, design, secret formula or process, of which the other entity is the owner or in respect of which the other enterprise has exclusive rights.

(viii) **Dependence on supply in manufacturing process** - 90% or more of raw materials and consumables required for the manufacture or processing of goods or articles or business carried out by one enterprise, are supplied by the other enterprise, or by persons specified by the other enterprise, where the prices and other conditions relating to the supply are influenced by such other enterprise.

(ix) **Dependence on sale** - The goods or articles manufactured or processed by one enterprise, are sold to the other enterprise or to persons specified by the other enterprise, and the prices and other conditions relating thereto are influenced by such other enterprise.
(x) **Individual control** - Where one enterprise is controlled by an individual, the other enterprise is also controlled by such individual or his relative or jointly by such individual and his relatives.

*Example:* Mr. A and Mr. B are relatives. Mr. A has control over X Ltd. and Mr. B has control over Y Ltd. Therefore, both X Ltd. and Y Ltd. will be deemed associated enterprises.

(xi) **Control by Hindu Undivided Family** - Where one enterprise is controlled by a Hindu undivided family (HUF) and the other enterprise is controlled by a member of such HUF or by relative of a member of such HUF or jointly by such member and his relative

(xii) **Holding in a firm, association of persons or body of individuals** – Where one enterprise is a firm, association of persons or body of individuals, the other enterprise holds 10% or more interest in firm/AOPs/BOIs.

(xiii) **Mutual interest relationship** - There exists between the two enterprises, any relationship of mutual interest, as may be prescribed.

**Meaning of Enterprise:** The term “enterprise” is defined in section 92F(iii) to mean a person (including its certain specified Permanent Establishment) who is, or has been, or is proposed to be, engaged in any activity.
1.16 INTERNATIONAL TAXATION

- relating to the production, storage, supply, distribution, acquisition or control of articles or goods, or know-how, patents, copy rights, trade-marks, licences, franchises or any other business or commercial rights of similar nature or any data, documentation, drawing or specification relating to any patent, invention, model, design, secret formula or process, of which the other enterprise is the owner or in respect of which the other enterprise has exclusive rights, or

- the provision of services of any kind, or in carrying out any work in pursuance of a contract, or in investment, or providing loan or in the business of acquiring, holding, underwriting or dealing with shares, debentures or other securities of any other body corporate,

whether such activity or business is carried on, directly or through one or more of its units or divisions or subsidiaries, or whether such unit or division or subsidiary is located at the same place where the enterprise is located or at a different place or places.

For this purpose, the term “Permanent establishment” is defined in section 92F(iiiia) to include a fixed place of business through which the business of the enterprise is wholly or partly carried on.

1.9 INTERNATIONAL TRANSACTION

(1) International transaction [Section 92B(1)]

As per section 92B of the Act, an international transaction means:

(i) a transaction between two or more associated enterprises, either or both of whom are non-residents; and

(ii) transaction in the nature of:

(a) sale/purchase/lease of tangible property; or

(b) sale/purchase/lease of intangible property; or

(c) provision of services; or

(d) lending/borrowing money; or

(e) any other transaction having a bearing on profits, income, losses or assets of such enterprises; or

(f) mutual agreement or arrangement between two or more associated enterprises for the allocation or apportionment of, or any contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service or facility provided or to be provided to any one or more of such enterprises.

(2) Deemed international transaction [Section 92B(2)]

Where, in respect of a transaction entered into by an enterprise with a person other than an associated enterprise (hereinafter referred to as “other person”),
there exists a prior agreement in relation to the relevant transaction between the other
person and the associated enterprise or,

where the terms of the relevant transaction are determined in substance between such
other person and the associated enterprise; and

either the enterprise or the associated enterprise or both of them are non-residents,

then such transaction entered into between the enterprise and the other person shall be **deemed
to be an international transaction** entered into between two associated enterprises, **whether or
not such other person is a non-resident.**

**Example:**

*If A Ltd., an Indian company, has entered into an agreement for sale of product X to Mr. B, an
unrelated party, on 1/6/2019 and Mr. B has entered into an agreement for sale of product X with C
Inc., a non-resident entity, which is a specified foreign company in relation to A Ltd., on 30/5/2019,
then, the transaction between A Ltd. and Mr. B shall be deemed to be an international transaction
entered into between two associated enterprises, irrespective of whether or not Mr. B is a non-
resident.*

**Note** – *C Inc. is deemed to be an associated enterprise of A Ltd. since it is a specified foreign
compny in relation to A Ltd., which means that A Ltd. holds 26% or more in the nominal value of
the equity share capital of C Inc.*
(3) The scope of “international transaction” shall include:

<table>
<thead>
<tr>
<th>Transactions</th>
<th>Amplification of scope of terms used</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) Purchase, sale, transfer, lease or use of tangible property</td>
<td>Tangible property includes -</td>
</tr>
<tr>
<td></td>
<td>• building,</td>
</tr>
<tr>
<td></td>
<td>• transportation vehicle,</td>
</tr>
<tr>
<td></td>
<td>• machinery, equipment, tools, plant,</td>
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<tr>
<td></td>
<td>• furniture,</td>
</tr>
<tr>
<td></td>
<td>• commodity or</td>
</tr>
<tr>
<td></td>
<td>• any other article, product or thing;</td>
</tr>
<tr>
<td>(2) Purchase, sale, transfer, lease or use of intangible property, including</td>
<td>“Use of certain rights” refer to –</td>
</tr>
<tr>
<td>transfer of ownership or the provision of use of certain rights</td>
<td>• land use,</td>
</tr>
<tr>
<td></td>
<td>• copyrights, patents, trademarks, licences, franchises,</td>
</tr>
<tr>
<td></td>
<td>• customer list, marketing channel, brand, commercial secret,</td>
</tr>
<tr>
<td></td>
<td>• know-how,</td>
</tr>
<tr>
<td></td>
<td>• industrial property right,</td>
</tr>
<tr>
<td></td>
<td>• exterior design or practical and new design or</td>
</tr>
<tr>
<td></td>
<td>• any other business or commercial rights of similar nature.</td>
</tr>
<tr>
<td>(3) Capital financing</td>
<td>• any type of long-term or short-term borrowing,</td>
</tr>
<tr>
<td></td>
<td>• lending or guarantee,</td>
</tr>
<tr>
<td></td>
<td>• purchase or sale of marketable securities or</td>
</tr>
<tr>
<td></td>
<td>• any type of advance, payments or deferred payment or receivable or any other debt arising during the</td>
</tr>
<tr>
<td></td>
<td>• course of business.</td>
</tr>
<tr>
<td>(4) Provision of services</td>
<td>• provision of market research,</td>
</tr>
<tr>
<td></td>
<td>• market development,</td>
</tr>
<tr>
<td></td>
<td>• marketing management,</td>
</tr>
<tr>
<td></td>
<td>• administration,</td>
</tr>
<tr>
<td></td>
<td>• technical service,</td>
</tr>
<tr>
<td></td>
<td>• repairs,</td>
</tr>
<tr>
<td></td>
<td>• design,</td>
</tr>
<tr>
<td></td>
<td>• consultation,</td>
</tr>
<tr>
<td></td>
<td>• agency,</td>
</tr>
<tr>
<td></td>
<td>• scientific research,</td>
</tr>
<tr>
<td></td>
<td>• legal or accounting service.</td>
</tr>
</tbody>
</table>
(5) Business restructuring or reorganization entered into by an enterprise with an associated enterprise

All such transactions are included in the definition of "international transaction", whether or not it has bearing on the profit, income, losses or assets of such enterprises at the time of the transaction or at any future date.

(4) Further, the expression “intangible property” shall include

<table>
<thead>
<tr>
<th>Type of intangible asset in relation to</th>
<th>Examples of each type of intangible asset</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) Marketing</td>
<td>• Trademarks</td>
</tr>
<tr>
<td></td>
<td>• trade names</td>
</tr>
<tr>
<td></td>
<td>• brand names</td>
</tr>
<tr>
<td></td>
<td>• logos</td>
</tr>
<tr>
<td>(2) Technology</td>
<td>• Process patents</td>
</tr>
<tr>
<td></td>
<td>• patent applications</td>
</tr>
<tr>
<td></td>
<td>• technical documentation such as laboratory notebooks</td>
</tr>
<tr>
<td></td>
<td>• technical know-how</td>
</tr>
<tr>
<td>(3) Artistic</td>
<td>• literary works and copyrights</td>
</tr>
<tr>
<td></td>
<td>• musical compositions</td>
</tr>
<tr>
<td></td>
<td>• copyrights</td>
</tr>
<tr>
<td></td>
<td>• maps</td>
</tr>
<tr>
<td></td>
<td>• engravings</td>
</tr>
<tr>
<td>(4) Data processing</td>
<td>• proprietary computer software</td>
</tr>
<tr>
<td></td>
<td>• software copyrights</td>
</tr>
<tr>
<td></td>
<td>• automated databases</td>
</tr>
<tr>
<td></td>
<td>• integrated circuit masks and masters</td>
</tr>
<tr>
<td>(5) Engineering</td>
<td>• industrial design</td>
</tr>
<tr>
<td></td>
<td>• product patents</td>
</tr>
<tr>
<td></td>
<td>• trade secrets</td>
</tr>
<tr>
<td></td>
<td>• engineering drawing and schematics</td>
</tr>
<tr>
<td></td>
<td>• blueprints</td>
</tr>
<tr>
<td></td>
<td>• proprietary documentation</td>
</tr>
<tr>
<td>(6) Customer</td>
<td>• customer lists</td>
</tr>
<tr>
<td></td>
<td>• customer contracts</td>
</tr>
<tr>
<td></td>
<td>• customer relationship</td>
</tr>
<tr>
<td></td>
<td>• open purchase orders</td>
</tr>
</tbody>
</table>
### (7) Contract
- favourable supplier
- contracts,
- licence agreements
- franchise agreements
- non-compete agreements

### (8) Human
- trained and organised work force
- employment agreements
- union contracts

### (9) Location
- leasehold interest
- mineral exploitation rights
- easements
- air rights
- water rights

### (10) Goodwill
- institutional goodwill
- professional practice goodwill
- personal goodwill of professional
- celebrity goodwill
- general business going concern value

### (11) methods, programmes, systems, procedures, campaigns, surveys, studies, forecasts, estimates, or technical data;

### (12) any other similar item that derives its value from its intellectual content rather than its physical attributes.

## (5) Meaning of Transaction
As per section 92F(v) of the Act, “transaction” includes an arrangement, understanding or action in concert –

(a) whether or not such arrangement, understanding or action is formal or in writing; or

(b) whether or not such arrangement, understanding or action is intended to be enforceable by legal proceeding.

Section 92F(v) provides an inclusive definition of the term “transaction”. Based on the reading of the section, it is evident that it is not necessary that for a transaction undertaken between two enterprises there needs to be a formal written agreement between them. It is only relevant whether a transaction has been entered into in substance. The section also negates the requirement as to the legal enforceability of agreement or understanding.
1.10 SPECIFIED DOMESTIC TRANSACTIONS

It is common knowledge that the under invoicing of sales and over invoicing of expenses is ordinarily revenue neutral in case of a domestic transaction. However, shifting of profits from a profit making entity to related entity which is into losses or from one group entity to another to take undue advantage of tax incentive (tax holiday or any other), can create unwarranted situation of significant revenue loss to the Government.

To understand such situations in a greater detail, following examples can be referred to:

**Example 1: Profit shifting from a domestic tariff area (DTA) unit to a tax holiday unit**

### Actual situation

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Tax Holiday Unit</th>
<th>DTA Unit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax Rate</td>
<td>-</td>
<td>30%</td>
</tr>
<tr>
<td>Income from related party transaction (‘RPT’)</td>
<td>100</td>
<td>-</td>
</tr>
<tr>
<td>Other income</td>
<td>300</td>
<td>300</td>
</tr>
<tr>
<td>Expenses in relation to RPT</td>
<td>-</td>
<td>100</td>
</tr>
<tr>
<td>Other expenses</td>
<td>200</td>
<td>50</td>
</tr>
<tr>
<td>Profit / (loss)</td>
<td>200</td>
<td>150</td>
</tr>
<tr>
<td>Tax</td>
<td>0</td>
<td>45 (i.e. 150 * 30%)</td>
</tr>
</tbody>
</table>

### Shifting of profits

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Tax Holiday Unit</th>
<th>DTA Unit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax Rate</td>
<td>-</td>
<td>30%</td>
</tr>
<tr>
<td>Income from related party transaction (‘RPT’)</td>
<td>250</td>
<td>-</td>
</tr>
<tr>
<td>Other income</td>
<td>300</td>
<td>300</td>
</tr>
<tr>
<td>Expenses in relation to RPT</td>
<td>-</td>
<td>250</td>
</tr>
<tr>
<td>Other expenses</td>
<td>200</td>
<td>50</td>
</tr>
<tr>
<td>Profit / (loss)</td>
<td>350</td>
<td>0</td>
</tr>
<tr>
<td>Tax</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>
Example 2: Profit shifting from a profit making entity to a related loss making concern.

Actual situation

<table>
<thead>
<tr>
<th>Particulars</th>
<th>ABC Ltd.</th>
<th>XYZ Ltd.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax Rate</td>
<td>30%</td>
<td>30%</td>
</tr>
<tr>
<td>Income from related party transaction ('RPT')</td>
<td>100</td>
<td>-</td>
</tr>
<tr>
<td>Other income</td>
<td>300</td>
<td>300</td>
</tr>
<tr>
<td>Expenses in relation to RPT</td>
<td>-</td>
<td>100</td>
</tr>
<tr>
<td>Other expenses</td>
<td>700</td>
<td>50</td>
</tr>
<tr>
<td>Profit / (loss)</td>
<td>(300)</td>
<td>150</td>
</tr>
<tr>
<td>Tax</td>
<td>0</td>
<td>45 (i.e. 150 * 30%)</td>
</tr>
</tbody>
</table>

Tax planning to shift profits

<table>
<thead>
<tr>
<th>Particulars</th>
<th>ABC Ltd.</th>
<th>XYZ Ltd.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax Rate</td>
<td>30%</td>
<td>30%</td>
</tr>
<tr>
<td>Income from related party transaction ('RPT')</td>
<td>250</td>
<td>-</td>
</tr>
<tr>
<td>Other income</td>
<td>300</td>
<td>300</td>
</tr>
<tr>
<td>Expenses in relation to RPT</td>
<td>-</td>
<td>250</td>
</tr>
<tr>
<td>Other expenses</td>
<td>700</td>
<td>50</td>
</tr>
<tr>
<td>Profit / (loss)</td>
<td>(150)</td>
<td>0</td>
</tr>
<tr>
<td>Tax</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>

In order to provide objectivity in determination of income from domestic related party transactions and determination of reasonableness of expenditure between related domestic parties, the provisions of section 92 have been extended to include within its ambit the specified domestic transactions.

The transfer pricing provisions and other related provisions pertaining to Specified Domestic Transaction are discussed in detail in “Chapter 1: Transfer pricing and other provisions to check avoidance of tax” of Module 4: Part II- International Taxation of Paper 7: Direct Tax Laws and International Taxation.

1.11 COMPUTATION OF ARM’S LENGTH PRICE (SECTION 92C)

“Arm's length price” is defined in section 92F(ii) to mean price which is applied or proposed to be applied in a transaction between persons other than associated enterprises in uncontrolled conditions.

Section 92C deals with the method for determining arm’s length price and the factors which are to be considered for applicability or non-applicability of a particular method to a given situation. The factors as well as methods incorporated in this section are not exhaustive and the CBDT may prescribe further factors and methods.
It provides that the arm’s length price in relation to an international transaction shall be determined by any of the following methods, being the most appropriate method, having regard to the nature of transaction or class of transaction or class of associated persons or functions performed by such persons or such other relevant factors as the Board may prescribe, namely -

(a) comparable uncontrolled price method;
(b) resale price method;
(c) cost plus method;
(d) profit split method;
(e) transactional net margin method;
(f) such other method as may be prescribed by the Board.

Accordingly, the Board has prescribed that the other method for determination of arm’s length price in relation to an international transaction shall be any method which takes into account the price which has been charged or paid, or would have been charged or paid, for the same or similar uncontrolled transaction, with or between non-associated enterprises, under similar circumstances, considering all the relevant facts. [Rule 10AB]

Section 92C(2) provides that the most appropriate method out of the above methods has to be applied for determination of arm’s length price, in the prescribed manner.

Rule 10B(1) prescribed the manner to determine the arm’s length price under the five methods as stated in above diagram in respect of any goods, property or services purchased or sold under any international transaction.
(1) **Comparable uncontrolled price method:**

A comparable uncontrolled price is the price agreed between unconnected parties for the transaction of goods or services under similar circumstances.

Mechanism to determine CUP is as follows:

(i) Identification of price charged or paid for property transferred or services provided under any comparable uncontrolled transaction(s).

(ii) Such price is adjusted to account for differences, if any, between the international transaction and comparable uncontrolled transactions or between the enterprises entering into such transactions which could materially affect the price in the open market can be made.

(iii) Adjusted price arrived above taken to be as arm’s length price in respect of the property transferred or services provided in the international transaction.

**Meaning of “Uncontrolled transaction”:** Uncontrolled transaction means a transaction between enterprises other than associated enterprises, whether resident or non-resident.

The comparable uncontrolled price method requires a high degree of comparability of products, services and functions and such comparability can be improved by carrying out necessary reasonable adjustments, in respect of differences arising on account of various factors such as quality of the product or service, contractual terms, credit terms, transport terms, level of the market (i.e. wholesale, retail, etc.), geographic market in which the transaction takes place, etc.

A Comparable uncontrolled price can be determined as follows:
Transaction between AE1 and AE2 are subject to transfer pricing. Transaction #1 and #2 are internal transactions since it is entered by AEs with unrelated parties and Transaction #3 is an external transaction since it is entered between unrelated parties. Hence, controlled transactions need to be compared with either Transaction #1 (if AE1 is the tested party) or Transaction #2 (if AE2 is the tested party) or Transaction #3.

In the given example, AE1 and AE2 are parties to a controlled transaction. Assume, AE1 provides back office support services to AE2 (i.e., engaged in manufacturing of goods). The functions performed, assets deployed and risk assumed for back office support services is less complex vis-à-vis the functions performed, assets deployed and risk assumed in manufacturing activities. Hence, AE1 must be selected as tested party which has a least complex functional profile. Accordingly, controlled transaction need to be compared with Transaction #1 i.e., between unrelated party and AE1.

ILLUSTRATION 1

US Ltd., a US company has a subsidiary, IND Ltd. in India. US Ltd. sells computer monitors to IND Ltd. for resale in India. US Ltd. also sells computer monitors to CMI Ltd., another computer reseller. It sells 50,000 computer monitors to IND Ltd. at ₹11,000 per unit. The price fixed for CMI Ltd. is ₹10,000 per unit. The warranty in case of sale of monitors by IND Ltd. is handled by IND Ltd. However, for sale of monitors by CMI Ltd., US Ltd. is responsible for the warranty for 3 months. Both US Ltd. and IND Ltd. offer extended warranty at a standard rate of ₹1,000 per annum. On these facts, how is the assessment of IND Ltd. going to be affected?

SOLUTION

US Ltd., the foreign company and IND Ltd., the Indian company are associated enterprises since US Ltd. is the holding company of IND Ltd. US Ltd. sells computer monitors to IND Ltd. for resale in India. US Ltd. also sells identical computer monitors to CMI Ltd., which is not an associated enterprise. The price charged by US Ltd. for a similar product transferred in comparable uncontrolled transaction is, therefore, identifiable. Therefore, Comparable Uncontrolled Price (CUP) method for determining arm’s length price can be applied.

While applying CUP method, the price in comparable uncontrolled transaction needs to be adjusted to account for difference, if any, between the international transaction (i.e., transaction between US Ltd. and IND Ltd.) and uncontrolled transaction (i.e., transaction between US Ltd. and CMI Ltd.) and the price so adjusted shall be the arm’s length price for the international transaction.

For sale of monitors by CMI Ltd., US Ltd. is responsible for warranty for 3 months. The price charged by US Ltd. to CMI Ltd. includes the charge for warranty for 3 months. Hence arm’s length price for computer monitors being sold by US Ltd. to IND Ltd. would be:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>No.</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sale price charged by US Ltd. to CMI Ltd.</td>
<td></td>
<td>10,000</td>
</tr>
</tbody>
</table>
Less: Cost of warranty included in the price charged to CMI Ltd. 
(₹ 1,000 x 3 /12) 
<table>
<thead>
<tr>
<th>Arm’s length price</th>
<th>250</th>
</tr>
</thead>
<tbody>
<tr>
<td>Actual price paid by IND Ltd. to US Ltd.</td>
<td>9,750</td>
</tr>
<tr>
<td>Difference per unit</td>
<td>11,000</td>
</tr>
<tr>
<td>No. of units supplied by US Ltd. to IND Ltd.</td>
<td>1,250</td>
</tr>
<tr>
<td>Addition required to be made in the computation of total income of IND Ltd. (₹ 1,250 × 50,000)</td>
<td>6,25,00,000</td>
</tr>
</tbody>
</table>

No deduction under chapter VI-A would be allowable in respect of the enhanced income of ₹ 6.25 crores.

Note: It is assumed that IND Ltd. has not entered into an advance pricing agreement or opted to be subject to Safe Harbour Rules.

(2) Resale price method

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. The RPM requires high level of functional comparability and is mainly applicable where the controlled party is a distributor.

The RPM evaluates whether the amount charged in a controlled transaction is at arm’s length by reference to the gross margin realised in comparable uncontrolled transactions. RPM can be computed as follows:

(i) Identification of resale price by tested party i.e., the price at which property purchased or services obtained by the enterprise from an associated enterprise is resold or provided to an unrelated enterprise.

(ii) Resale price is reduced by normal gross profit margin with reference to uncontrolled transaction(s).

(iii) Such price reduced by expenses incurred (customs duty etc.) in connection with purchase of the product/services.

(iv) This price may be adjusted to account for functional and other differences, if any, including differences in accounting practices which could materially affect the gross profit margin in the open market.

(v) Adjusted price arrived above taken to be as arm’s length price.

RPM is generally used to test transactions involving distribution function, i.e. when the tested party purchases products/acquires services from related party and resells the same to independent parties. The use of RPM is appropriate where the reseller does not add substantially to the value
of the product/services. Where the transactions are not comparable in all ways and the differences have a material effect on price, one has to make adjustments to eliminate the effect of those differences. For this purpose, consideration of operating expenses associated with functions performed and risks assumed may be necessary, because differences in functions performed are often reflected in operating expenses.

Using RPM as the most appropriate method, ALP can be computed as follows:

\[
\begin{align*}
\text{Resale Price Method} \\
\text{Associated Enterprise 1} & \quad \text{Arm's length price?} & \text{Associated Enterprise 2} & \quad \text{Given price} & \text{Independent Enterprise} \\
\text{Given price} & = & \text{US$100} \\
\text{Resale price margin (25\%)} & = & \text{US$25} \\
\text{Arm's length price} & = & \text{US$75}
\end{align*}
\]

AE2 has purchased goods from AE1 and re-sold to independent enterprise at USD 100. A similar transaction is entered into by unrelated parties with resale price margin of USD 25. Thus, the arm's length price arrived at is USD 75 (i.e. market value of goods at which AE2 should have purchased from AE1 (assuming no other costs for AE2 for simplicity purposes).

(3) **Cost plus method**

The Cost Plus Method (‘CPM’) determines an arm's-length price by adding an appropriate gross profit margin to an associated entity’s costs of producing goods or services. The gross profit margin should reflect the functions performed by an entity and should include a return for capital used and risks assumed by the entity.

Mechanism to compute ALP based on CPM is as follows:

(i) Identification of direct and indirect costs of production incurred by the enterprise in respect of property transferred or services provided to an associated enterprise.

(ii) Determination of amount of normal gross profit mark-up to such costs arising from the transfer or provision of the same or similar property or services by the enterprise or by an unrelated enterprise in comparable uncontrolled transaction or transactions.

(iii) The normal gross profit mark-up determined above is adjusted to account for functional and
other differences, if any, which could materially affect such profit mark-up in the open market.

(iv) Adjusted gross profit mark-up added to total costs identified in (i) above.

(v) Sum arrived above is taken to be arm’s length price in relation to the supply of property or provision of services by the enterprise.

This method probably is most useful where semi-finished goods are sold between related parties, where related parties have concluded joint facility agreements or long-term buy-and-supply arrangements, or where the controlled transaction is the provision of services.

Using CPM as the most appropriate method, ALP can compute as follows:

<table>
<thead>
<tr>
<th>Cost Plus Method</th>
</tr>
</thead>
<tbody>
<tr>
<td>Associated</td>
</tr>
<tr>
<td>Enterprise 1</td>
</tr>
<tr>
<td>Arm’s length price?</td>
</tr>
<tr>
<td>Associated</td>
</tr>
<tr>
<td>Enterprise 2</td>
</tr>
</tbody>
</table>

<p>| |</p>
<table>
<thead>
<tr>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost of Associated Enterprise 1 =</td>
</tr>
<tr>
<td>$500</td>
</tr>
<tr>
<td>+ Gross profit mark-up (50%) =</td>
</tr>
<tr>
<td>$250</td>
</tr>
<tr>
<td>Arm’s length price =</td>
</tr>
<tr>
<td>$750</td>
</tr>
</tbody>
</table>

AE2 has purchased manufactured goods from AE1. A similar transaction is entered into by unrelated parties with gross profit margin of USD 250. Thus, the arm’s length price arrived at is USD 750 i.e. market value of goods at which AE2 should have purchased from AE1.

If there are differences between the controlled and uncontrolled transactions that would affect the gross profit mark-up, adjustments should be made to the gross profit mark-up earned in the comparable uncontrolled transaction. For this purpose, consideration of the operating expenses associated with the functions performed and risks assumed may be necessary, because differences in functions performed are often reflected in operating expenses.

(4) Profit split method

This is a method which may be applicable mainly in international transactions involving transfer of unique intangibles or in multiple international transactions which are so inter-related that they cannot be evaluated separately for the purpose of determining the arm’s length price of any one transaction.

The Profit Split Method (PSM) evaluates whether the allocation of the combined operating profit or loss attributable to one or more controlled transactions is at arm’s length with reference to the relative value of each controlled taxpayer’s contribution to that combined operating profit or loss. The combined operating profit or loss must be derived from the most prominently identifiable business activity of the controlled taxpayers for which data is available that includes the controlled transactions (relevant business activity).
Profit split method, generally, is applied as per following steps:

(i) Determination of combined net profit of the associated enterprises arising out of international transaction in which they are engaged.

(ii) Evaluation of relative contributions by each enterprise to the earning of such combined net profit on the basis of functions performed, risks assumed and assets employed by each enterprise. This evaluation is to be made on the basis of reliable external market data which can indicate how such contribution would be evaluated by unrelated enterprises performing comparable functions in similar circumstances.

(iii) Splitting of combined net profit amongst the enterprises in proportion to their relative contributions, as evaluated above.

(iv) Profit thus apportioned to the assessee is taken into account to arrive at the arm’s length price in relation to the international transaction.

Allocation of profits must be made in accordance with one of the following allocation methods:

(a) Comparable profit split - Under this method, uncontrolled taxpayer’s percentage of the combined operating profit or loss is used to allocate the combined operating profit or loss of the relevant business activity.

(b) Residual profit split - Following the two-step process:
   i. Allocate income to routine contributions
   ii. Allocate residual profit

The following example explains the PSM:

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Suppose in the above example, Net profit margins from all transactions were USD 100M. Depending on the contribution of each AE, the net profit of USD 70M will be distributed to all AEs (i.e. Allocate income to routine contributions). Further, after the respective contribution is allocated specifically, the residual profit of USD 30M will be distributed among AEs based on various factors.

Total profit for Related Party X:

1. Income for specific contribution (suppose 40% by X and 60% by Y) made by X: USD 28M (i.e. USD 70M x 40%)
2. Income as residual profit (i.e. 50:50) (allocated considering various factors): USD 15M (i.e. 30M x 50%)

Total Arm’s length profit of related party X: USD 43M (USD 28M + USD 15M)

(5) **Transactional net margin method**

Under the Transactional net margin method (TNMM), an arm’s-length price is determined by comparing the net profit margin in relation to an appropriate base (example costs, sales, assets) of the tested party with the net profit margin in relation to the same base, of an uncontrolled party engaged in comparable transactions.

The following steps are required to determine ALP using TNMM:

(i) Computation of net profit margin realized by the enterprise from the international transaction with an AE having regard to costs incurred or sales effected or assets employed or having regard to any other relevant base.

(ii) Computation of net profit margin realized by the enterprise or an unrelated enterprise in a comparable uncontrolled transaction by applying the same base as above.

(iii) Net profit margin realized from uncontrolled transaction is adjusted to account for differences, if any, which could materially affect the net profit margin in the open market.

(iv) The net profit margin realized by the enterprise referred in (i) above is established to be the same as net profit margin referred in (iii) above.

(v) The net profit margin thus established is taken into account to arrive at an arm’s length price for the international transaction.

The following example explains the TNMM:

<table>
<thead>
<tr>
<th>Given price</th>
<th>=</th>
<th>$10 000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost of goods sold</td>
<td>=</td>
<td>$_____?</td>
</tr>
<tr>
<td>Gross profit</td>
<td>=</td>
<td>_____?</td>
</tr>
<tr>
<td>Operating expenses</td>
<td>=</td>
<td>$ 2 000</td>
</tr>
<tr>
<td>Net profit (5% of price)</td>
<td>=</td>
<td>$ 500 Comparable</td>
</tr>
</tbody>
</table>

AE1 has purchased raw materials from its AE2 and manufactures goods for sale to third parties. The similar transaction is entered into by unrelated parties with net margin of 5% of sale price.
Thus, if AE1 earns net margin of 5% of sale price, then its transaction of purchase of raw materials from AE2 will be at arm’s length.

The following table summarises the application of method and its preferences on a general basis (The below table is illustrative only and not binding – Applicability of methods can change depending on the facts of each case):

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Comodities/Oil</td>
<td></td>
<td>√</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Payment of Interest</td>
<td></td>
<td>√</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Distribution of goods</td>
<td></td>
<td></td>
<td>√</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Provision of Services</td>
<td></td>
<td></td>
<td></td>
<td>√</td>
<td>√</td>
<td></td>
</tr>
<tr>
<td>Contract manufacturing</td>
<td></td>
<td>√</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Manufacturing</td>
<td></td>
<td>√</td>
<td></td>
<td>√</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Payment of Royalty</td>
<td></td>
<td>√</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Multiple transactions involving intangibles</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>√</td>
</tr>
<tr>
<td>Management Charges</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>No Specified Method</td>
<td>Benefit test and acceptable allocation</td>
</tr>
<tr>
<td>Sales of shares, Intangible Assets (trademark, brand name etc.)</td>
<td></td>
<td>No Specified Method</td>
<td></td>
<td>Can rely on valuation report under the other method</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

(6) **Other Method as may be prescribed by the CBDT**

The Other method allows the use of ‘any method’ which takes into account

(i) the price which has been charged or paid or

(ii) would have been charged or paid for the same or similar uncontrolled transactions with or between non-associated enterprises, under similar circumstances.

The various data which may possibly be used for comparability purposes under this method could be third party quotations, valuation reports, tender/Bid documents, documents relating to the negotiations, standard rate cards, commercial & economic business models; etc.
For applying the above methods, the comparability of the international transaction with an uncontrolled transaction is to be judged with reference to the following factors:

(i) The specific characteristics of the property transferred or services provided in either transaction;

(ii) The functions performed, taking into account assets employer or to be employer and the risks assumed, by the respective parties to the transactions;

(iii) The contractual terms (whether or not such terms are formal or in writing) of the transactions which lay down explicitly or implicitly how the responsibilities, risks and benefits are to be divided between the respective parties to the transactions;

(iv) Conditions prevailing in the markets in which the respective parties to the transactions operate, including the geographical location and size of the markets, the laws and Government orders in force, costs of labour and capital in the markets, overall economic development and level of competition and whether the markets are wholesale or retail.

Rule 10B(3) provides that an uncontrolled transaction shall be comparable to an international transaction

- if none of the differences between the transactions being comparable or between the enterprises entering into such transactions is likely to materially affect the price or cost charged or paid in, or the profit arising from, such transactions in the open market or

- reasonably accurate adjustments can be made to eliminate the material effects of such differences.

Data to be used for analyzing the comparability of an uncontrolled transaction with an international transaction

The data to be used for analyzing the comparability of an uncontrolled transaction and an international transaction should relate to the financial year (current year) in which the international transaction has been entered into.

In case the most appropriate method for determination of ALP of a transaction entered into on or after 1.4.2014 is the resale price method or cost plus method or the transactional net margin method, then, the data to be used for analyzing the comparability of an uncontrolled transaction with an international transaction shall be –

(a) the data relating to the current year; or

(b) the data relating to the financial year immediately preceding the current year, if the data relating to the current year is not available at the time of furnishing the return of income by the assessee, for the assessment year relevant to the current year.

However, where the data relating to the current year is subsequently available at the time of determination of arm’s length price of an international transaction during the course of any assessment proceeding for the assessment year relevant to the current year, then, such data shall be used for such determination irrespective of the fact that the data was not available at the time of furnishing the return of income of the relevant assessment year.
Methods for computing ALP [Section 92C]

- **CUP Method**
  - This method is applied where there are similar transaction(s) b/w unconnected parties.
  - Identify price in a comparable uncontrolled transaction (CUCT).
  - Adjust the price for material differences in terms of contract, credit, transport etc.
  - Adjusted price is ALP.

- **Resale Price Method (RPM)**
  - This method is applied where item obtained from AE is resold to unrelated party.
  - Identify the RP at which the item is resold to unrelated party.
  - Reduce the RP by the normal GP margin on CUCT & expenditure incurred (customs duty) w.r.t. purchase.
  - Adjusted price is ALP.

- **Cost Plus Method (CPM)**
  - This method is generally applied where semi-finished goods are sold to AEs.
  - Identify direct & indirect COP incurred for property transferred or services provided to AE.
  - Adjust the price for functional & other differences materially affecting GP margin in open market (OM).
  - Total Costs ↑d by adjusted mark up = ALP.

- **Profit Split Method (PSM)**
  - This method is applied where there is transfer of unique intangibles or in multiple International Transaction.
  - Determine combined NP of the AEs arising out of International Transaction.
  - Adjust the normal GP mark-up for functional and other differences materially affecting GP mark-up in OM.
  - ALP to be determined on the basis of profit apportioned.

- **Transactional Net Margin Method (TNMM)**
  - Compute NP margin of the enterprise from International Transaction with AE having regard to cost incurred/sales effected/assets employed.
  - Evaluate the relative contribution of each enterprise to the earning of combined NP on the basis of FAR.
  - Compare NP margin relative to costs/sales/assets of the AE with NP margin of uncontrolled party in comparable transactions.
  - Adjust NP margin to a/c for differences affecting NP margin in the OM.
  - Adjust NP margin realised from CUCT to a/c for differences affecting NP margin in the OM.
  - Adjust NP margin taken into a/c to arrive at ALP.
(7) Selection of tested party

The tested party will be the participant in the controlled transaction whose profitability/ pricing attributable to the controlled transactions can be verified based on the most appropriate data and requiring the fewest & most reasonable adjustments, and for which reliable data regarding uncontrolled comparables can be located.

Consequently, in most cases the tested party will be the “least complex” of the controlled taxpayers and will not own valuable intangible property or unique assets that distinguish it from potential uncontrolled comparables.

In the given example, AE1 and AE2 are parties to a controlled transaction. Assume, AE1 provides back office support services to AE 2 (i.e. engaged in manufacturing of goods). The functions performed, assets deployed and risk assumed for back office support services is less complex vis-à-vis the functions performed, assets deployed and risk assumed in manufacturing activities. Hence, AE1 must be selected as tested party which has least complex functional profile.

(8) Selection of Profit Level Indicator

A profit level indicator (PLI) is selected to test the profitability of tested party. PLIs are ratios that measure relationships between profits and costs incurred or resources employed. A variety of PLI’s can be calculated in any given case.

PLI should always have an untainted base (denominator) like adopting cost as base for export transactions and revenue as base for import transactions.

It is a practice to adopt the denominator of the PLI as being un-tainted or less-tainted. A tainted income or expense would mean one that is received from an AE or paid to an AE and therefore cannot be considered to be independent or at arm’s length. Untainted on the other hand would mean revenue or costs which relate to transactions with independent third parties and are therefore more reliable.

In above example, the revenue from back support services will be tainted because it is received from related party. So, the PLI, in the above case, should be costs.
The following table briefly summarises the various PLIs used:

<table>
<thead>
<tr>
<th>Overview of Various Profit Level Indicators</th>
</tr>
</thead>
<tbody>
<tr>
<td>Return on Assets (ROA)</td>
</tr>
<tr>
<td>Return on Capital Employed (ROCE)</td>
</tr>
</tbody>
</table>

*Johnson Matthey India (P.) Ltd. Vs Deputy Commissioner of Income-tax (2016) 380 ITR 43 (Delhi)* – It was held that reliability of ROCE as a PLI depends upon extent to which composition of assets/capital deployed by tested party and their valuation is similar to that of comparables and if balance sheet does not accurately reflect average use of capital throughout year, ROCE would be less reliable.

<table>
<thead>
<tr>
<th>Operating Margin (OM)</th>
<th>Operating profit divided by sales</th>
</tr>
</thead>
<tbody>
<tr>
<td>Return on Total Costs (ROTC)</td>
<td>Operating profit divided by total costs</td>
</tr>
<tr>
<td>Return on Cost of Goods Sold</td>
<td>Gross profit divided by cost of goods sold</td>
</tr>
<tr>
<td>Berry Ratio</td>
<td>Gross profit divided by operating expenses</td>
</tr>
</tbody>
</table>

(9) **Most Appropriate Method**

Rule 10C deals with the determination of most appropriate method. Under this Rule, the method which is best suited to the facts and circumstances and which provides the most reliable measure of an arm’s length price in relation to the international transaction will be considered to be the most appropriate method.

For the purpose of selecting the most appropriate method, the following factors should be taken into account.

(i) The nature and class of the international transaction;

(ii) The class, or classes of associated enterprises entering into the transaction and the functions performed by them taking into account assets employed or to be employed and risks assumed by such enterprises;

(iii) The availability, coverage and reliability of data necessary for application of the method;

(iv) The degree of comparability existing between the international transaction and the uncontrolled transaction and between the enterprises entering into such transactions;

(v) The extent to which reliable and accurate adjustments can be made to account for difference, if any, between the international transaction and the comparable uncontrolled transaction or between the enterprises entering into such transactions;
(vi) The nature, extent and reliability of assumptions required to be made in application of a method.

(10) Manner of computation of Arm’s length price (Applicable for international transactions undertaken on or after 1.4.2014) [Third proviso to section 92C(2)]

In case of an international transaction undertaken on or after 1.4.2014, where more than one price is determined by the most appropriate method, the ALP shall be computed in the prescribed manner specified in Rule 10CA.

Computation of arm’s length price in certain cases (Rule 10CA)

Determination of arm’s length price using one of the prescribed methods

The price thus determined is the arm’s length price

Whether a single price is arrived at?

Yes

No

As per range concept, if prescribed conditions are satisfied (covered in later sections),

(or)

By applying Arithmetic Mean in any other case

Rule 10CA(1) provides that where in respect of an international transaction, the application of the most appropriate method referred to in section 92C(1) results in determination of more than one price, then, the arm’s length price in respect of such international transaction has to be computed on the basis of the dataset constructed by placing such prices in an ascending order as provided in Rule 10CA(2).

Application of multiple year data for construction of dataset

Multiple year data allowed only in cases where determination of ALP is done using TNMM, RPM or CPM
Where the most appropriate method is the resale price method or cost plus method or
transactional net margin method and the comparable uncontrolled transaction has been identified
on the basis of data relating to the current year and the enterprise undertaking the said
uncontrolled transaction, [not being the enterprise undertaking the international transaction
referred to in sub-rule (1)], has in either or both of the two financial years immediately preceding
the current year undertaken the same or similar comparable uncontrolled transaction then,-

(i) the most appropriate method used to determine the price of the comparable uncontrolled
transaction undertaken in the current year shall be applied in similar manner to the
comparable uncontrolled transaction or transactions undertaken in the aforesaid period and
the price in respect of such uncontrolled transactions shall be determined; and

(ii) the weighted average of the prices, computed in accordance with the manner provided in
sub-rule (3), of the comparable uncontrolled transactions undertaken in the current year and
in the aforesaid period preceding it shall be included in the dataset instead of the price
referred to in sub-rule (1).

Further, where the most appropriate method is the resale price method or cost plus method or
transactional net margin method where the comparable uncontrolled transaction has been
identified on the basis of the data relating to the financial year immediately preceding the
current year and the enterprise undertaking the said uncontrolled transaction, [not being the
enterprise undertaking the international transaction referred to in sub-rule (1)], has in the financial
year immediately preceding the said financial year undertaken the same or similar comparable
uncontrolled transaction then, -

(i) the price in respect of such uncontrolled transaction shall be determined by applying the
most appropriate method in a similar manner as it was applied to determine the price of the
comparable uncontrolled transaction undertaken in the financial year immediately preceding
the current year; and

(ii) the weighted average of the prices, computed in accordance with the manner provided in
sub-rule (3), of the comparable uncontrolled transactions undertaken in the aforesaid period
of two years shall be included in the dataset instead of the price referred to in sub-rule (1).

Also, in such cases, where the use of data relating to the current year for determination of ALP
subsequently at the time of assessment establishes that,-

(i) the enterprise has not undertaken same or similar uncontrolled transaction during the
current year; or

(ii) the uncontrolled transaction undertaken by an enterprise in the current year is not a
comparable uncontrolled transaction,

then, irrespective of the fact that such an enterprise had undertaken comparable uncontrolled
transaction in the financial year immediately preceding the current year or the financial year
immediately preceding such financial year, the price of comparable uncontrolled transaction or the
weighted average of the prices of the uncontrolled transactions, as the case may be, undertaken by such enterprise shall not be included in the dataset.

Rule 10CA(3) provides that where an enterprise has undertaken comparable uncontrolled transactions in more than one financial year, then for the purposes of sub-rule (2) the weighted average of the prices of such transactions shall be computed in the following manner, namely:-

<table>
<thead>
<tr>
<th>Method used to determine the prices</th>
<th>Manner of computation of weighted average of the prices</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) The resale price method</td>
<td>By assigning weights to the quantum of sales which has been considered for arriving at the respective prices</td>
</tr>
<tr>
<td>(ii) The cost plus method</td>
<td>By assigning weights to the quantum of costs which has been considered for arriving at the respective prices</td>
</tr>
<tr>
<td>(iii) The transactional net margin method</td>
<td>By assigning weights to the quantum of costs incurred or sales effected or assets employed or to be employed, or as the case may be, any other base which has been considered for arriving at the respective prices.</td>
</tr>
</tbody>
</table>

Range Concept: Rule 10CA(4) provides that where the most appropriate method applied is –

(i) a method other than the profit split method or a method prescribed by the CBDT under section 92C(1)(d)/(f); and

(ii) the dataset constructed in accordance with sub-rule (2) consists of six or more entries,

an arm's length range beginning from the thirty-fifth percentile of the dataset and ending on the sixty-fifth percentile of the dataset shall be constructed.

If the price at which the international transaction has actually been undertaken is within the said range, then, the price at which such international transaction has actually been undertaken shall be deemed to be the arm’s length price [Rule 10CA(5)].

If the price at which the international transaction has actually been undertaken is outside the said arm’s length range, the arm’s length price shall be taken to be the median of the dataset [Rule 10CA(6)].

When to apply range concept?

• Most appropriate method selected is Comparable uncontrolled price method, resale price method, cost plus method or transactional net margin method and

• The dataset constructed has six or more entries.

How to apply?

• Arrange the values in the dataset in the ascending order.

• Where the actual transaction price falls within 35th and 65th percentile of the dataset, the value of transaction will be accepted to be arm’s length price.

• Where the transfer price does not fall within the above range, then median of dataset shall be taken as the Arm's Length price.
### Meaning of certain terms [Rule 10CA(8)]

<table>
<thead>
<tr>
<th>Term</th>
<th>Meaning</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) the thirty-fifth percentile of a dataset (having values arranged in an ascending order)</td>
<td>The lowest value in the dataset such that at least 35% of the values included in the dataset are equal to or less than such value. However, if the number of values that are equal to or less than the aforesaid value is a whole number, then, the thirty-fifth percentile shall be the arithmetic mean of such value and the value immediately succeeding it in the dataset.</td>
</tr>
<tr>
<td>(b) the sixth-fifth percentile of a dataset (having values arranged in an ascending order)</td>
<td>The lowest value in the dataset such that at least 65% of the values included in the dataset are equal to or less than such value. However, if the number of values that are equal to or less than the aforesaid value is a whole number, then, the sixty-fifth percentile shall be the arithmetic mean of such value and the value immediately succeeding it in the dataset.</td>
</tr>
<tr>
<td>(c) the median of the dataset (having values arranged in an ascending order)</td>
<td>The lowest value in the dataset such that at least 50% of the values included in the dataset are equal to or less than such value. However, if the number of values that are equal to or less than the aforesaid value is a whole number, then, the median shall be the arithmetic mean of such value and the value immediately succeeding it in the dataset.</td>
</tr>
</tbody>
</table>

#### Example 1: Where the data set comprises 7 data points (arranged in ascending order), and the percentiles computed are not whole numbers

<table>
<thead>
<tr>
<th>Percentile</th>
<th>Formula</th>
<th>Result</th>
<th>Value to be selected</th>
</tr>
</thead>
<tbody>
<tr>
<td>35&lt;sup&gt;th&lt;/sup&gt;</td>
<td>Total no. of data points in dataset x 35% = [7 x 35%]</td>
<td>2.45</td>
<td>3&lt;sup&gt;rd&lt;/sup&gt; value*</td>
</tr>
<tr>
<td>65&lt;sup&gt;th&lt;/sup&gt;</td>
<td>Total no. of data points in dataset x 65% = [7 x 65%]</td>
<td>4.55</td>
<td>5&lt;sup&gt;th&lt;/sup&gt; value*</td>
</tr>
<tr>
<td>Median</td>
<td>Total no. of data points in datasets x 50% = [7 x 0.5]</td>
<td>3.50</td>
<td>4&lt;sup&gt;th&lt;/sup&gt; value*</td>
</tr>
</tbody>
</table>

* Value referred to here is the place value in the data set as arranged in ascending order.

#### Example 2: Where the data set comprises 20 data points (arranged in ascending order), and the percentiles computed are whole numbers.

<table>
<thead>
<tr>
<th>Percentile</th>
<th>Formula</th>
<th>Result</th>
<th>Value to be selected</th>
</tr>
</thead>
<tbody>
<tr>
<td>35&lt;sup&gt;th&lt;/sup&gt;</td>
<td>Total no. of data points in dataset x 35% = [20 x 35%]</td>
<td>7</td>
<td>Mean of 7th &amp; 8th value</td>
</tr>
<tr>
<td>65&lt;sup&gt;th&lt;/sup&gt;</td>
<td>Total no. of data points in dataset x 65% = [20 x 65%]</td>
<td>13</td>
<td>Mean of 13th &amp; 14th value</td>
</tr>
</tbody>
</table>
Median Total no. of data points in datasets \( x \) 50% = \([20 \times 0.5]\)

10 Mean of 10th & 11th value

If the transaction price falls within the range, then the same shall be deemed to be the ALP. If the transaction price falls outside the range, the ALP shall be taken to be the Median of the data set.

Range concept not applicable:

In a case where the provisions of Rule 10CA(4) are not applicable, the arm’s length price shall be the arithmetical mean of all the values included in the dataset. However, if the variation between the arm’s length price so determined and price at which the international transaction has actually been undertaken does not exceed such percentage not exceeding 3% of the latter, as may be notified by the Central Government in the Official Gazette in this behalf, the price at which the international transaction has actually been undertaken shall be deemed to be the arm’s length price [Rule 10CA(7)].

1.12 FUNCTIONS, ASSETS AND RISK (FAR) ANALYSIS

Functions, Assets and Risk (‘FAR’) analysis is an analysis of the functions performed, taking into account assets used and risks assumed by associated enterprises (AEs) in controlled transactions.

A method of finding and organizing facts about a business in terms of the functions performed, assets used (including intangible property) and risks assumed by such business to:

- identify how they are divided among the AEs; and
- assess the importance of each function in the overall value chain.

FAR analysis is the starting point in determining the arm’s length price of an international transaction.

Let us take an example. Can we compare a manufacturer with a logistic service provider? The answer is “No”. Both of them will perform different functions, employ different kind of assets and undertake different type of risks. How would one determine whether the entity is a manufacturer or a logistic service provider? Simply, by undertaking FAR analysis.

Manufacturer

\[\begin{array}{c}
\text{Logistic service provider} \\
\times
\end{array}\]

Cannot be compared

Manufacturer

\[\begin{array}{c}
\text{Manufacturer} \\
\checkmark
\end{array}\]

Can be compared

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Components of a FAR analysis

The FAR analysis should direct the reader unambiguously to the correct conclusion about the characterization of the entity. For understanding the FAR, it is important to understand the entire value chain of the business that one is analyzing. A detailed discussion of the three elements of the FAR is as under:

(a) **Functions performed:** Functions performed are the activities that are carried out by each of the parties to the transaction. In performing functional analysis, important and significant functions are considered. Such functions add more value to the transactions and therefore, are expected to fetch higher returns for the entity performing such functions. Thus, the focus should not only be on identifying the maximum number of functions but on identification of critical functions performed by the related parties.

While functions performed depends on the facts of the case, some of the important functions that are generally observed and examined in a transaction are:

- Research and development
- Budgeting
- Purchasing and materials management
- Manufacturing, production or assembly work
- Warehousing and inventory
- Marketing and distribution
- Business process management/ administrative functions
- Scheduling
- Supervision

The above may differ based on the kind of entity for which one is undertaking FAR analysis. For example, in case of trading entity, the research & development related functions, or manufacturing related functions may not be present.

Having identified the principle functions performed by the parties in the controlled transaction, the next step is to compare the same with the functions performed in the uncontrolled transactions to determine the extent of comparability.
(b) **Assets employed:** As regards assets employed, one needs to identify the assets (tangible as well as intangible) used by the entities being compared in relation to the transaction under consideration. The analysis of assets employed into tangible assets and intangible assets is of vital importance.

The existence of intangible assets in the form of technical knowhow, trademarks, patents, etc. contribute to the super normal growth in profits of an enterprise.

However, an entity which owns only tangible assets which are used in normal course of operations such as computers, furniture & fixture, plant and machinery, etc. is expected to earn routine/normal profits as earned by other companies engaged in similar business.

(c) **Risks assumed:** Risk study involves identification of various risks that are assumed by each of the parties to the transaction. It is commonly understood that risk and return go hand in hand. In the open market, more the risks assumed by an enterprise, higher the returns that it expects. Conversely, in case where the risks undertaken by the enterprise in a transaction are minimal, the returns expected to be generated from such transactions should also normally be lower. An illustrative list of risks is provided below:

<table>
<thead>
<tr>
<th>Nature of risks</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Market risk</td>
<td>Risk relating to increased competition and relative pricing pressures, change in demand patterns and needs of customers, inability to develop/penetrate in a market, etc.</td>
</tr>
<tr>
<td>Inventory risk</td>
<td>Risk associated with management of inventory in case of overstocking or slow/non-moving inventory. As a result, the enterprise may be forced to bear a loss of margin on the inventory, or incur additional costs to dispose-of the same.</td>
</tr>
<tr>
<td>Credit risk</td>
<td>Risk relating to default in receivables by customers.</td>
</tr>
<tr>
<td>Product liability risk</td>
<td>Risk associated with product failures including non-performance to generally accepted or regulatory standards. This could result in product recalls and possible injuries to end-users.</td>
</tr>
<tr>
<td>Foreign exchange risk</td>
<td>Risk relating to the potential impact on profits that may arise because of changes in foreign exchange rates.</td>
</tr>
<tr>
<td>R&amp;D risk</td>
<td>Risk associated with loss incurred due to unsuccessful R&amp;D expenditure</td>
</tr>
<tr>
<td>Capacity Utilization risk</td>
<td>Risk associated with loss of profits due to unutilized capacity</td>
</tr>
<tr>
<td>Attrition risk</td>
<td>Risk associated with losing trained personnel which contribute to the success of the enterprise</td>
</tr>
</tbody>
</table>
Risk study is an important exercise as it facilitates adjustments based on differences in risks that are undertaken in a controlled transaction as compared to uncontrolled transactions. A careful analysis of the risks assumed by the transacting entities would determine the true characterization of each of the parties to the transaction. For instance, a distributor solely engaged in purchasing goods for the purpose of resale without performing any value addition may be characterized as a low risk distributor whereas a distributor who performs significant value addition in terms of packing goods, holding inventory, incurring advertisement and promotional expenditure, undertaking market risk, etc. may be characterized as a ‘full-fledged distributor’.

**Conclusion**

In practice, one cannot compare all the functions, risks and assets employed. Hence, a crucial step in the comparability analysis is the comparison of the “economically significant” functions performed, risks assumed and assets employed (i.e. such functions, assets and risks that are likely to have an impact on cost/expenses, prices, profits arising in a transaction) by the associated enterprises with those by the independent parties which have been selected as potentially comparable for benchmarking the arm’s length price of the controlled transactions.

To summarize, FAR analysis is central/core to the transfer pricing analysis. It helps in:

- Determining the nature of functions performed by the taxpayer and AE(s);
- On the basis of the above, determining true and correct characterization of the entities;
- Providing guidance on selection of most appropriate method for transfer pricing analysis; and
- Determining parameters for establishing comparability and undertaking economic adjustments.

An illustrative list of functions, assets and risks for a different entities is provided below:

<table>
<thead>
<tr>
<th>Type of entity</th>
<th>Functions</th>
<th>Assets</th>
<th>Risks</th>
</tr>
</thead>
<tbody>
<tr>
<td>Manufacturer</td>
<td>- Budgeting</td>
<td>- Intangibles</td>
<td>- Business risk</td>
</tr>
<tr>
<td></td>
<td>- Administration</td>
<td></td>
<td>- Inventory risk</td>
</tr>
<tr>
<td></td>
<td>- Product strategy and design</td>
<td></td>
<td>- Scheduling risk</td>
</tr>
<tr>
<td></td>
<td>- R&amp;D</td>
<td></td>
<td>- Product liability risk</td>
</tr>
<tr>
<td></td>
<td>- Purchasing</td>
<td></td>
<td>- Credit and collection risk</td>
</tr>
<tr>
<td></td>
<td>- Product manufacturing</td>
<td></td>
<td>- Foreign exchange fluctuation risk</td>
</tr>
<tr>
<td></td>
<td>- Quality control</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>- Inventory management</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>- Logistics</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>- Marketing</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>- Intangibles</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>- Patents, technical knowhow, trademarks, etc.</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>- Plant &amp; Machinery</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>- Storage/warehouse</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>- Office equipment</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>- Land &amp; Building</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>- Vehicles</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

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The above list is only illustrative and will depend totally on the facts of the case. There can be further difference within the types of entities, such as Manufacturer (full-fledged manufacturer, contract manufacturer, and toll manufacturer), Trader (full-fledged trader, limited risk distributor), etc.

### 1.13 CONCEPT OF COMPARABILITY ADJUSTMENTS

An uncontrolled transaction should be considered comparable to the controlled transaction only if there are no material differences (in terms of functions, assets and risks) between the transactions being compared or the enterprises entering into such transactions which would materially affect the prices or costs charged or margins arising in such transactions in the open market.

Comparability adjustments can take various forms. Some examples of prevalent comparability adjustments are provided below:

<table>
<thead>
<tr>
<th>Nature of comparable adjustment</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Working capital adjustment</td>
<td>The levels of inventories, cash on hand, debtors, creditors, other current assets and liabilities impact the level of free reserves that the company has to fulfill its day-to-day working capital requirements and the consequent levels of borrowings it needs to make to fund its working capital requirements. The extent to which companies extend and receive credit in the form of accounts payable and receivable affects their sales and cost of sales. The</td>
</tr>
</tbody>
</table>
serving price incorporates two elements: the price of the product and the time value of money lent.

Presumably, if a company were to make all sales on a cash basis, it would be willing to accept a slightly lower price for its products than if the company were to allow its customers to pay at a later date. Of course, the argument works in reverse for companies that hold accounts payable.

For example, two companies sell the same product for the same base price, but one company sells the product on a cash basis while the other extends credit and charges a slightly higher price above the base price to cover the time value of money lent to the customer.

Without an adjustment for the different terms of sale, it would appear that the company that sold its product for cash earned a lower gross margin than the other firm.

When different terms of purchase and sale distort the cost of goods sold, analysis of related party transactions can also be distorted. As a result, the cost of goods sold and sales of the comparable companies needs to be adjusted so that the terms of purchase and sale are same across all the companies.

A working capital adjustment is undertaken to adjust the margins of the comparable companies and align them with the tested party.

### Capacity Utilization adjustment

This adjustment is to bring entities with different level of capacity utilization at par with each other for comparison purpose. Capacity utilization by enterprises is an essential factor affecting net profit margin in open market because lower capacity utilization results in higher per unit cost, which, in turn results in lower profits. For example, if an entity A Ltd. is utilizing 50% of its capacity while entity B Ltd. is operating at full capacity, it may not be appropriate to compare A Ltd. and B Ltd. without undertaking this adjustment. The level of capacity utilization of the resources (plant and machinery, fixed assets, etc.) impacts the direct and fixed costs of the company. For example, if a company has high installed capacity but less utilized capacity, it shall be incurring heavy fixed costs and not earning proportionate revenue for the same. This in effect, impacts the profitability of the company. A capacity utilization adjustment is undertaken to eliminate such differences in the profitability of the tested party and the comparable companies.

### Risk adjustments

Risk adjustment is mainly relevant in case of captive entities (entities providing services or selling goods only to its associated enterprises) or low risk bearing entities.

For comparison of tested party with comparable companies, risk profiles of each of them should ideally be similar.

The comparables that would be identified might have different risk profiles as compared to tested party and in case the difference is material, adjustment would be required. Accordingly, risk adjustment is made to
adjust for the difference in the level of risks assumed by the tested party and comparables.

Accounting adjustments

This adjustment is carried out to bring the entity being compared at par with the taxpayer in terms of differences in accounting policies being followed.

1.14 DOCUMENTATION AND COMPLIANCES

(1) Documentation requirement under the Income-tax Act, 1961

Transfer pricing documentation is the documentation maintained to review Transfer Pricing arrangements for transactions taking place between different entities of the same group (also known as intra-group transactions). The primary objective of the transfer pricing documentation is to review the arm’s length (fair price) nature of the transactions taking place between different entities of an Multi National Company.

(1) Persons responsible for keeping and maintaining prescribed information and document - Section 92D imposes responsibility on every person

(i) who enters into an international transaction to keep and maintain such information and documents in respect thereof as may be prescribed by CBDT

(ii) being a constituent entity of an international group, to keep and maintain the prescribed information and document in respect of an international group.

The constituent entity is required to keep and maintain the information and document irrespective of the fact whether or not any international transaction is undertaken by such constituent entity.

The constituent entity has to furnish the information and document to the authority prescribed under section 286(1), i.e., Director General of Income-tax (Risk Assessment) in the prescribed manner, on or before prescribed date.

(2) Information and documents to be kept and maintained for prescribed period - The CBDT is empowered to prescribe the period for which the information and documents shall be kept and maintained.

(3) Assessing Officer & Commissioner (Appeals) empowered to require persons entering into international transaction to furnish prescribed information and documents - The Assessing Officer or the Commissioner (Appeals) may, in the course of any proceedings under the Income-tax Act, require any person who has entered into an international transaction to furnish any such prescribed information or documents within a period of 30 days from the date of receipt of a notice issued in this regard. The requisition period may, on request, be extended further for a period not exceeding thirty days by the Assessing Officer or the Commissioner (Appeals).
(2) Information and documents to be kept and maintained under section 92D [Rule 10D]

As per Rule 10D(1) of the Income-tax Rules, 1962, the transfer pricing documentation requirement under section 92D(1)(i) should contain the following details:

| (a) | Ownership structure of the assessee with details of shares or other ownership interest held therein by other enterprise; |
| (b) | Profile of the multinational group and basic details of associated enterprises with whom assessee has entered into international transaction; |
| (c) | Business description of the business of the assessee and associated enterprises and the industry in which the assessee operates; |
| (d) | Nature and terms (including price) of the international transactions, details of property transferred or services provided and quantum and value of each such transaction; |
| (e) | Description of functions performed, risks assumed and assets employed by the assessee and associated enterprises; |
| (f) | Records of economic and market analysis, budgets, forecasts, financial estimates for the business as a whole and for each division or product separately which may have a bearing on such transaction; |
| (g) | Record of uncontrolled transaction (if any) for analysing comparability of international transaction with such uncontrolled transaction(s); |
| (h) | Record of the analysis performed to evaluate comparability of uncontrolled transactions with the relevant international transaction or specified domestic transactions. |
| (i) | Description of method considered for determining ALP, most appropriate method along with the explanations as to why such method was selected and applied; |
| (j) | Analysis performed to determine the arm’s length price of the transactions between related parties, etc. |
| (k) | Assumptions, policies and price negotiations, if any, which critically affected the determination of the arm’s length price; |
| (l) | Details of transfer pricing adjustment(s) made (if any) and consequent adjustment made to the total income for tax purposes. |
| (m) | Any other information, data or document including information or data relating to associated enterprise which may be relevant for determining ALP. |
Rule 10D(2) provides that in a case where the aggregate value of international transactions does not exceed ₹ 1 crore, it will not be obligatory for the assessee to maintain the above information and documents.

However, it is provided that in the above cases also the assessee will have to substantiate that the income arising from the international transactions with associated enterprises, as disclosed by the accounts, is in accordance with section 92. This will mean that, even if the aggregate value of the international transactions is less than ₹ 1 crore, the assessee will have to maintain adequate records and evidence to show that the international transactions with associated enterprises are on the basis of arm’s length principle.

Information to be supported by authentic documents [Rule 10D(3)]

The information to be maintained by the assessee, is to be supported by authentic documents. These documents may include the following:

(i) Official publications, reports, studies and data bases from the Government of the country of residence of the associated enterprise, or of any other country;

(ii) Reports of market research studies carried out and technical publications brought out by institutions of national or international repute;

(iii) Price publications including stock exchange and commodity market quotations;

(iv) Published accounts and financial statements relating to the business affairs of the associated enterprises;

(v) Agreements and contracts entered into with associated enterprises or with unrelated enterprises in respect of transactions similar to the international transactions;

(vi) Letters and other correspondence documenting any terms negotiated between the assessee and the associated enterprise;

(vii) Documents normally issued in connection with various transactions under the accounting practices followed.

It is also provided that the information and documents to be maintained should be contemporaneous and should exist latest by the date specified for getting the audit report. In the case of international transactions which continue to have effect over more than one financial year, fresh documents will not be required to be maintained for each year if there are no significant change which may affect the determination of arm’s length price.

The above information and documents are required to be maintained for a period of eight years from the end of the relevant assessment year.
## (3) Structure of Transfer Pricing documentation

The illustrative structure of Transfer Pricing Study can be summarized as below:

<table>
<thead>
<tr>
<th>Executive Summary</th>
<th>Group Overview</th>
<th>Industry analysis</th>
<th>Functional analysis</th>
<th>Economic analysis</th>
<th>Conclusion</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Brief description of the business profile of the overall group</td>
<td>• Brief description of the Group’s business activities/operations/division</td>
<td>• Background of the industry</td>
<td>• Functions performed</td>
<td>• Search process</td>
<td>• High level summary of the Transfer Pricing study including transactions involving Most appropriate method etc.</td>
</tr>
<tr>
<td>• Brief description of the business profile of the assessee including AE with whom the company has undertaken international taxation</td>
<td>• Brief overview of the nature of business operations of the assessee</td>
<td>• Key drivers</td>
<td>• Assets utilized</td>
<td>• Comparable details</td>
<td></td>
</tr>
<tr>
<td>• Overview of international and specified domestic transactions</td>
<td>• Factual informational of the Group during relevant period such as turnover, number of employees etc.</td>
<td>• Challenges</td>
<td>• Risks assumed</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Information pertaining to various products and services offered by the group</td>
<td>• Future outlook</td>
<td></td>
<td></td>
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<tr>
<td></td>
<td>• Significant development during the year and etc.</td>
<td></td>
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</tr>
</tbody>
</table>

### (a) Executive Summary

The Executive summary section of the Transfer Pricing documentation captures high level analysis of the entire Transfer Pricing documentation and summarizes the results of benchmarking analysis performed to determine arm’s length price of the international transaction(s) undertaken during the relevant period.
(b) **Group Overview**

This section includes a brief description of Group’s as well as the taxpayer’s business operations.

**How to source the information?**

- The annual report of the Group is considered to be the most reliable and authentic source for information pertaining to nature of business operations, shareholding structure, products and services offered, etc.
- In case of unavailability of annual report, reliance could be placed upon other sources such as website of the Group, reference websites, publicly available databases like Prowess, Capitaline, etc.

The Group overview could be illustrated by way of the following example:

Associated Enterprise 1, a bicycle manufacturer in Country 1, sells bicycles to Associated Enterprise 2 which resells the bicycles to the independent enterprise, an unrelated bicycle dealer in Country 2.

In the instant case, the Group overview would include the following broad headings:

- Brief description of the business operations of the Group – including range of products/services offered, geographical presence, sales trend during past years, etc.
- Brief description of business operations of Associated Enterprise 1 and Associated Enterprise 2 – including details of products/services offered, date of incorporation, regional presence, shareholding pattern/structure, etc.

(c) **Industry Overview**

This section provides an understanding of the taxpayer/company’s relative positioning in the industry vis-à-vis other players and overall justification of the taxpayer’s financial results. The key objectives of industry overview are to:

- Determine taxpayer’s position within the industry;
- Provide information about the market share of the client;
- Establish linkage of industry overview with functional and economic analysis;
- Highlight the key growth drivers of the industry;
- Determining threats/challenges and opportunities pertaining to the industry; and
- Provide information about past trends and future projections of the industry.

The industry overview could be illustrated by way of following example:

Continuing the same example as above, where Associated Enterprise 1, a bicycle manufacturer in Country 1, sells bicycles to Associated Enterprise 2 which resells the bicycles to the independent enterprise, an unrelated bicycle dealer in Country 2, the following broad heads could be included while drafting the industry overview:
Industry structure – Types of bicycles produced and sold in the market, market size, demand-supply gap analysis, etc.

Characteristics of bicycle industry – Distribution channels, brief overview of legal regulations affecting the industry, factors affecting demand, sales trend of each category of bicycles relating to past 5-6 years, factors affecting demand, etc.

Key growth drivers of the industry and the potential regulatory as well as competitive threats affecting the industry, complete SWOT (Strengths, Weaknesses, Opportunities and Threats) analysis of the industry

Way forward – Future projections pertaining to industry growth and potential challenges anticipated

(d) Functional Analysis

As discussed earlier in detail, for every international transaction, the following analysis needs to be undertaken:

Identify which entity bears significant risks

Identify tangible and intangible assets used

Characterize entities based on the functions performed

Determine functions performed by the Indian entity and AE

Functional analysis

Determine pricing mechanism/strategy used

(e) Economic Analysis

Economic (or Benchmarking) analysis means analyzing or comparing the transfer price i.e. prices set in controlled environment with that of uncontrolled environment. This would broadly involve the following steps:

Selection of Tested Party

Choice of PLI

Selection of MAM

Selection of database

Selection of comparable companies

Arm’s length price

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The entire benchmarking process is illustrated with the help of following example:

**Facts of the case:** AE 1, a bicycle manufacturer in Country 1, sells bicycles to AE 2 which resells the bicycles to the independent enterprise, an unrelated bicycle dealer in Country 2.

Let AE 2 be selected as the tested party and TNMM be selected as the most appropriate method. The most appropriate PLI is ‘Operating Profit/Sales’.

For benchmarking the international transaction pertaining to import of bicycle by AE 2, the following steps need to be undertaken:

- **Selection of time period:** The Act prescribes the use of current year data in which the transaction has been undertaken. However, if the data for current year is not available for comparable companies at the time of furnishing return of income by the assesse for the assessment year, the taxpayer may consider data relating to the financial year immediately preceding the current year.

- **Undertaking search for comparables:** Assuming that in the above case study, Associated Enterprise 2 i.e. the tested party is situated in India, the search for comparable companies engaged in the business of distribution of bicycles could be undertaken by using databases such as Prowess, Capitoline, etc. Illustratively, the selection of comparables would involve application of common filters such as:
  1. Selection of comparables having sales greater than ₹ 1 crore;
  2. Selection of comparables having net worth greater than 0 (zero);
  3. Selection of comparables having trading sales/total sales greater than 50%;
  4. Selection of comparables having segment related to bicycle sales;
  5. Rejection of comparables having Related party transactions/Sales > 25%; and/or (Illustrative)
  6. Qualitative criteria: Selection of comparables engaged in distribution of bicycles.

If required, the appropriate adjustments could be carried out to account for differences in the type and quality of products, risk incurred, geographical factors, etc.
The process of selection of comparables can be illustrated as under:

Universe of comparable companies → Final set of comparable companies

Application of quantitative and qualitative filters such as Turnover, net worth, sales vs services, related party transactions, etc.

(f) Conclusion
The Conclusion section of Transfer Pricing documentation captures high level summary of the Transfer Pricing documentation, primarily including the transactions involved, most appropriate method and PLI used and the results of the benchmarking analysis.

In case the tested party is incurring losses, the justification for the same is included in this section.

Summary of Transfer Pricing Documentation

<table>
<thead>
<tr>
<th>Inputs</th>
<th>Industry Overview</th>
<th>Group Overview</th>
<th>Functional Analysis and</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
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<td></td>
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</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Selection of the tested party</td>
</tr>
<tr>
<td></td>
<td>Economic analysis</td>
<td>Selection of the most appropriate method</td>
<td>Benchmarking/ Search process</td>
</tr>
<tr>
<td></td>
<td>Economic analysis</td>
<td>Qualitative analysis/ Adjustment</td>
<td>Output</td>
</tr>
<tr>
<td></td>
<td>Economic analysis</td>
<td>Arm’s Length Price</td>
<td>Output</td>
</tr>
</tbody>
</table>

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(4) Audit Report [Section 92E]:

Under section 92E, every person who enters into an international transaction during a previous year is required to obtain a report from a chartered accountant and furnish such report on or before the specified date on the prescribed form.

Rule 10E provides that the auditor’s report shall be in Form No.3CEB. It requires the auditor to state that he has examined the accounts and records of the assessee relating to the international transactions entered into by the assessee during the relevant year. He has also to give his opinion whether the prescribed information and documents relating to the above transactions have been kept by the assessee. Further, he has to state that the particulars stated in the Annexure to his report are true and correct. The Annexure is in two parts.

In the first part of the Annexure, general information of the assessee is required to be reported. In the second part of the Annexure, the particulars about the international transactions are required to be stated. Broadly stated these particulars include list of associated enterprises, particulars and description of transactions relating to purchase, sales, provisions of service, loans, advances, etc.

“Specified date” shall have the same meaning as assigned to due date in Explanation 2 below sub-section (1) of section 139. The due date for filing of transfer pricing report under section 92E in Form 3CEB is 30th November of the assessment year.

(5) Penalties

Stringent penalties are provided in various sections for non-compliance with the above provisions. These are as under:

Penalty for failure to report any international transaction or any transaction deemed to be an international transaction: Under section 270A, penalty@50% of tax payable on under-reported income is leviable. However, the amount of under-reported income represented by any addition made in conformity with the arm’s length price determined by the Transfer Pricing Officer would not be included within the scope of under-reported income under section 270A, where the assessee had maintained information and documents, as prescribed under section 92D, declared the international transactions under Chapter X and disclosed all material facts relating to the transaction.

Failure to report any international transaction or any transaction deemed to be an international transaction to which the provisions of Chapter X applies would constitute ‘misreporting of income’ under section 270A(9), in respect of which penalty@200% would be attracted.

Penalty for failure to keep and maintain information and documentation [Section 271AA]: In order to ensure compliance with the transfer pricing regulations, section 271AA provides that, the Assessing Officer or Commissioner (Appeals) may direct the person entering into an international transaction to pay a penalty@2% of the value of each international transaction entered into by him, if the person:
(1) fails to keep and maintain any such document and information as required by section 92D(1) or section 92D(2);

(2) fails to report such international transaction which is required to be reported; or

(3) maintains or furnishes any incorrect information or document.

Penalty for failure to furnish information or document under section 92D [Section 271G]

Section 271G provides that if any person who has entered into an international transaction fails to furnish any such information or document as required by Assessing Officer or TPO or Commissioner (Appeals) within a period of 30 days from the date of receipt of a notice issued in this regard, then such person shall be liable to a penalty up to 2% of the value of each international transaction.

Penalty for failure to furnish report under section 92E [Section 271BA]

If any person fails to furnish a report from an accountant, the Assessing Officer may direct that such person shall pay, by way of penalty, a sum of ₹ 1 lakh.

<table>
<thead>
<tr>
<th>Section</th>
<th>Nature of default</th>
<th>Penalty</th>
</tr>
</thead>
<tbody>
<tr>
<td>270A(9)</td>
<td>Failure to report any International transaction or deemed International transaction to which the provision of Chapter X applies would constitute ‘misreporting of income’</td>
<td>200% of the tax payable on under-reported income</td>
</tr>
<tr>
<td>271BA</td>
<td>Failure to furnish a report from an accountant as required under section 92E</td>
<td>₹ 1 lakh</td>
</tr>
<tr>
<td>271G</td>
<td>Failure to furnish info or doc as required by Assessing Officer or CIT(A) u/s 92D(3) within 30 days from the date of receipt of notice or extended period not exceeding 30 days, as the case may be.</td>
<td>2% of the value of the International transaction for each failure</td>
</tr>
<tr>
<td>271AA</td>
<td>(1) Failure to keep and maintain any such document and information as required by section 92D(1)/(2); (2) Failure to report such International transaction which is required to be reported; or (3) Maintaining or furnishing any incorrect information or document.</td>
<td>2% of the value of each such International transaction</td>
</tr>
</tbody>
</table>

Notes:
- The penalty u/s 271AA shall be in addition and not in substitution of penalty u/s 271BA.
- If the assessee proves that there was reasonable cause for the failure, no penalty would be leviable under section 271BA, 271G and 271AA.
1.15 SPECIFIC REPORTING REQUIREMENTS – COUNTRY BY COUNTRY REPORTING

(i) Requirements as per OECD report on Action 13 of BEPS Action Plan

The report provides for:

(a) revised standards for transfer pricing documentation; and
(b) a template for country-by-country reporting of income, earnings, taxes paid and certain measure of economic activity.

(ii) Three-tier structure mandated by BEPS

The BEPS report recommends that countries adopt a standardised approach to transfer pricing documentation; it mandates the following three-tier structure:-

<table>
<thead>
<tr>
<th>Document</th>
<th>Information</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) Master File</td>
<td>Standardised information relevant for all multinational enterprises (MNE) group members</td>
</tr>
<tr>
<td>(2) Local file</td>
<td>Specific reference to material transactions of the local taxpayer</td>
</tr>
<tr>
<td>(3) Country-by-country report</td>
<td>Information relating to the global allocation of the MNE’s income and taxes paid; and Indicators of the location of economic activity within the MNE group.</td>
</tr>
</tbody>
</table>

(iii) Advantages of the three tier structure [as per BEPS Report]:

(a) Taxpayers will be required to articulate consistent transfer pricing positions;
(b) Tax administrations would get useful information to assess transfer pricing risks;
(c) Tax administrations would be able to make determinations about where their resources can most effectively be deployed, and, in the event audits are called for, provide information to commence and target audit enquiries.

(iv) Country-by-country Report: Reporting Requirements of MNEs

The Country-by-Country (CbC) report has to be submitted by parent entity of an international group to the prescribed authority in its country of residence. This report is to be based on consolidated financial statement of the group.

(a) MNEs have to report annually and for each tax jurisdiction in which they do business:

(1) the amount of revenue;
(2) profit before income tax; and
(3) income tax paid and accrued.
(b) MNEs have to report their total employment, capital, accumulated earnings and tangible assets in each tax jurisdiction.

(c) MNEs have to identify each entity within the group doing business in a particular tax jurisdiction and provide an indication of the business activities each entity engages in.

(v) **Master File: Objective & Features**

(a) The master file would provide an overview of the MNE groups business, including:

(1) the nature of its global business operations,

(2) its overall transfer pricing policies, and

(3) its global allocation of income and economic activity

in order to assist tax administrations in evaluating the presence of significant transfer pricing risk.

(b) The master file is intended to provide a high-level overview in order to place the MNE group’s transfer pricing practices in their global economic, legal, financial and tax context.

(c) The master file shall contain information which may not be restricted to transaction undertaken by a particular entity situated in particular country.

(d) Thus, information in master file would be more comprehensive than the existing regular transfer pricing documentation.

(e) The master file shall be furnished by each entity to the tax authority of the country in which it operates.

(vi) **Implementation of international consensus in India**

India is one of the active members of BEPS initiative and part of international consensus. For the purpose of implementing the international consensus, a specific reporting regime in respect of CbC reporting and also the master file has been incorporated in the Income-tax Act, 1961. The essential elements have been incorporated in the Income-tax Act, 1961 while remaining aspects would be dealt with in detail in the Income-tax Rules, 1962.

(vii) **Elements relating to CbC reporting requirement and related matters which have been incorporated in the Income-tax Act, 1961 [Section 286]**

(a) **Threshold limit for applicability of CbC reporting [Sub-section (7)]:** The reporting provision shall apply in respect of an international group for an accounting year, if the total consolidated group revenue as reflected in the consolidated financial statement (CFS) for the accounting year preceding such accounting year is above a threshold to be prescribed i.e., ₹ 5,500 crore.

Where the total consolidated group revenue of the international group, as reflected in the consolidated financial statement, is in foreign currency, the rate of exchange for the
calculation of the value in rupees of such total consolidated group revenue shall be the telegraphic transfer buying rate (TTBR) of such currency on the last day of the accounting year preceding the accounting year [Rule 10DB(7)].

(b) **Time limit for furnishing CbC report [Sub-section (2)]:** The parent entity of an international group or the alternate reporting entity, if it is resident in India shall be required to furnish the report in respect of the group to the Director General of Income-tax (Risk Assessment) for every reporting accounting year, within a period of twelve months from the end of the said reporting accounting year for which the report is being furnished, in Form No. 3CEAD.

(c) **Details to be furnished by constituent entity resident in India [Sub-section (1)]:** Every constituent entity, resident in India, of an international group having parent entity that is not resident in India, shall notify the Director General of Income-tax (Risk Assessment) at least two months prior to the due date for furnishing CbC report –

1. whether it is the alternate reporting entity of the international group; or
2. the details of the parent entity or the alternate reporting entity, if any of the international group, and the country of territory of which the said entities are resident.

The report shall be furnished in Form No. 3CEAC.

(d) **Details/ information to be included in CbC report [Sub-section (3)]:** It should contain aggregate information in respect of:

1. the amount of revenue,
2. profit and loss before income-tax,
3. amount of income-tax paid and accrued,
4. details of stated capital, accumulated earnings, number of employees, tangible assets other than cash or cash equivalent in respect of each country or territory along with details of each constituent’s incorporation country and residential status, nature and details of main business activity or activities of each constituent entity and any other information as may be prescribed.

This shall be based on the template provided in the OECD BEPS report on Action Plan 13.

(e) **Furnishing of CbC report by resident constituent entity [Sub-section (4)]:** A constituent entity of an international group resident in India, other than the parent entity or the alternate reporting entity, shall be required to furnish CbC report in Form No. 3CEAE within the **twelve months from the end of the reporting accounting year** to the Director General of Income-tax (Risk Assessment), if the parent entity of the group is resident of a country or territory,-

1. in which it is not obligated to file report of the nature of CbC report;
2. with which India does not have an arrangement for exchange of the CbC report; or
(3) there has been a systemic failure of the country or territory i.e., such country is not exchanging information with India even though there is an agreement and this fact has been intimated to the entity by the prescribed authority.

However, in case the parent entity of the constituent entity is resident of a country or territory, where, there has been a systemic failure of the country or territory and the said failure has been intimated to such constituent entity, the period for submission of the report would be six months from the end of the month in which said systemic failure has been intimated.

(f) Nomination of one constituent entity for furnishing CbC report [Proviso to subsection (4)]: If there are more than one such constituent entity of the group, resident in India, other than the parent entity or the alternate reporting entity, then the group can nominate (under intimation in writing on behalf of the group to the prescribed authority), then, one constituent entity that shall furnish the report on behalf of the group. This entity would then furnish the report.

(g) No obligation to furnish CbC report in certain cases [Sub-section (5)]: If an international group, having parent entity which is not resident in India, had designated an alternate entity for filing its report with the tax jurisdiction in which the alternate entity is resident and such alternate entity has furnished such report on or before the date specified by that country or territory, then, the entities of such group operating in India would not be obliged to furnish report if

- the report is required to be furnished under the law for the time being in force in the said country or territory
- the report can be obtained under the agreement of exchange of such reports by Indian tax authorities
- No systemic failure in respect of the said country or territory has been conveyed to any constituent entity of the group that is resident in India
- the said country or territory has been informed in writing by the constituent entity that it is the alternative reporting entity on behalf of the international group
- the same has been informed to the prescribed authority by the entity in accordance with section 286(1).

(h) Entity to furnish documents and information called for [Sub-section (6)]: The DGIT (Risk Assessment) may call for such document and information from the entity furnishing the report as it may specify in notice in writing for the purpose of verifying the accuracy. The entity shall be required to make submission within thirty days of receipt of notice or further period if extended by the prescribed authority, but extension shall not be beyond a further period of 30 days.
(viii) **Penalty for non-furnishing of the report by any reporting entity which is obligated to furnish such report [Section 271GB(1) & (3)]**

<table>
<thead>
<tr>
<th>Period of delay/default</th>
<th>Penalty</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) Not more than a month</td>
<td>₹ 5,000 per day</td>
</tr>
<tr>
<td>(b) beyond one month</td>
<td>₹ 15,000 per day for the period exceeding one month</td>
</tr>
<tr>
<td>(c) Continuing default even after service of order levying penalty either under (a) or under (b)</td>
<td>₹ 50,000 per day of continuing failure beginning from the date of service of order</td>
</tr>
</tbody>
</table>

(ix) **Penalty for failure to produce information and documents within prescribed time [Section 271GB(2) & (3)]**

<table>
<thead>
<tr>
<th>Default</th>
<th>Penalty</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) Failure to produce information and documents before prescribed authority within the period allowed u/s 286(6)</td>
<td>₹ 5,000 per day of continuing failure, from the day immediately following the day on which the period for furnishing the information and document expires.</td>
</tr>
<tr>
<td>(b) Continuing default even after service of penalty order</td>
<td>₹ 50,000 per day for the period of default beyond the date of service of order.</td>
</tr>
</tbody>
</table>

(x) **Penalty for submission of inaccurate information in the CBC report [Section 271GB(4)]**

If the reporting entity has provided any inaccurate information in the report, the penalty would be ₹ 5,00,000 if ,- 

(a) the entity has knowledge of the inaccuracy at the time of furnishing the report but does not inform the prescribed authority; or

(b) the entity discovers the inaccuracy after the report is furnished and fails to inform the prescribed authority and furnish correct report within a period of fifteen days of such discovery; or

(c) the entity furnishes inaccurate information or document in response to notice of the prescribed authority under section 286(6).

(xi) **Non-levy of penalty if reasonable cause for failure is proved [Section 273B]**

Section 273B provides for non-levy of penalty under various sections if the assessee proves that there was reasonable cause for such failure. Section 271GB has been included within the scope of section 273B. Therefore, the entity can offer reasonable cause defence for non-levy of penalties mentioned above.

(xii) **Maintenance and furnishing of Master file: Consequent amendments in the Income-tax Act, 1961**

<table>
<thead>
<tr>
<th>Section</th>
<th>Provision</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) 92D(1)(ii)</td>
<td><em>Every person, being constituent entity of an international group, has</em></td>
</tr>
</tbody>
</table>
to keep and maintain the prescribed information and document in respect of the international group. Constituent entity has to keep and maintain such prescribed information and document irrespective of the fact whether or not any international transaction is undertaken by such constituent entity.

The rules shall, thereafter, prescribe the information and document as mandated for master file under OECD BEPS Action 13 report;

(2) 92D(4) The information and document shall also be furnished to the prescribed authority u/s 286(1) within such period as may be prescribed and the manner of furnishing may also be provided for in the rules.

(3) 271AA(2) For non-furnishing of the information and document to the prescribed authority, a penalty of ₹ 5 lakh shall be leviable.

(4) 273B Reasonable cause defence against levy of penalty shall be available to the entity.

(xiii) Meaning of certain terms [Section 286(9)]

<table>
<thead>
<tr>
<th>Term</th>
<th>Meaning</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>(a) Accounting year</strong></td>
<td></td>
</tr>
<tr>
<td>Case</td>
<td></td>
</tr>
<tr>
<td>In a case where the parent entity is resident in India; or</td>
<td>Accounting year</td>
</tr>
<tr>
<td>In any other case</td>
<td>An annual accounting period, with respect to which the parent entity of the international group prepares its financial statements under any law for the time being in force or the applicable accounting standards of the country or territory of which such entity is resident</td>
</tr>
<tr>
<td><strong>(b) Agreement</strong></td>
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<tr>
<td>A combination of all of the following agreements, namely –</td>
<td></td>
</tr>
<tr>
<td>(i) an agreement referred to in section 90(1) or section 90A(1); or</td>
<td></td>
</tr>
<tr>
<td>(ii) an agreement for exchange of the CbC report referred to in section 286(2) as may be notified by the Central Government.</td>
<td></td>
</tr>
<tr>
<td><strong>(c) Alternate reporting entity</strong></td>
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</tr>
<tr>
<td>Any constituent entity of the international group that has been designated by such group, in the place of the parent entity, to furnish the CbC report in the country or territory in which the said constituent entity is resident on behalf of such group.</td>
<td></td>
</tr>
<tr>
<td><strong>(d) Constituent entity</strong></td>
<td></td>
</tr>
<tr>
<td>(i) any separate entity of an international group that is included in the consolidated financial statement of the said group for financial reporting purposes, or may be so included for the said purpose, if the equity share of any entity of the international group were to be listed on a stock exchange;</td>
<td></td>
</tr>
<tr>
<td>(ii) any such entity that is excluded from the consolidated financial statement of the international group solely on the basis of size or materiality; or</td>
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</tr>
<tr>
<td>(iii)</td>
<td>any permanent establishment of any separate business entity of the international group included in sub clause (i) or sub clause (ii), if such business unit prepares a separate financial statement for such permanent establishment for financial reporting, regulatory, tax reporting or internal management control purposes.</td>
</tr>
</tbody>
</table>
| (e) Group | This includes a parent entity and all the entities in respect of which, for the reason of ownership or control, a consolidated financial statement for financial reporting purposes,—  
(i) is required to be prepared under any law for the time being in force or the accounting standards of the country or territory of which the parent entity is resident; or  
(ii) would have been required to be prepared had the equity shares of any of the enterprises were listed on a stock exchange in the country or territory of which the parent entity is resident. |   |
| (f) Consolidated financial statement | The financial statement of an international group in which the assets, liabilities, income, expenses and cash flows of the parent entity and the constituent entities are presented as those of a single economic entity. |   |
| (g) International group | Any group that includes,—  
(i) two or more enterprises which are resident of different countries or territories; or  
(ii) an enterprise, being a resident of one country or territory, which carries on any business through a permanent establishment in other countries or territories; |   |
| (h) Parent entity | A constituent entity, of an international group holding, directly or indirectly, an interest in one or more of the other constituent entities of the international group, such that,—  
(i) it is required to prepare a consolidated financial statement under any law for the time being in force or the accounting standards of the country or territory of which the entity is resident; or  
(ii) it would have been required to prepare a consolidated financial statement had the equity shares of any of the enterprises were listed on a stock exchange,  
and, there is no other constituent entity of such group which, due to ownership of any interest, directly or indirectly, in the first mentioned constituent entity, is required to prepare a consolidated financial statement, under the circumstances referred to in sub clause (i) or sub clause (ii), that includes the separate financial statement of the first mentioned constituent entity. |   |
| (i) Permanent establishment | Meaning assigned to it in clause (iiia) of section 92F i.e., includes a fixed place of business through which the business of the enterprise is wholly or partly carried on. |   |
| (j) Reporting accounting | The accounting year in respect of which the financial and operational results are required to be reflected in the report to be furnished every year by the parent entity or the alternate reporting entity, resident in India, in respect of |   |
year the international group of which it is a constituent under section 286(2) or by a constituent entity of an international group referred to in section 286(4).

(k) Reporting entity The constituent entity including the parent entity or the alternate reporting entity, that is required to furnish a report referred to in section 286(2) and 286(4).

(l) Systemic failure Systemic failure, with respect to a country or territory, means that the country or territory has an agreement with India providing for exchange of report of the nature referred to in section 286(2), but—

(i) in violation of the said agreement, it has suspended automatic exchange; or

(ii) has persistently failed to automatically provide to India the report in its possession in respect of any international group having a constituent entity resident in India.

### 1.16 TRANSFER PRICING ASSESSMENT

Transfer pricing assessment procedure in India is captured graphically as below:

![Transfer Pricing Assessment Diagram]
(1) Power of Assessing Officer to determine ALP [Section 92C(3) & (4)]

Section 92C(3) and (4) gives power to the Assessing Officer to determine the arm’s length price under the following circumstances and also empowers the Assessing Officer to re-compute total income of the assessee having regard to arm’s length price determined by him. It also provides that deduction under section 10AA and Chapter VI-A shall not be allowed from the additional income computed by him.

For example, if the total income declared by the assessee in his return of income is, say ₹ 7 lakhs and the total income computed by the Assessing Officer applying the arm’s length principle is, say ₹ 9 lakhs, the difference of ₹ 2 lakhs will not qualify for deduction under section 10AA or Chapter VI-A.

The Assessing Officer may invoke the power to determine arm’s length price if during the course of any proceeding, he is of the opinion that, on the basis of material or information or documents in his possession:

(a) The price charged or paid in an international transaction has not been determined in accordance with section 92C(1) and (2); or

(b) Any information and documents relating to an international transaction has not been kept and maintained by the assessee in accordance with the provisions contained in section 92D(1) and the rules made in this behalf (Rule 10D); or

(c) The information or data used in computation of the arm’s length price is not reliable or correct; or

(d) The assessee has failed to furnish within the specified time, any information or documents which he was required to furnish by a notice issued under section 92D(3).

Before invoking the power to determine arm’s length price, an opportunity of being heard is to be given to the assessee.

Second proviso to section 92C(4) provides that if the total income of an associated enterprise is computed under this section on the determination of arm’s length price paid to another associated enterprise, from which tax is deducted or deductible at source, the income of the other associated enterprise shall not be recomputed on this count.

For example, if “A” Ltd. has paid royalty to “B” Ltd. (Non-Resident) @10% of sales and tax is deducted at source, “B” Ltd. cannot claim refund if the Assessing Officer has determined 8% as arm’s length price in the case of “A” Ltd. and disallowed 2% of the royalty amount.

Bright Line Test – To cater to the Indian market, MNC sets up subsidiaries in India. The Indian subsidiaries act as a distributor/provider of goods/services and generally incurred certain expenses, which are popularly known as Advertisement, marketing and sale promotion expenditure ("AMP expenses") for marketing and promotion of the products imported by them.
The intellectual property rights ("IPR") in products/services and the brands lies with the parent entities. To test that whether the transaction is at ALP or not and to determine the excess/non-routine advertising, marketing and promotion (AMP) expenditure incurred by the taxpayer for building brand of its associated enterprises in India, Revenue Authorities' sometimes adopt the Bright Line Test ("BLT"). The issue under consideration is whether bright line test can be used by the Assessing Officer to determine the excess/non-routine advertising, marketing and promotion (AMP) expenditure incurred by the taxpayer for building brand of its associated enterprises in India.

The Delhi High Court, in *Bausch & Lomb Eyecare (India) (P.) Ltd. v. Addl. CIT [2016] 381 ITR 227*, held that advertisement expense is not an international transaction and there is no machinery provision for computation of AMP expense adjustment.

In *Sony Ericsson Mobile Communications India (P) Ltd v. CIT (2015) 374 ITR 118*, the Delhi High Court held that bright line test has no statutory mandate and a broad-brush approach is not mandated or prescribed. It further opined that the exercise to separate "routine" and "non-routine" advertising, marketing and promotion or brand building exercise by applying the bright line test of non-comparables should not be sanctioned.

Applying the rationale of the above rulings of the High Court, the Revenue Authorities' are not justified in adopting the "Bright Line Test" for disallowing or adjusting the advertisement expenditure in computing arm's length price.

(2) **Reference to Transfer Pricing Officer [Section 92CA]**

This section provides for a procedure for reference to a Transfer Pricing Officer (TPO) of any issue relating to computation of arm’s length price in an international transaction. The procedure is as under -

(i) The option to make reference to TPO is given to the Assessing Officer. Where the assessee has entered into an international transaction in any previous year and if Assessing Officer considers it necessary or expedient to do so he may refer the computation of the arm’s length price in relation to the said international transaction to the TPO. This option is not, however, available to the assessee.

(ii) The Assessing Officer has to take the approval of the Principal Commissioner of Income-tax (PCIT)/Commissioner of Income-tax (CIT) before making such a reference.

(iii) Any Joint/ Deputy/Assistant Commissioner of Income-tax, authorised by CBDT, can be appointed as TPO.

(iv) When such reference is made, TPO would serve a notice to the assessee requiring him to produce on a date specified in the notice, any evidence on which the assessee relied in support of the computation of arm’s length price made by him in relation to the international transaction.
(v) The TPO can also determine the ALP of other international transactions identified subsequently in the course of proceedings before him as if such transaction is referred to the TPO by the Assessing Officer under section 92CA(1) [Sub-section (2A)].

(vi) 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) [Sub-section (2B)].

(vii) The TPO has to pass an order determining the arm’s length price after considering the evidence, documents, etc. produced by the assessee and after considering the material gathered by him. He has to send a copy of his order to Assessing Officer as well as the assessee.

(viii) The order of the Transfer Pricing Officer determining the arm’s length price of an international transaction is binding on the Assessing Officer and the Assessing Officer shall proceed to compute the total income in conformity with the arm’s length price determined by the Transfer Pricing Officer [Sub-section (4)].

(ix) In order to provide sufficient time to the Assessing Officer to complete the assessment in a case where reference is made to the Transfer Pricing Officer, section 92CA(3A) provides for determination of arm’s length price of international transactions by the Transfer Pricing Officer at least 60 days before the expiry of the time limit under section 153 or section 153B for making an order of assessment by the Assessing Officer. This provision would apply in a case where reference is made on or after 1.6.2007 or in a case where reference is made before that date but the order of the Transfer Pricing Officer is pending on that date [Sub-section (3A)].

(x) In many cases, it becomes necessary to seek information from foreign jurisdictions for the purpose of determining the arm's length price by the TPO. At times, proceedings before the TPO may also be stayed by a court order.

Taking into consideration such cases, it has been provided that where assessment proceedings are stayed by any court or where a reference for exchange of information has been made by the competent authority under an agreement referred to in section 90 or 90A, the time available to the Transfer Pricing Officer for making an order after excluding the time for which assessment proceedings were stayed or the time taken for receipt of information, as the case may be, is less than 60 days, then, such remaining period shall be extended to 60 days.

(xi) The TPO has power to rectify his order under section 154 if any mistake apparent from the record is noticed. If such rectification is made, the Assessing Officer has to rectify the assessment order to bring it in conformity with the same.
(xii) The TPO can exercise all or any of the powers specified in clause (a) to (d) of section 131(1) or section 133(6) or section 133A for determination of arm's length price once the above reference is made to him.

(3) **Secondary adjustment [Section 92CE]**

(i) **Meaning of Primary Adjustment and Secondary Adjustment**

"Primary adjustment" to a transfer price means the determination of transfer price in accordance with the arm’s length principle resulting in an increase in the total income or reduction in the loss, as the case may be, of the assessee.

"Secondary adjustment" means an adjustment in the books of accounts of the assessee and its associated enterprise to reflect that the actual allocation of profits between the assessee and its associated enterprise are consistent with the transfer price determined as a result of primary adjustment, thereby removing the imbalance between cash account and actual profit of the assessee.

(ii) **Forms of Secondary Adjustment** - As per the OECD’s Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD transfer pricing guidelines), secondary adjustment may take the form of constructive dividends, constructive equity contributions, or constructive loans.

(iii) **Alignment of economic benefit of the transaction with the arm’s length position** - The provisions of secondary adjustment are internationally recognised and are already part of the transfer pricing rules of many leading economies in the world. Whilst the approaches to secondary adjustments by individual countries vary, they represent an internationally recognised method to align the economic benefit of the transaction with the arm’s length position.

(iv) **Cases where secondary adjustment has to be made** - In order to align the transfer pricing provisions in line with OECD transfer pricing guidelines and international best practices, section 92CE provides that the assessee shall be required to carry out secondary adjustment where the primary adjustment to transfer price:

(a) has been made *suo motu* by the assessee in his return of income; or

(b) made by the Assessing Officer has been accepted by the assessee; or

(c) is determined by an advance pricing agreement entered into by the assessee under section 92CC *on or after the 1.4.2017*; or

(d) is made as per the safe harbour rules framed under section 92CB; or

(e) is arising as a result of resolution of an assessment by way of the mutual agreement procedure under an agreement entered into under section 90 or 90A for avoidance of double taxation.
(v) **No requirement of secondary adjustment in certain cases** - Such secondary adjustment, however, shall not be carried out if, the amount of primary adjustment made in the case of an assessee in any previous year does not exceed ₹ 1 crore or the primary adjustment is made in respect of A.Y.2016-17 or an earlier assessment year.

(vi) **Non-repatriation of excess money by the associated enterprise deemed to be an advance** - Where, as a result of primary adjustment to the transfer price, there is an increase in the total income or reduction in the loss, as the case may be, of the assessee, the excess money or part thereof, as the case may be, which is available with its associated enterprise, if not repatriated to India within the time as may be prescribed, shall be deemed to be an advance made by the assessee to such associated enterprise and the interest on such advance, shall be computed as the income of the assessee, in the prescribed manner.

_Such excess money or part thereof may be repatriated from any of the associated enterprises of the assessee which is not resident in India._

"**Excess money**" means the difference between the arm’s length price determined in primary adjustment and the price at which the international transaction has actually taken place.

(vii) **Time limit for repatriation of excess money or part thereof**

Rule 10CB(1) prescribes the time limit for repatriation of excess money i.e., on or before _90 days_ from the date given in column (3) in the cases mentioned in column (2) of the table below:

<table>
<thead>
<tr>
<th>Case</th>
<th>Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1)</td>
<td>(2)</td>
</tr>
<tr>
<td>(i)</td>
<td>Where primary adjustments to transfer price has been made <em>suo-moto</em> by the assessee in his return of income</td>
</tr>
<tr>
<td>(ii)</td>
<td>If primary adjustments to transfer price as determined in the order of the Assessing Officer or the appellate authority has been accepted by the assessee</td>
</tr>
</tbody>
</table>
(iii) Where agreement for advance pricing has been entered into by the assessee under section 92CD

<table>
<thead>
<tr>
<th>Case</th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Where the international transaction is denominated in Indian rupee</td>
<td>At the one year marginal cost of fund lending rate of SBI as on 1st April of the relevant previous year + 3.25%</td>
</tr>
</tbody>
</table>

(iv) Where option has been exercised by the assessee as per the safe harbour rules under section 92CB

<table>
<thead>
<tr>
<th>Case</th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Where the international transaction is denominated in foreign currency</td>
<td>At six month London Interbank Offered Rate (LIBOR) as on 30th September of the relevant previous year + 3.00%</td>
</tr>
</tbody>
</table>

(v) Where agreement under the Mutual agreement procedure under a DTAA has been entered into u/s 90 or 90A

<table>
<thead>
<tr>
<th>Case</th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>the due date of filing of return u/s 139(1)</td>
</tr>
</tbody>
</table>

(viii) Rate of interest for the purpose of computation on interest on excess money or part thereof, if not repatriated within the prescribed time

Rule 10CB(2) prescribes the rate at which the per annum interest income shall be computed in case of failure to repatriate the excess money within the above time limit. The interest would be computed at the rates mentioned in column (3) in respect of the cases mentioned in column (2) of the table below:

<table>
<thead>
<tr>
<th>Case</th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Where the international transaction is denominated in Indian rupee</td>
<td>At the one year marginal cost of fund lending rate of SBI as on 1st April of the relevant previous year + 3.25%</td>
</tr>
<tr>
<td>Where the international transaction is denominated in foreign currency</td>
<td>At six month London Interbank Offered Rate (LIBOR) as on 30th September of the relevant previous year + 3.00%</td>
</tr>
</tbody>
</table>

(ix) Option to pay additional income-tax, if the excess money not repatriated: In a case where the excess money or part thereof has not been repatriated within the prescribed time as mentioned above, the assessee has the option to pay additional income-tax @ 20.9664% (i.e., tax@18% plus surcharge@12% plus cess@4%) on such excess money or part thereof, as the case may be.

Where additional income-tax is so paid by the assessee, he will not be required to make secondary adjustment and compute interest from the date of payment of such tax. This implies that he would, in any case, be required to compute interest upto the date of payment of such additional tax.

The additional income-tax so paid by the assessee shall be treated as the final payment of tax in respect of excess money or part thereof not repatriated and no further credit would be allowed to the assessee or to any other person in respect of the amount of additional income-tax so paid.
Further, no deduction in respect of the amount on which such additional income-tax has been paid, would be allowed under any other provision of the Act.

(4) Dispute Resolution Mechanism

The evolving tax dispute resolution mechanism in India consists of the following forums:

- Filing of objections before the Dispute Resolution Panel or Appeal before the Commissioner of Income Tax (Appeals);
- Appeal before the Income Tax Appellate Tribunal;
- Appeal before the High Court / Supreme Court;
- Safe Harbour Rules;
- Advance Pricing Agreement; and
- Mutual Agreement Procedure

Each of the above dispute resolution mechanisms have been explained in the subsequent paragraphs.

(i) Filing of objections before the Dispute Resolution Panel [Section 144C]

Key features of the DRP process is listed below:

- To facilitate expeditious resolution of disputes, a collegium comprising of three Principal Commissioners or Commissioners of Income-tax has been constituted by the CBDT.
- The following assessee are eligible for filing objections before the DRP:-
  - A Foreign Company
  - Any person in whose case variation arises on account of order of Transfer Pricing Officer
- The Assessing Officer shall, forward a draft of the proposed order of assessment to the eligible assessee if he proposes to make, on or after 1st October, 2009, any variation in the income or loss returned which is prejudicial to the interest of such assessee.
- Assessee can file his acceptance to the Assessing Officer or can file his objections against the draft assessment order with the DRP and the Assessing Officer within thirty days of the receipt of the draft order.
- Upon acceptance by assessee or no objection received from assessee within the specified time, the Assessing Officer, notwithstanding anything contained in section 153 or section 153B, shall complete the assessment and pass the assessment order within one month from the end of the month in which the acceptance is received or 30 days expires.
• The Dispute Resolution Panel shall, in a case where any objections are received, issue such directions, as it thinks fit, for the guidance of the Assessing Officer to enable him to complete the assessment.

• After considering draft order, all objections, evidence etc., the DRP issues binding directions to the Assessing Officer.

• The Dispute Resolution Panel may, before issuing any such directions make such further enquiry, as it thinks fit; or cause any further enquiry to be made by any income tax authority and report the result of the same to it.

• In a case where the proposed direction are prejudicial to the interest of the assessee or the interest of the revenue, the direction cannot be issued without giving an opportunity of being heard to the assessee and the Assessing Officer, as the case may be.

• The Dispute Resolution Panel may confirm, reduce or enhance the variations proposed in the draft order. However, it cannot set aside any proposed variation or issue any direction for further enquiry and passing of the assessment order.

• The power of the DRP to enhance the variation includes the power to consider any matter arising out of the assessment proceeding relating to the draft order. This power to consider any issue shall be irrespective of whether the matter was raised by the eligible assessee or not.

• If the members of the DRP differ in opinion on any point, the point shall be decided according to the opinion of the majority of the members.

• Every direction issued by the DRP shall be binding on the Assessing Officer.

• Such direction has to be issued within nine months from the end of the month in which the draft order is forwarded to the eligible assessee.

• Upon receipt of such direction, the Assessing Officer has to complete the assessment in accordance with the same, within one month from the end of the month in which the direction is received. There is no requirement of providing any further opportunity of being heard to the assessee.

• The order of the Assessing Officer is directly appealable before the Tribunal.

• The CBDT may make rules for the purpose of efficient functioning of the DRP and expeditious disposal of the objections filed by the eligible assessee.

• DRP does not have jurisdiction over the assessment orders are passed by the Assessing Officer declaring based on the provisions of GAAR and with the prior approval of Principal Commissioner or Commissioner, as referred under section 144BA(12).
The procedure to be followed by the assessee under DRP route is depicted below:

<table>
<thead>
<tr>
<th>Step 1</th>
<th>Step 2</th>
<th>Step 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>AO to determine ALP u/s 92C(3)</td>
<td>Taxpayer to file objections with DRP</td>
<td>DRP to pass directions</td>
</tr>
<tr>
<td>AO may also refer determination of ALP to the TPO with the prior approval of PCIT/CIT</td>
<td>AO to pass Draft order</td>
<td>AO to pass final order</td>
</tr>
<tr>
<td>Taxpayer to substantiate transfer price as ALP to TPO</td>
<td>AO to compute taxable income</td>
<td>AO order appealable before Tribunal</td>
</tr>
<tr>
<td>TPO to determine ALP by passing an order</td>
<td>Intimation to taxpayer &amp; AO by sending copy of order</td>
<td></td>
</tr>
</tbody>
</table>

(ii) **Appeal before the Commissioner of Income Tax (Appeals) – [Sections 246A, 249 & 250]**

Key features of the appeal before CIT (A) is listed below:

- **First Appellate Authority**
- **Appeal may be against the orders including:**
  - Assessment order passed u/s 143(3) or 144 of the Income-tax Act
  - Intimation passed u/s 143(1)
  - Reassessment order passed u/s 147 or 150 (re-computation)
  - Assessment or reassessment of search cases u/s 153(A)
  - Rectification Order made u/s 154
  - Order made under section 92CD(3)
- **Time Limit -** Appeal has to be filed within 30 days of date of service of the notice of demand related to assessment order issued by the Assessing Officer
- **Prescribed filing fee is to be paid at the time of filing appeal**
- **The CIT(A) cannot set-aside the order passed by the Assessing Officer**
The following table enumerates the key differences between the DRP and the appeal process before the CIT (A):

<table>
<thead>
<tr>
<th>Aspect</th>
<th>DRP</th>
<th>CIT(A)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Constitution</td>
<td>Case heard by 3 Principal Commissioners</td>
<td>Case heard by a single Commissioner</td>
</tr>
<tr>
<td>Time limit for filing objections/appeal</td>
<td>Objections need to be filed along with all necessary submissions within 30 days of receipt of the draft order.</td>
<td>An appeal filed within 30 days of date of service of demand notice or the date on which intimation of order sought to be appealed against is served, as the case may be.</td>
</tr>
<tr>
<td>Condonation of delay</td>
<td>No power to condone delay</td>
<td>Discretion of CIT(A)</td>
</tr>
<tr>
<td>Filing Fees</td>
<td>No filing fees</td>
<td>₹ 250 to ₹ 1,000, depending upon assessed income</td>
</tr>
<tr>
<td>Stay of demand</td>
<td>Automatic stay of demand as the order is a draft order.</td>
<td>A stay application to be filed with the Income-tax Officer requesting for a stay of demand. In case the stay is rejected, the demand to be paid off is decided by the Income-tax Officer.</td>
</tr>
<tr>
<td>Time limit for completion</td>
<td>To be completed within a period of 9 months from the end of the month in which the draft order is forwarded to the assessee.</td>
<td>The Commissioner (Appeals) may decide the appeal within a period of one year from the end of the financial year in which such appeal is filed before him.</td>
</tr>
<tr>
<td>Penalty Proceedings</td>
<td>No penalty proceedings can be initiated until the matter is disposed</td>
<td>Typically penalty proceedings are initiated by the ITO and a stay of penalty would need to be filed.</td>
</tr>
<tr>
<td>Next steps on completion of proceedings</td>
<td>Once the order of the DRP is passed, the same is sent to the assessing officer who will pass a final assessment order.</td>
<td>Once the order of the CIT(A) is passed, the same is sent to the assessing officer who will pass an order giving effect to the order of the CIT(A).</td>
</tr>
</tbody>
</table>

The CBDT has issued a press release dated 30.12.2015 stating that as part of the endeavor of the Income-tax Department to digitize various functions of the Department for providing efficient taxpayer services, electronic filing of appeal before CIT(Appeals) is being made mandatory for persons who are required to file the return of income electronically.
(iii) **Appeal before the Income Tax Appellate Tribunal [Sections 253 & 254]**

Key features of the appeal process before the Income Tax Appellate Tribunal is listed below:

- Once the order of the Assessing Officer after giving effect to DRP directions or CIT(A) are issued, an appeal can be filed with the Income-tax Appellate Tribunal (‘the Tribunal’) within a period of 60 days from the date on which the order sought to be appealed against is communicated to the assessee.

- If the revenue authorities have filed an appeal on a matter where the CIT(A) has held in favor of the assessee, then Principal Commissioner or Commissioner of Income-tax can direct Assessing officer to file an appeal on order of CIT(A) filed before the Tribunal;

- In the case of an order arising pursuant to directions of the DRP, the demand becomes payable and a stay application will need to be filed with the AO requesting for a stay of demand;

- In case the stay application is rejected by the AO, the demand is to be paid by the assessee. Alternatively, the assessee can prefer a stay application before the Tribunal;

- An order is passed by the Tribunal after hearing arguments from both the assessee and the Revenue authorities.

- Once the order of the Tribunal is issued, an order giving effect will need to be passed by the AO and consequential demands paid off/refunds issued.

(iv) **Appeal before the High Court / Supreme Court [Sections 260A & 260B/ Sections 261 & 262]**

Key features of the appeal process before the High Court is listed below:

- Appeal lies to High Court against decision given by Appellate tribunal

- Appeal can be filed by the aggrieved –
  - Principal Chief Commissioner; or
  - Chief Commissioner; or
  - Principal Commissioner; or
  - Commissioner; or
  - Assessee

- Condition precedent
  - Appeal shall be heard by not less than 2 judges of the High Court
  - If HC satisfied that the case involves a ‘substantial question of law’
• Substantial Question of Law means:
  ➢ Issue must be debatable
  ➢ Not previously settled by Law of Land
  ➢ Should not be settled by a binding precedent
  ➢ Must have a material bearing on decision of the case

• Time Limit for filing an appeal - Appeal to be preferred within 120 days from the date of receipt of the Tribunal’s order

• Filing Fee and Jurisdiction
  ➢ Fee is decided as per relevant court rules and Code of Civil Procedure
  ➢ Jurisdiction is decided on the basis of the location of AO who framed the disputed order

Key features of the appeal process before the Supreme Court is listed below:
• Appeal lies to Supreme Court against decision given by the High Court.
• Condition precedent
  ➢ High Court should certify that the case is fit for appeal
  ➢ If High Court refuses – application to Supreme Court can be made under Article 136 of the Constitution for special leave

• Decision of Supreme Court becomes the Law of the Land

The monetary tax limits for Departmental appeal filing before ITATs, HCs and SCs are as follows:

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Appeals in income-tax matters</th>
<th>Monetary Limits (in ₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Before ITAT</td>
<td>50,00,000</td>
</tr>
<tr>
<td>2.</td>
<td>Before High Court</td>
<td>1,00,00,000</td>
</tr>
<tr>
<td>3.</td>
<td>Before Supreme Court</td>
<td>2,00,00,000</td>
</tr>
</tbody>
</table>

(v) Safe Harbour Rules

In order to reduce the increasing number of transfer pricing audits and prolonged disputes, the Finance (No. 2) Act, 2009 with retrospective effect from 1.4.2009 inserted section 92CB to provide that determination of arm’s length price under section 92C or Section 92CA shall be subject to Safe Harbour rules. Section 92CB(2) empowers the CBDT to prescribe safe harbour rules.

Safe Harbour means circumstances in which the income-tax authorities shall accept the transfer price declared by the assessee.

The Safe Harbour Rules relevant for A.Y. 2020-21 are yet to be notified by the CBDT as on the date of release of the Study Material. These rules, when notified, will form part of the webhosted Statutory Update.
(vi) Advance Pricing Agreements

What is APA?

In order to gain certainty prior to entering into an international transaction with an AE, the taxpayers have an option of applying for an Advance Pricing Agreement (APA) and obtaining results before the transaction is actually undertaken. The same has the potential to reduce litigation for the taxpayer and provide certainty for a longer period of time.

An APA is an agreement between a taxpayer/applicant and the CBDT, which determines the arm’s length price of future intercompany transactions. It can also be used for existing intercompany transactions. The taxpayer/applicant mutually agree on the transfer pricing methodology to be applied and its application, in relation to the taxpayer’s international transactions for certain future period of time.


Once an APA has been entered into with respect to an international transaction, the arm’s length price with respect to that international transaction, for the period specified in the APA, will be determined only in accordance with the APA. The APA shall be binding on the person as well as the Income-tax authorities for the specified transaction and period as covered in the APA.

Types of APA

The APA scheme envisages three types of APA’s, viz.

- **Unilateral APA** – Agreement between the assessee and CBDT
- **Bilateral APA** – Agreement between the assessee and CBDT subsequent to and based on agreement between competent authorities of India with the competent authority in the other country regarding appropriate transfer pricing method or the ALP
- **Multilateral APA** - Agreement between the assessee and CBDT subsequent to and based on agreement between competent authorities of India with the competent authorities in the other countries regarding appropriate transfer pricing method or the ALP

Request for bilateral or multilateral APA can be accepted by the Indian competent authority where:

- A tax treaty exists between India and other contracting state containing an article on ‘Mutual Agreement Procedure’;
- The corresponding APA program exists in the other country.

[In case of international transactions leading to economic double taxation arising out of TP adjustments; presently it seems Indian Competent Authority accepts bilateral/ multilateral]
APA only if the said tax treaty contains provisions similar to article 9(2) of the OECD model convention on ‘Associated Enterprises]

**Advantages of APA program**

The APA program is designed to:

- Provide certainty with regard to determination of ALP of the international transaction (viz. transactions covered by the APA);
- Impart flexibility in developing practical approaches for complex transfer pricing issues;
- Reduce the risk of potential double taxation through bilateral and multi-lateral APA;
- Reduce compliance costs by eliminating the risk of transfer pricing audit and resolving long drawn and time consuming litigation;
- Reduce the burden of record keeping, as the taxpayer knows in advance the required documentation to be maintained to substantiate the agreed terms and conditions of the agreement.

**Applicability of APA**

Section 92CC enables the Board (with the approval of the Central Government), to enter into an APA with any person undertaking an international transaction.

(i) **Purpose of APA:** The APA shall relate to an international transaction to be entered into by such person. The APA shall be entered into for the purpose of determination of the arm’s length price or specifying the manner in which arm’s length price shall be determined, in relation to such international transaction.

(ii) **Manner of determination of Arm’s Length Price in APA:** The manner for determination of arm’s length price referred above may include methods referred to in section 92C(1) or any other method with necessary adjustments or variations.

(iii) **Non-applicability of section 92C or section 92CA:** In case an APA has been entered into in respect of any international transaction, the arm’s length price in relation to that transaction shall be determined in accordance with that APA notwithstanding any contrary provisions contained in section 92C or section 92CA i.e., the provisions of the APA shall apply overriding the provisions of section 92C or section 92CA, which are normally applicable for determination of arm’s length price.

(iv) **Validity of APA:** The APA shall be valid for such period as specified in the agreement, which shall in no case exceed five consecutive previous years.

(v) **Binding nature of APA:** The APA so entered into shall be binding on:

(a) the person in whose case, and in respect of the transaction in relation to which, the APA has been entered into; and
(b) the Principal Commissioner or Commissioner and the income-tax authorities subordinate to him, in respect of the said person and the said transaction.

(vi) **Not binding of APA:** The APA shall not be binding if there is any change in law or facts having bearing on such APA.

(vii) **Conditions to declare APA as void ab initio:** In case the Board finds that the APA so entered into has been obtained by the person by way of fraud or misrepresentation of facts, the Board is empowered to pass an order declaring any such APA to be void ab initio, with the approval of Central Government.

(viii) **Consequences of declaration of an APA as void ab initio:** As a result of declaration of an APA as void ab initio:

(a) all the provisions of the Act shall apply to such person as if such APA had never been entered into.

(b) The period beginning with the date of such APA and ending on the date of order declaring the APA as void ab initio, shall be excluded for the purpose of computation of any period of limitation under this Act (for example period of limitation specified in the section 153, 153B etc). This is irrespective of anything contained in any other provision of the Act.

(c) In case the period of limitation after exclusion of the above mentioned period is less than 60 days, such remaining period of limitation shall be extended to 60 days.

(ix) If an application is made by a person for entering into an APA, then, the proceeding, in respect of such person for the purpose of the Act, shall be deemed to be pending.

(x) **Prescribed scheme for APA:** The Board is empowered to prescribe a scheme specifying the manner, form, procedure and any other matter generally in respect of the APA.

**Prescribed Advance Pricing Agreement Scheme for the purpose of section 92CC [Rule 10F to 10T]:** In exercise of the powers conferred in section 92CC(9) read with section 295 of the Income-tax Act, 1961, the CBDT has prescribed rules specifying an Advance Pricing Agreement (APA) Scheme. Some of the important provisions of the scheme are briefed hereunder –

(1) **Persons eligible to apply [Rule 10G]:** Any person who has undertaken an international transaction or is contemplating to undertake an international transaction, shall be eligible to enter into an agreement under these rules.

(2) **Pre-filing Consultation [Rule 10H]:**

   (a) Any person proposing to enter into an agreement under these rules may, by an application in writing, make a request for a pre-filing consultation in the prescribed form to the Director General of Income-tax (International Taxation).
(b) 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.

(c) The pre-filing consultation shall –

(i) not bind the Board or the person to enter into an agreement or initiate the agreement process;
(ii) not be deemed to mean that the person has applied for entering into an agreement.

(3) Application for advance pricing agreement [Rule 10-I]

(a) Any person who is eligible to apply may enter into agreement may, if such person desires to enter into an agreement furnish an application in the prescribed form along with proof of payment of requisite fee as specified, to the Director General of Income-tax (International Taxation) in case of unilateral agreement and to the competent authority in India in case of bilateral or multilateral agreement.

(b) 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.

Note - The applicant may withdraw the application for agreement at any time before the finalisation of the terms of the agreement. However, application fees paid shall not be refunded on withdrawal of application by the applicant.

(4) Approval of Central Government: The agreement shall be entered into by the Board with the applicant after its approval by the Central Government.

(5) Terms of the agreement [Rule 10M]

(a) An agreement may among other things, include –

(i) the international transactions covered by the agreement;
(ii) the agreed transfer pricing methodology, if any;
(iii) determination of arm’s length price, if any;
(iv) definition of any relevant term to be used in item (ii) or (iii);
(v) critical assumptions i.e., the factors and assumptions that are so critical and significant that neither party entering into an agreement will continue to be bound by the agreement, if any of the factors or assumptions is changed;

(vi) rollback provision referred to in Rule 10MA;

(vii) the conditions, if any, other than provided in the Act or these rules.

(b) The agreement shall not be binding on the Board or the assessee if there is a change in any of critical assumptions or failure to meet conditions subject to which the agreement has been entered into.

(c) The binding effect of agreement shall cease only if any party has given due notice of the concerned other party or parties.

(d) In case there is a change in any of the critical assumptions or failure to meet the conditions subject to which the agreement has been entered into, the agreement can be revised or cancelled, as the case may be.

(6) Furnishing of Annual Compliance Report [Rule 10-O]: The assessee shall furnish an annual compliance report in quadruplicate in the prescribed form to Director General of Income-tax (International Taxation) for each year covered in the agreement, within 30 days of the due date of filing income-tax return for that year, or within 90 days of entering into an agreement, whichever is later.

(7) Compliance Audit of the agreement [Rule 10P]:

(a) The Transfer Pricing Officer having the jurisdiction over the assessee shall carry out the compliance audit of the agreement for each of the year covered in the agreement. For this purpose, the Transfer Pricing Officer may require –

(i) the assessee to substantiate compliance with the terms of the agreement, including satisfaction of the critical assumptions, correctness of the supporting data or information and consistency of the application of the transfer pricing method;

(ii) the assessee to submit any information, or document, to establish that the terms of the agreement has been complied with.

(b) The compliance audit report shall be furnished by the Transfer Pricing Officer within six months from the end of the month in which the Annual Compliance Report is received by the Transfer Pricing Officer.

(8) Revision of an agreement [Rule 10Q]:

(a) An agreement, after being entered, may be revised by the Board either suo moto or on request of the assessee or the competent authority in India or the Director General of Income-tax (International Taxation), if—
(i) there is a change in critical assumptions or failure to meet a condition subject to which the agreement has been entered into;

(ii) there is a change in law that modifies any matter covered by the agreement but is not of the nature which renders the agreement to be non-binding; or

(iii) there is a request from competent authority in the other country requesting revision of agreement, in case of bilateral or multilateral agreement.

(b) Except when the agreement is proposed to be revised on the request of the assessee, the agreement shall not be revised unless an opportunity of being heard has been provided to the assessee and the assessee is in agreement with the proposed revision.

(c) The revised agreement shall include the date till which the original agreement is to apply and the date from which the revised agreement is to apply.

(9) Cancellation of an agreement [Rule 10R]:

(a) An agreement shall be cancelled by the Board for any of the following reasons:

(i) the compliance audit has resulted in the finding of failure on the part of the assessee to comply with the terms of the agreement;

(ii) the assessee has failed to file the annual compliance report in time;

(iii) the annual compliance report furnished by the assessee contains material errors; or

(iv) the assessee is not in agreement with the revision proposed in the agreement or the agreement is to be cancelled under rule 10RA(7);

(b) The Board shall give an opportunity of being heard to the assessee, before proceeding to cancel an application.

(c) The order of cancellation of the agreement shall be in writing and shall provide reasons for cancellation and for non-acceptance of assessee’s submission, if any.

(d) The order of cancellation shall also specify the effective date of cancellation of the agreement, where applicable.

(e) The order under the Act, declaring the agreement as void ab initio, on account of fraud or misrepresentation of facts, shall be in writing and shall provide reason for such declaration and for non-acceptance of assessee’s submission, if any.
(10) Mere filing of an application for an agreement under these rules shall not prevent the operation of Chapter X of the Act for determination of arms' length price under that Chapter till the agreement is entered into. [Rule 10T(1)].

(11) The negotiation between the competent authority in India and the competent authority in the other country or countries, in case of bilateral or multilateral agreement, shall be carried out in accordance with the provisions of the tax treaty between India and the other country or countries. [Rule 10T(2)].

(ix) **Provision for Roll back in APA Scheme [Section 92CC]**

(a) In order to reduce current pending as well as future litigation in respect of the transfer pricing matters, section 92CC(9A) provides roll back mechanism in the APA scheme.

(b) Accordingly, the 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 undertaken.

The CBDT has, vide Notification No.23/2015 dated 14.3.2015, in exercise of the powers conferred by 92CC(9A) read with section 295, following conditions, procedure and manner for determining the arm’s length price or for specifying the manner in which arm’s length price is to be determined in relation to an international transaction:

<table>
<thead>
<tr>
<th>Rule</th>
<th>Particulars</th>
<th>Conditions, Procedure &amp; Manner of determination of ALP</th>
</tr>
</thead>
<tbody>
<tr>
<td>10F(ba)</td>
<td>Definition of Applicant</td>
<td>A person who has made an application.</td>
</tr>
<tr>
<td>10F(ha)</td>
<td>Definition of Rollback year</td>
<td>Any previous year, falling within the period not exceeding four previous years preceding the first of the five consecutive previous years referred to in section 92CC(4).</td>
</tr>
</tbody>
</table>
| 10MA | Roll back of the agreement | The said rule provides the following:  
1. The agreement may provide for determining the arm’s length price or specify the manner in which arm’s length price shall be determined in relation to the international transaction entered into by the person during the rollback year (hereinafter referred as “rollback provision”).  
2. **Conditions for applying for rollback provisions:** The agreement shall contain rollback provision in respect of an international transaction subject to the following, namely:-  
   (i) the international transaction is same as the |
international transaction to which the agreement (other than the rollback provision) applies;

(i) the return of income for the relevant rollback year has been or is furnished by the applicant before the due date as specified in Explanation 2 of section 139(1).

(ii) the report in respect of the international transaction had been furnished in accordance with section 92E;

(iii) the applicability of rollback provision, in respect of an international transaction, has been requested by the applicant for all the rollback years in which the said international transaction has been undertaken by the applicant; and

(iv) the applicant has made an application seeking rollback in Form 3CEDA in accordance with sub-rule (5);

3. **Non-applicability of Rollback provision:** 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.

4. **Manner for determining arm length price to be the same for rollback years and other previous years:** Where the rollback provision specifies the manner in which arm’s length price shall be determined in relation to an international transaction undertaken in any rollback year then such manner shall be the same as the manner which has been agreed to be provided for determination of arm’s length price of the same international transaction to be undertaken in any previous year to which the agreement applies, not being a rollback year.

5. **Fees for filling application for rollback provision:** The applicant may furnish along with the application for advance pricing agreement, the request for rollback provision in Form No. 3CEDA with proof of payment of an additional fee of ₹ 5 lakh.
### Rule 10RA

**Procedure for giving effect to rollback provision of an Agreement**

- **(i)** The applicant shall furnish modified return of income referred to in section 92CD in respect of a rollback year to which the agreement applies along with the proof of payment of any additional tax arising as a consequence of and computed in accordance with the rollback provision.

- **(ii)** The modified return in respect of rollback year shall be furnished along with the modified return to be furnished in respect of first of the previous years for which the agreement has been requested for in the application.

- **(iii)** If any appeal filed by the applicant is pending before the Commissioner (Appeals), Appellate Tribunal or the High Court for a rollback year, on the issue which is the subject matter of the rollback provision for that year, the said appeal to the extent of the subject covered under the agreement shall be withdrawn by the applicant before furnishing the modified return for the said year.

- **(iv)** If any appeal filed by the Assessing Officer or the Principal Commissioner or Commissioner is pending before the Appellate Tribunal or the High Court for a rollback year, on the issue which is subject matter of the rollback provision for that year, the said appeal to the extent of the subject covered under the agreement, shall be withdrawn by the Assessing Officer or the Principal Commissioner or the Commissioner, as the case may be, within three months of filing of modified return by the applicant.

- **(v)** The applicant, the Assessing Officer or the Principal Commissioner or the Commissioner, shall inform the Dispute Resolution Panel or the Commissioner (Appeals) or the Appellate Tribunal or the High Court, as the case may be, the fact of an agreement containing rollback provision having been entered into along with a copy of the same as soon as it is practicable to do so.

- **(vi)** In case effect cannot be given to the rollback provision of an agreement in accordance with this rule, for any rollback year to which it applies, on account of failure on the part of applicant, the agreement shall be cancelled.

Subsequent to the notification of the rules, the CBDT has issued *Circular No. 10/2015 dated 10.6.2015* adopting a Question and Answer format to clarify certain issues arising out of the said Rules. The questions raised and answers to such questions as per the said Circular are given hereunder:

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Question 1

Under rule 10MA(2)(ii) there is a condition that the return of income for the relevant roll back year has been or is furnished by the applicant before the due date specified in Explanation 2 to section 139(1). It is not clear as to whether applicants who have filed returns under section 139(4) or 139(5) of the Act would be eligible for roll back.

Answer

The return of income under section 139(5) can be filed only when a return under section 139(1) has already been filed. Therefore, the return of income filed under section 139(5) of the Act, replaces the original return of income filed under section 139(1). Hence, if there is a return which is filed under section 139(5) to revise the original return filed before the due date specified in Explanation 2 to sub-section (1) of section 139, the applicant would be entitled for rollback on this revised return of income.

However, rollback provisions will not be available in case of a return of income filed under section 139(4) because it is a return which is not filed before the due date.

Note – A belated return filed under section 139(4) can also be revised under section 139(5). In such a case, the revised return would replace the belated return. Therefore, an applicant would not be entitled for roll back provisions on a revised return which replaces a belated return.

Question 2

Rule 10MA(2)(i) mandates that the rollback provision shall apply in respect of an international transaction that is same as the international transaction to which the agreement (other than the rollback provision) applies. It is not clear what is the meaning of the word “same”. Further, it is not clear whether this restriction also applies to the Functions, Assets, Risks (FAR) analysis.

Answer

The international transaction for which a rollback provision is to be allowed should be the same as the one proposed to be undertaken in the future years and in respect of which the agreement has been reached. There cannot be a situation where rollback is finalised for a transaction which is not covered in the agreement for future years. The term same international transaction implies that the transaction in the rollback year has to be of same nature and undertaken with the same associated enterprise(s), as proposed to be undertaken in the future years and in respect of which agreement has been reached. In the context of FAR analysis, the restriction would operate to ensure that rollback provisions would apply only if the FAR analysis of the rollback year does not differ materially from the FAR validated for the purpose of reaching an agreement in respect of international transactions to be undertaken in the future years for which the agreement applies.

The word “materially” is generally being defined in the Advance Pricing Agreements being entered into by CBDT. According to this definition, the word “materially” will be interpreted consistently with its ordinary definition and in a manner that a material change of facts and circumstances would be understood as a change which could reasonably have resulted in an agreement with significantly different terms and conditions.
Question 3

Rule 10MA(2)(iv) requires that the application for rollback provision, in respect of an international transaction, has to be made by the applicant for all the rollback years in which the said international transaction has been undertaken by the applicant. Clarification is required as to whether rollback has to be requested for all four years or applicant can choose the years out of the block of four years.

Answer

The applicant does not have the option to choose the years for which it wants to apply for rollback. The applicant has to either apply for all the four years or not apply at all. However, if the covered international transaction(s) did not exist in a rollback year or there is some disqualification in a rollback year, then the applicant can apply for rollback for less than four years. Accordingly, if the covered international transaction(s) were not in existence during any of the rollback years, the applicant can apply for rollback for the remaining years. Similarly, if in any of the rollback years for the covered international transaction(s), the applicant fails the test of the rollback conditions contained in various provisions, then it would be denied the benefit of rollback for that rollback year. However, for other rollback years, it can still apply for rollback.

Question 4

Rule 10MA(3) states that the rollback provision shall not be provided in respect of an international transaction for a rollback year if the determination of arm’s length price of the said international transaction for the said year has been the 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. Further, Rule 10 RA(4) provides that if any appeal filed by the applicant is pending before the Commissioner (Appeals), Appellate Tribunal or the High Court for a rollback year, on the issue which is subject matter of the rollback provision for that year, the said appeal to the extent of the subject covered under the agreement shall be withdrawn by the applicant.

There is a need to clarify the phrase “Tribunal has passed an order disposing of such appeal” and on the mismatch, if any, between Rule 10MA(3) and Rule 10RA(4).

Answer

The reason for not allowing rollback for the international transaction for which Appellate Tribunal has passed an order disposing of an appeal is that the ITAT is the final fact finding authority and hence, on factual issues, the matter has already reached finality in that year. However, if the ITAT has not decided the matter and has only set aside the order for fresh consideration of the matter by the lower authorities with full discretion at their disposal, the matter shall not be treated as one having reached finality and hence, benefit of rollback can still be given.

There is no mismatch between Rule 10MA(3) and Rule 10RA(4).

Question 5

Rule 10MA(3)(ii) provides that rollback provision shall not be provided in respect of an international transaction for a rollback year if 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. It may be clarified whether the rollback provisions in such situations can be applied in a manner so as to ensure that the returned income or loss is accepted as the final income or loss after applying the rollback provisions.

Answer

It is clarified that in case the terms of rollback provisions contain specific agreement between the Board and the applicant that the agreed determination of ALP or the agreed manner of determination of ALP is subject to the condition that the ALP would get modified to the extent that it does not result in reducing the total income or increasing the total loss, as the case may be, of the applicant as declared in the return of income of the said year, the rollback provisions could be applied. For example, if the declared income is ₹ 100, the income as adjusted by the TPO is ₹ 120, and the application of the rollback provisions results in reducing the income to ₹ 90, then the rollback for that year would be determined in a manner that the declared income ₹ 100 would be treated as the final income for that year.

Question 6

Rule 10RA(7) states that in case effect cannot be given to the rollback provision of an agreement in accordance with this rule, for any rollback year to which it applies, on account of failure on the part of applicant, the agreement shall be cancelled. It is to be clarified as to whether the entire agreement is to be cancelled or only that year for which roll back fails.

Answer

The procedure for giving effect to a rollback provision is laid down in Rule 10RA. Sub-rules (2), (3), (4) and (6) of the Rule specify the actions to be taken by the applicant in order that effect may be given to the rollback provision. If the applicant does not carry out such actions for any of the rollback years, the entire agreement shall be cancelled. This is because the rollback provision has been introduced for the benefit of the applicant and is applicable at its option. Accordingly, if the rollback provision cannot be given effect to for any of the rollback years on account of the applicant not taking the actions specified in sub-rules (2), (3), (4) or (6), the entire agreement gets vitiated and will have to be cancelled.

Question 7

If there is a Mutual Agreement Procedure (MAP) application already pending for a rollback year, what would be the stand of the APA authorities? Further, what would be the view of the APA Authorities, if MAP has already been concluded for a rollback year?

Answer

If MAP has been already concluded for any of the international transactions in any of the rollback year under APA, rollback provisions would not be allowed for those international transactions for that year but could be allowed for other years or for other international transactions for that year,
subject to fulfilment of specified conditions in Rules 10MA and 10RA. However, if MAP request is pending for any of the rollback year under APA, upon the option exercised by the applicant, either MAP or application for roll back shall be proceeded with for such year.

Question 8

Rule 10MA(1) provides that the agreement may provide for determining ALP or manner of determination of ALP. However, Rule 10MA(4) only specifies that the manner of determination of ALP should be the same as in the APA term. Does that mean the ALP could be different?

Answer

Yes, the ALP could be different for different years. However, the manner of determination of ALP (including choice of Method, comparability analysis and Tested Party) would be same.

Question 9

Will there be compliance audit for roll back? Would critical assumptions have to be validated during compliance audit?

Answer

Since rollback provisions are for past years, ALP for the rollback years would be agreed after full examination of all the facts, including validation of critical assumptions. Hence, compliance audit for the rollback years would primarily be to check if the agreed price or methodology has been applied in the modified return.

Question 10

Whether applicant has an option to withdraw its rollback application? Can the applicant accept the rollback results without accepting the APA for the future years?

Answer

The applicant has an option to withdraw its roll back application even while maintaining the APA application for the future years. However, it is not possible to accept the rollback results without accepting the APA for the future years. It may also be noted that the fee specified in Rule 10MA(5) shall not be refunded even where a rollback application is withdrawn.

Question 11

For already concluded APAs, will new APAs be signed for rollback or earlier APAs could be revised?

Answer

The second proviso to Rule 10MA(5) provides for revision of APAs already concluded to include rollback provisions.
Question 12

For already concluded APAs, where the modified return has already been filed for the first year of the APA term, how will the time-limit for filing modified return for rollback years be determined?

Answer

The time to file modified return for rollback years will start from the date of signing the revised APA incorporating the rollback provisions.

Question 13

In case of merger of companies, where one or more of those companies are APA applicants, how would the rollback provisions be allowed and to which company or companies would it be allowed?

Answer

The agreement is between the Board and a person. The principle to be followed in case of merger is that the person (company) who makes the APA application would only be entitled to enter into the agreement and be entitled for the rollback provisions in respect of international transactions undertaken by it in rollback years. Other persons (companies) who have merged with this person (company) would not be eligible for the rollback provisions.

To illustrate, if A, B and C merge to form C and C is the APA applicant, then the agreement can only be entered into with C and only C would be eligible for the rollback provisions. A and B would not be eligible for the rollback provisions. To illustrate further, if A and B merge to form a new company C and C is the APA applicant, then nobody would be eligible for rollback provisions.

Question 14

In case of a demerger of an APA applicant or signatory into two or more companies (persons), who would be eligible for the rollback provisions?

Answer

The same principle as mentioned in the previous answer, i.e., the person (company) who makes an APA application or enters into an APA would only be entitled for the rollback provisions, would continue to apply. To illustrate, if A has applied for or entered into an APA and, subsequently, demerges into A and B, then only A will be eligible for rollback for international transactions covered under the APA. As B was not in existence in rollback years, availing or grant of rollback to B does not arise.

Section 92CD provides for the following procedure for giving effect to an APA

(i) In case a person has entered into an APA and prior to the date of entering into such APA, he has furnished the return of income under the provisions of section 139 in respect of any assessment year relevant to a previous year to which the APA applies, then, such person shall, within a period of three months from the end of the month in which the said
agreement was entered into, furnish a modified return, notwithstanding any contrary provision contained in section 139.

(ii) Such modified return shall be in accordance with and limited to the provisions of such APA i.e., modifications can only be made on account of such APA in the return to be filed.

(iii) All other provisions of this Act shall apply as if the modified return is a return furnished under section 139, unless anything to the contrary is provided in this section.

(iv) If the assessment or reassessment proceedings for an assessment year relevant to a previous year to which the APA applies have been completed before the expiry of period allowed for furnishing of modified return, the Assessing Officer shall, in a case where modified return is filed in accordance with the provisions of this section, proceed to assess or reassess or re-compute the total income of the relevant assessment year having regard to and in accordance with the APA.

**However, with effect from 1.9.2019, Assessing Officer shall pass an order modifying the total income of the relevant assessment year determined in such assessment or reassessment, as the case may be, having regard to and in accordance with the APA, instead of proceeding to assess or reassess the total income.**

Such order for assessment or reassessment or re-computation of total income shall be passed within a period of 1 year from the end of the financial year in which the modified return was furnished. This shall apply notwithstanding the period of limitation contained under section 153 or 153B or 144C.

The appeal against such order shall lie to Commissioner (Appeals) [Section 246A]

(v) Where the assessment or reassessment proceedings for an assessment year relevant to the previous year to which the APA applies, are pending on the date of filing of modified return, the Assessing Officer shall proceed to complete the assessment or reassessment proceedings in accordance with the APA taking into consideration the modified return so furnished.

In this case, the time period of completion of pending assessment or reassessment mentioned under section 153 or 153B or 144C shall be extended by 12 months. This shall apply notwithstanding the period of limitation contained under section 153 or 153B or 144C.

(vi) The assessment or reassessment proceedings for an assessment year shall be deemed to have been completed where -

(a) an assessment or reassessment order has been passed; or

(b) no notice has been issued under section 143(2) till the expiry of the limitation period provided under the said section.
(vii) Mutual Agreement Procedure (MAP)

The mutual agreement procedure is a well-established means through which tax administrations consult to resolve disputes regarding the application of double tax conventions. This procedure, described and authorized by Article 25 of the OECD Model Tax Convention, can be used to eliminate double taxation that could arise from a transfer pricing adjustment.

Article 25 sets out three different areas where mutual agreement procedures are generally used. The first area includes instances of “taxation not in accordance with the provisions of the Convention” and is covered in paragraphs 1 and 2 of the Article. Procedures in this area are typically initiated by the taxpayer. The other two areas, which do not necessarily involve the taxpayer, are dealt with in paragraph 3 and involve questions of “interpretation or application of the Convention” and “the elimination of double taxation in cases not otherwise provided for in the Convention”. Paragraph 10 of the Commentary on Article 25 makes clear that Article 25 is intended to be used by competent authorities in resolving not only problems of juridical double taxation but also those of economic double taxation arising from transfer pricing adjustments made pursuant to paragraph 1 of Article 9 (Article 9 – Associated enterprises).

Juridical double taxation

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

Economic double taxation

‘Economic double taxation’ happens when the same transaction, item of income or capital is taxed in two or more states but in hands of different person.

(a) Categories of Disputes covered under MAP

<table>
<thead>
<tr>
<th>Specific case provisions</th>
<th>General interpretative provisions</th>
<th>Cases not provided for in DTAA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Arise where a person who is resident of a contracting state considers that the actions of one or both the contracting states results or will result in taxation not in accordance with the provisions of a DTAA</td>
<td>Includes issues relating to interpretation or application of the treaty</td>
<td>Provides for elimination of double taxation in cases not provided in DTAA</td>
</tr>
</tbody>
</table>
(b) Mechanism under MAP

![Diagram]

(c) Need for MAP

- Double Taxation Avoidance Agreements ('tax treaties') are available for capturing and curtailing juridical double taxation.
- Tax treaties generally do not cover instances of economic double taxation.
- MAP provides relief in cases of economic double taxation.
- MAP also provides relief in cases where automatic relief, such as tax credits, tax exemption, etc. are not available

(d) Steps involved in the MAP application process

- Brief facts and background of the case must be summarized
- Contentions of Indian Revenue must be summarized in the application
- The net tax and interest impact only by virtue of transfer pricing adjustment is computed
- Take note of transactions only relating to one country (in one application), e.g. USA, UK, etc.
- All documents including tax returns, TP study, notices, submissions, orders, etc. must be furnished.
- Relevant judicial precedence and their applicability to taxpayer's case must be demonstrated.
(e) Typical MAP process in India

- Overseas Taxpayer can invoke CA proceedings in case there is double taxation or taxation not in accordance with the tax treaty.
- MAP application is possible even before exhaustion of domestic remedies.

(f) Outcome of MAP process:

- The Assessing Officer gives effect of the decision of the MAP, after receiving instructions from the CCIT / DGIT (within 90 days of receiving instructions).
- If taxpayer is aggrieved by decision of the Competent Authority, he may reject the decision and go ahead with the remedies under the domestic law.
- If remedies are not granted by the domestic law, the taxpayer may apply to the Competent Authorities again for subsequent years.
- Decision of a Competent Authority is generally case specific and not a precedent for the taxpayer for subsequent years or other taxpayers on same issues.

(g) Drawbacks of the MAP process:

- Time limits under domestic law may make corresponding adjustments unavailable if those limits are not waived in the relevant tax treaty.
- Mutual agreement procedures may take too long to complete.
- Taxpayer participation may be limited.
- Published procedures may not be readily available to instruct taxpayers on how the procedure may be used; and
There may be no procedures to suspend the collection of tax deficiencies or the accrual of interest pending resolution of the mutual agreement procedure

**Indian Statutory regime – MAP**

<table>
<thead>
<tr>
<th>MAP- Indian Statutory Regime</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Rule 44G</strong></td>
</tr>
<tr>
<td>Applicable to resident assessee</td>
</tr>
<tr>
<td>Aggrieved by action of the tax authority outside India</td>
</tr>
<tr>
<td>Such action is not in accordance with the agreement or tax laws</td>
</tr>
<tr>
<td>May make an application to Competent Authority in Form 34F in India to invoke MAP</td>
</tr>
</tbody>
</table>

**1.17 TRANSFER OF INCOME TO NON RESIDENTS [SECTION 93]**

Section 93 hits at transactions which are effected with a view to avoiding liability to taxation. For the purpose, the word “non-resident” also includes a person who is not-ordinarily resident. In order to attract the provisions of this section, all the following conditions must be satisfied:

(a) There is a transfer of assets - whether movable or immovable and whether tangible or intangible.

(b) The transfer is made by any person in India or outside irrespective of his residential status or citizenship.

(c) The transfer is made either alone or in connection with associated operations.

(d) The assets transferred directly yield income chargeable to tax under this Act.

(e) The transfer of assets is effected in such a manner that the income becomes payable to a person outside India who is either a non-resident or a not ordinarily resident in India.

(f) The transferor acquires any right by virtue of which he gets the power to enjoy the income whether immediately or in future.

(g) The Assessing Officer is satisfied that avoidance of liability to tax in India is the purpose of the transfers.

In particular, this section deems any income of a non-resident person which, if it were the income of a resident person, would be chargeable to tax in India (in the absence of this Section), as the income of the resident person in India for all purposes of the Act provided that all the conditions
stated above are satisfied. This section also covers a variety of transactions constituting a transfer including cases where assets are transferred to a non-resident person and the transferor indirectly derives income under the guise of obtaining loans or repayment of loans. If the aforesaid conditions are fulfilled, the income from the assets transferred should be treated as the income of the transferor and would accordingly be taxable in his hands. Therefore, where assets are transferred to a body corporate outside India, in consideration of shares allotted by it to the transferor, he (the transferor), will become assessable under this section in respect of the income of the company derived by it from those assets. This section will not, however, apply to cases where it is shown to the satisfaction of the Assessing Officer that (i) neither the transfer nor any associated operation had for its purpose or for one of its purposes the avoidance of liability to taxation or (ii) it is provided to the satisfaction of the Assessing Officer that the transfer was effected for bonafide commercial purpose and with no intent to avoid tax.

The income which is deemed to be that of the transferor under this section may also arise as a result of the transfer in connection with associated operations. However, in this case also, the treatment of the income would be the same.

**Meaning of “associated operation”:** The expression ‘associated operation,” in relation to a transfer, means an operation of any kind effected by any person in relation to:

(i) any of the assets transferred;
(ii) any assets representing, whether directly or indirectly, any of the assets transferred;
(iii) any income arising from such assets;
(iv) any assets representing, whether directly or indirectly, the accumulation of income arising from such assets.

**Meaning of “Assets”:** It includes property or rights of any kind.

**Meaning of “transfer”:** In relation to rights, transfer includes the creation of those rights.

**Meaning of “benefit”:** It includes a payment of any kind.

In order to determine the liability of the assessee in respect of the deemed income it is immaterial if the income or benefits from the transfer (i) are actually received or not or (ii) are received or are receivable in cash or kind or (iii) are receivable directly or indirectly. For purposes of this section, a person is deemed to have the power to enjoy the income of a non-resident if:

(i) the income, in fact, so dealt with by any person as to be calculated at some point of time to enure for the benefit of the transferor, whether in the same form of the income or otherwise;
(ii) the receipt or accrual of the income operates to increase value of any assets held by the transferor or for his direct or indirect benefit;
(iii) the transferor receives or is entitled to receive at any time any benefit out of the income or out of any money available for the purpose by reason of the effect or successive effects of the associated operations on that income and the assets which represent that income;
(iv) the transferor is in a position to obtain for himself the beneficial enjoyment of the income by exercising any power of appointment or power of revocation or otherwise, whether with or without the consent of any other person, or

(v) the transferor is able to control directly or indirectly the application of the income in any manner whatsoever.

However, in determining whether a person has the power to enjoy the income due regard shall be had to the substantial result and effect of the transfer and any associated operations must be taken into consideration irrespective of the nature or form of the benefits.

It may be noted that where an assessee has been charged to tax in respect of a sum deemed to be his income under this section, the subsequent receipt of that sum by the assessee, whether as income or in any other form, shall not be liable to tax in his hands at the time of receipt.

1.18 INTRODUCTION OF SPECIFIC ANTI AVOIDANCE MEASURES IN RESPECT OF TRANSACTIONS WITH PERSONS LOCATED IN NOTIFIED JURISDICTIONAL AREA [SECTION 94A]

The objective of anti-avoidance measures is to discourage assessees from entering into transactions with persons located in countries or territories which do not have effective information exchange mechanism with India. The following are the anti-avoidance measures introduced -

(i) The Central Government empowered to notify any such country or territory outside India as a NJA (Notified Jurisdictional Area), having regard to the lack of effective exchange of information with such country or territory.

(ii) A transaction where one of the parties thereto is a person located in a NJA would be deemed to be an international transaction then all parties to the transaction to be deemed as associated enterprises, and accordingly, all the provisions of transfer pricing to be attracted in case of such a transaction. However, the benefit of permissible variation between the ALP and the transfer price [provided for in the second proviso to section


Cyprus was specified as a "notified jurisdictional area" (NJA) under section 94A of the Income-tax Act, 1961 vide Notification No. 86/2013 dated 01.11.2013. The said Notification No. 86/2013 was subsequently rescinded vide Notification No. 114 dated 14.12.2016 and Notification No. 119 dated 16.12.2016 with effect from the date of issue of the notification.

The CBDT has, vide this Circular, clarified that Notification No. 86/2013 has been rescinded with effect from the date of issue of the said notification, thereby, removing Cyprus as a notified jurisdictional area with retrospective effect from 01.11.2013.
Transfer Pricing

92C(2)] based on the rate notified by the Central Government would not be available in respect of such transaction.

(iii) Such transaction may be in the nature of –

1. purchase, sale or lease of tangible or intangible property or
2. provision of service or
3. lending or borrowing money or
4. any other transaction having a bearing on the profits, income, losses or assets of the assessee. It may include a mutual agreement or arrangement for allocation or apportionment of, or contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service or facility provided or to be provided by or to the assessee.

(iv) Person located in a NJA shall include a person who is a resident of the NJA and a person, not being an individual, which is established in the NJA. It would also include a permanent establishment of any other person in the NJA.

(v) Payments made to any financial institution located in a NJA would not be allowed as deduction unless the assessee authorizes the CBDT or any other income-tax authority acting on its behalf to seek relevant information from the financial institution on behalf of the assessee.

(vi) No deduction in respect of any other expenditure or allowance, including depreciation, arising from the transaction with a person located in a NJA would be allowed unless the assessee maintains the relevant documents and furnishes the prescribed information.

(vii) Any sum credited or received from a person located in a NJA to be deemed to be the income of the recipient-assessee if he does not explain satisfactorily the source of such money in the hands of such person or in the hands of the beneficial owner, if such person is not the beneficial owner.

(viii) The rate of TDS in respect of any payment made to a person located in the NJA, on which tax is deductible at source, will be the higher of the following rates –

1. rates specified in the relevant provision of the Income-tax Act, 1961; or
2. rate or rates in force; or
3. 30%.

Illustration 2

A Ltd., an Indian company, provides technical services to a company, XYZ Inc., located in a NJA for a consideration of ₹ 40 lakhs in October, 2019. It charges ₹ 42 lakhs for similar services rendered to PQR Inc., which is not located in a NJA. PQR Inc. is not an associated enterprise of A Ltd.

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

Solution

Since XYZ Inc. is located in a NJA, the transaction of provision of technical services by the Indian company A Ltd. to XYZ Inc. falls under the provisions of section 92C. The transaction needs to be analyzed for transfer pricing, as the rate notified by the Central Government would not be available in respect of such transactions located in a NJA.

For the payment made to XYZ Inc. (located in a NJA), the higher rate of TDS will apply, which is the higher of the rates specified in the relevant provision of the Income-tax Act, 1961, or 30%.

For the payment made to PQR Inc. (not located in a NJA), the applicable rate of TDS will be based on the rates in force, which may be lower than the rate specified in the Income-tax Act.

The steps to be followed for tax implications include:

1. Analysis of the transaction nature under section 92C(2) to determine if it falls under any of the specified types of transactions.
2. Calculation of TDS at the higher rate if the transaction involves a person located in a NJA, as per section 92C.
3. Documentation and record-keeping of the relevant documents to support the transaction and the TDS calculation.

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company, A Ltd., would be deemed to be an international transaction and XYZ Inc. and A Ltd. would be deemed to be associated enterprises. Therefore, the provisions of transfer pricing would be attracted in this case.

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

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

It may be noted that the benefit of permissible variation between the ALP and transfer price is not available in respect of a transaction entered into with an entity in NJA.

**ILLUSTRATION 3**

Mr. X, a non-resident individual, is due to receive interest of ₹ 5 lakhs during March 2020 from a notified infrastructure debt fund eligible for exemption under section 10(47). He incurred expenditure amounting to ₹ 10,000 for earning such income. Assuming that Mr. X is a resident of a NJA, discuss the tax implications under section 94A, read with sections 115A and 194LB.

**SOLUTION**

The interest income received by Mr. X, a non-resident, from a notified infrastructure debt fund would be subject to a concessional tax rate of 5% under section 115A on the gross amount of such interest income. Therefore, the tax liability of Mr. X in respect of such income would be ₹ 26,000 (being 5% of ₹ 5 lakhs plus health and education cess@4%).

Under section 194LB, tax is deductible @5% (plus health and education cess@4%) on interest paid by such fund to a non-resident. However, since X is a resident of a NJA, tax would be deductible @30% (plus health and education cess@4%) as per section 94A, and not @5% specified under section 194LB. This is on account of the provisions of section 94A(5), which provides that "Notwithstanding anything contained in any other provision of this Act, where a person located in a NJA is entitled to receive any sum or income or amount on which tax is deductible under Chapter XVII-B, the tax shall be deducted at the highest of the following rates, namely—

(a) at the rate or rates in force;
(b) at the rate specified in the relevant provision of the Act;
(c) at the rate of thirty per cent."

Mr. X can, however, claim refund of excess tax deducted along with interest.

**1.19 LIMITATION OF INTEREST DEDUCTION IN CERTAIN CASES [SECTION 94B]**

(1) Preference of debt over equity as a measure to finance businesses: Debt and equity are the instruments through which a company is generally financed or capitalized. The manner in which a company is capitalized has a major impact on the amount of taxable
profit as the tax laws of countries generally provide for a deduction in respect of interest paid or payable while arriving at the taxable profit. However, the dividend paid on equity contribution is not deductible. Therefore, the higher the level of debt in a company, and thus, the amount of interest it pays, the lower will be its taxable income. Due to this reason, debt is considered a more tax efficient method of finance than equity. Multinational groups are often able to structure their financing arrangements to maximize tax benefits.

(2) **Tax Rules to prevent shifting of profits through excessive interest payments:** In order to address this issue, tax rules are in place in each country to fix a ceiling limit on the amount of interest deductible in computing a company’s profit for tax purposes. Such rules are designed to counter cross-border shifting of profit through excessive interest payments, with the objective of protecting a country’s tax base.

(3) **Relevant Action Plan of BEPS:** 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 Action Plan 4 and recommended certain measures in its final report.

(4) **Insertion of provision in the Income-tax Act, 1961 in line with BEPS Action Plan 4:** Section 94B has, accordingly, been inserted in the Income-tax Act, 1961, in line with the recommendations of OECD BEPS Action Plan 4, to provide that interest expenses claimed by an entity to its associated enterprises shall not be deductible in computation of income under the “Profits and gains of business or profession” to the extent that it arises from excess interest.

<table>
<thead>
<tr>
<th>Excess interest shall mean an amount of</th>
</tr>
</thead>
<tbody>
<tr>
<td>- total interest paid or payable* in excess of 30% of its earnings before interest, taxes, depreciation and amortization (EBITDA) of the borrower in the previous year or</td>
</tr>
<tr>
<td>- interest paid or payable to associated enterprise for that previous year</td>
</tr>
<tr>
<td>whichever is less.</td>
</tr>
</tbody>
</table>

*Total interest paid or payable may be interpreted as interest paid or payable to non-resident associated enterprise as per the intent expressed in section 94B(1) and also the Explanatory Memorandum to the Finance Bill, 2017.*

(5) **Applicability:** The provision shall be applicable to an Indian company, or a permanent establishment of a foreign company in India, being the borrower who incurs expenditure by way of interest or similar nature in respect of any form of debt issued by a non-resident who is an ‘associated enterprise’ of the borrower.

However, the provision of this section would be applicable only where the expenditure by way of interest or of similar nature exceeds ₹ 1 crore, in respect of any form of debt issued by a non-resident, being an ‘associated enterprise’ of such borrower.
(6) **Meaning of debt**: 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”.

(7) **Provision of guarantee and deposit of matching amount deemed to be debt issued**: 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.

(8) **Carry forward of excess interest**: The disallowed interest expense can be carried forward up to eight assessment years immediately succeeding the assessment year for which the disallowance was first made and claimed as deduction against the income computed under the head "Profits and gains of business or profession" to the extent of maximum allowable interest expenditure.

(9) **Businesses excluded from applicability of the provisions of section 94B**: Taking into consideration the special nature of business of Banks and Insurance business, an Indian company or permanent establishment of a foreign company which is engaged in these business have been excluded from the applicability of the provisions of this section.

**Limitation of interest deduction (Section 94B): A Summary**

<table>
<thead>
<tr>
<th>Is the borrower an Indian company or a PE of a Foreign company?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
</tr>
<tr>
<td>Is the borrower a bank or Insurance company?</td>
</tr>
<tr>
<td>Yes</td>
</tr>
<tr>
<td>No</td>
</tr>
<tr>
<td>Does the interest paid to NR AE exceed ₹ 1 crore?</td>
</tr>
<tr>
<td>Yes</td>
</tr>
<tr>
<td>No</td>
</tr>
</tbody>
</table>

**Meaning of Excess interest**

- Total interest paid or payable in excess of 30% of EBITDA or Interest paid or payable to AE for that previous year, whichever is lower
Safe Harbour Rules for determination of arm's length price in case of international transactions [Section 92CB]

(i) Section 92C provides for adjustment in the transfer price of an international transaction with an associated enterprise if the transfer price is not equal to the arm's length price. This has resulted in a large number of such transactions being subjected to adjustment giving rise to considerable dispute.

(ii) Therefore, section 92CB has been introduced to empower the CBDT to formulate safe harbour rules to determine the arm’s length price under section 92C and 92CA. ‘Safe harbour’ means circumstances in which the income-tax authorities shall accept the transfer price declared by the assessee.

Accordingly, in exercise of the powers conferred by section 92CB read with section 295 of the Income-tax Act, 1961, the CBDT has, vide notification, prescribed safe harbour rules. These rules are explained hereunder:

Safe Harbour Rules [Rule 10TD read with Rule 10TA, Rule 10TB and Rule 10TC]

Where an eligible assessee has entered into an eligible international transaction and the option exercised by the said assessee is not held to be invalid under Rule 10TE, the transfer price declared by the assessee in respect of such transaction shall be accepted by the income-tax authorities, if it is in accordance with the circumstances mentioned below:

<table>
<thead>
<tr>
<th>S. No.</th>
<th>Circumstances</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i)</td>
<td>Provision of software development services</td>
<td>The operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense incurred is –</td>
</tr>
<tr>
<td></td>
<td>[Rule 10TC]</td>
<td>[Rule 10TD]</td>
</tr>
<tr>
<td></td>
<td>Not less than the prescribed percentage</td>
<td>Where the value of international transaction entered</td>
</tr>
<tr>
<td></td>
<td>17% does not exceed a sum of Rs. 100 crore;</td>
<td>(i) Business application software and information system development using known methods and existing software tools;</td>
</tr>
<tr>
<td></td>
<td>18% exceeds a sum of Rs. 100 crore but does not exceed Rs. 200 crore.</td>
<td>(ii) support for existing systems;</td>
</tr>
</tbody>
</table>

It, however, does not include any R&D services whether or not in the nature of contract R&D services.
(ii) **Provision of information technology enabled services**

The operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense incurred is –

<table>
<thead>
<tr>
<th>Not less than the prescribed percentage</th>
<th>Where the aggregate value of such transactions entered into during the previous year</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>17%</strong></td>
<td><strong>Does not exceed a sum of Rs. 100 crore</strong></td>
</tr>
<tr>
<td><strong>18%</strong></td>
<td><strong>exceeds a sum of Rs. 100 crore but does not exceed Rs. 200 crore.</strong></td>
</tr>
</tbody>
</table>

“Information technology enabled services” means the following business process outsourcing services provided mainly with the assistance or use of information technology, namely:-

| (i) | back office operations                   |
| (ii) | Call centres or contact centre services |
| (iii) | data processing and data mining         |
| (iv) | insurance claim processing              |
| (v) | legal databases                         |
| (vi) | creation and maintenance of medical transcription excluding medical advice |
| (vii) | translation services                    |
| (viii) | Payroll                                |
| (ix) | remote maintenance                      |
| (x) | revenue accounting                      |
| (xi) | support centres                         |
| (xii) | website services                        |
| (xiii) | data search integration and analysis    |
| (xiv) | remote education excluding education content development |
| (xv) | Clinical database management services excluding clinical trials |

It, however, does not include any R & D services whether or not in the nature of contract R & D services.

(iii) **Provision of knowledge process outsourcing services**

The value of international transaction does not exceed Rs. 200 crore and the operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense is –

<table>
<thead>
<tr>
<th>Not less than the prescribed percentage</th>
<th>Employee Cost in relation to the Operating</th>
</tr>
</thead>
</table>

“Knowledge process outsourcing services” means the following business process outsourcing services provided mainly with the assistance or use of information technology requiring application of knowledge and advanced analytical and technical skills, namely:-

<p>| (i) | geographic information system          |
| (ii) | human resources                       |</p>
<table>
<thead>
<tr>
<th>percentage</th>
<th>Expense</th>
<th>services</th>
</tr>
</thead>
<tbody>
<tr>
<td>24%</td>
<td>at least 60%;</td>
<td>(iii) Engineering and design services</td>
</tr>
<tr>
<td>21%</td>
<td>40% or more but less than 60%;</td>
<td>(iv) Animation or content development and management</td>
</tr>
<tr>
<td>18%</td>
<td>Does not exceed 40%.</td>
<td>(v) business analytics</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(vi) financial analytics</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(vii) market research</td>
</tr>
</tbody>
</table>

It, however, does not include any R&D services whether or not in the nature of contract R&D services.

(iv) Advancing of intra-group loans where the amount of loan is denominated in Indian Rupees (INR)

The interest rate declared in relation to the eligible international transaction is not less than the one-year marginal cost of funds lending rate of SBI as on 1st April of the relevant previous year plus

<table>
<thead>
<tr>
<th>%</th>
<th>CRISIL rating of Associated Enterprise or its equivalent</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.75%</td>
<td>Between AAA to A</td>
</tr>
<tr>
<td>3.25%</td>
<td>BBB-, BBB, BBB+</td>
</tr>
<tr>
<td>4.75%</td>
<td>Between BB to B</td>
</tr>
<tr>
<td>6.25%</td>
<td>C to D</td>
</tr>
<tr>
<td>4.25%</td>
<td>Where no credit rating is available and the loan to AE including loans to all AEIs in Indian rupees does not exceed Rs. 100 crore in aggregate as on 31st March of the relevant P.Y.</td>
</tr>
</tbody>
</table>

“Intra-group loan” means loan advanced to wholly owned subsidiary being a non-resident, where the loan–

(i) is sourced in Indian rupees

(ii) is not advanced by an enterprise, being a financial company including a bank or a financial institution or an enterprise engaged in lending or borrowing in the normal course of business; and

(iii) does not include credit line or any other loan facility which has no fixed term for repayment.

Advancing of intra-group loans where

The interest rate declared in relation to the eligible international transaction is
the amount of loan is denominated in foreign currency not less than the six-month London Inter-Bank Offer Rate (LIBOR) of the relevant foreign currency as on 30th September of the relevant previous year plus

<table>
<thead>
<tr>
<th>%</th>
<th>CRISIL rating of Associated Enterprise or its equivalent</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.50%</td>
<td>Between AAA to A</td>
</tr>
<tr>
<td>3.00%</td>
<td>BBB-, BBB, BBB+</td>
</tr>
<tr>
<td>4.50%</td>
<td>Between BB to B</td>
</tr>
<tr>
<td>6.00%</td>
<td>C to D</td>
</tr>
<tr>
<td>4.00%</td>
<td>Where no credit rating is available and the loan to AE including loans to all AEs does not exceed Rs. 100 crore in aggregate as on 31st March of the relevant P.Y.</td>
</tr>
</tbody>
</table>

(v) Providing corporate guarantee

Where the amount guaranteed-

<table>
<thead>
<tr>
<th>Does not exceed Rs. 100 crore.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Exceeds Rs. 100 crore and the credit rating of the associated</td>
</tr>
</tbody>
</table>

1% p.a. on the amount guaranteed

“Corporate guarantee” means explicit corporate guarantee extended by a company to its wholly owned subsidiary being a non-resident in respect of any short-term or long-term borrowing. Explicit corporate guarantee, however, does not include-

| (i) letter of comfort; |
| (ii) implicit corporate guarantee; |
| (iii) performance guarantee; or |
| (iv) Any other guarantee of similar natur.
| (vi) Provision of contract R & D services wholly or partly relating to software development. | The operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense incurred is not less than 24%, where the value of the international transaction does not exceed Rs. 200 crore. | “Contract research and development (R&D) services wholly or partly relating to software development” means the following, namely:-

| (i) | R & D producing new theorems and algorithms in the field of theoretical computer science; |
| (ii) | development of information technology at the level of operating systems, programming languages, data management, communications software and software development tools; |
| (iii) | Development of Internet technology; |
| (iv) | research into methods of designing, developing, deploying or maintaining software; |
| (v) | software development that produces advances in generic approaches for capturing, transmitting, storing, retrieving, manipulating or displaying information; |
| (vi) | experimental development aimed at filling technology knowledge gaps as necessary to develop a software programme or |
| (vii) Provision of contract R&D services wholly or partly relating to generic pharmaceutical drugs | The operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense incurred is not less than 24%, where the value of the international transaction does not exceed Rs. 200 crore. | “Generic pharmaceutical drug” means a drug that is comparable to a drug already approved by the regulatory authority in dosage form, strength, route of administration, quality and performance characteristics, and intended use. |
| (viii) Manufacture and export of core auto components | The operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense is not less than 12%. | “Core auto components” means, (i) engine and engine parts, including piston and piston rings, engine valves and parts cooling systems and parts and power train components; (ii) transmission and steering parts, including gears, wheels, steering systems, axles and clutches; (iii) suspension and braking parts, including brake and brake assemblies, brake linings, shock absorbers and leaf springs; |
| (ix) Manufacture and export of non-core auto components | The operating profit margin declared by the eligible | “Non-core auto components” mean auto components other than core auto components. |
**non-core auto components**

assesssee from the eligible international transaction in relation to operating expense is not less than 8.5%.

than core auto components.

(x) **Receipt of low value-adding intra group services from one or more members of its group**

The entire value of the international transaction, including a mark-up not exceeding 5%, does not exceed a sum of Rs. 10 crore.

However, the method of cost pooling, the exclusion of shareholder costs and duplicate costs from the cost pool and the reasonableness of the allocation keys used for allocation of costs to the assesssee by the overseas associated enterprise, is certified by an accountant.

“Low value-adding intra group services” means services that are performed by one or more members of a multinational enterprise group on behalf of one or more other members of the same multinational enterprise group and which,

(i) are in the nature of support services;

(ii) are not part of the core business of the multinational enterprise group, i.e., such services neither constitute the profit-earning activities nor contribute to the economically significant activities of the multinational enterprise group;

(iii) are not in the nature of shareholder services or duplicate services;

(iv) neither require the use of unique and valuable intangibles nor lead to the creation of unique and valuable intangibles;

(v) neither involve the assumption or control of significant risk by the service provider nor give rise to the creation of significant risk or the service provider; and

(vi) do not have reliable external comparable services that can be used for determining their arm’s length price,

However, it does not include the following services, namely:

(i) research and development
services;
(ii) manufacturing and production services;
(iii) information technology (software development) services;
(iv) knowledge process outsourcing services;
(v) business process outsourcing services;
(vi) purchasing activities of raw materials or other materials that are used in the manufacturing or production process;
(vii) sales, marketing and distribution activities;
(viii) financial transactions;
(ix) extraction, exploration, or processing of natural resources; and
(x) insurance and reinsurance;”

### Meaning of certain terms:

<table>
<thead>
<tr>
<th>Term</th>
<th>Meaning</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) Eligible assessee</td>
<td>“Eligible assessee” means a person who has exercised a valid option for application of safe harbor rules and is engaged in providing software development services or information technology enabled services or knowledge process outsourcing services, with insignificant risk, to a non-resident associated enterprise;</td>
</tr>
<tr>
<td>(i)</td>
<td>has made any intra-group loan;</td>
</tr>
<tr>
<td>(ii)</td>
<td>has provided a corporate guarantee;</td>
</tr>
<tr>
<td>(iv)</td>
<td>is engaged in providing contract research and development services wholly or partly relating to software development, with insignificant risk, to a non-resident associated enterprise;</td>
</tr>
<tr>
<td>(v)</td>
<td>is engaged in providing contract research and development services wholly or partly relating to generic pharmaceutical drugs, with insignificant risk, to a non-resident associated enterprise;</td>
</tr>
<tr>
<td>(vi)</td>
<td>is engaged in the manufacture and export of core or non-core auto components and where ninety per cent or more of total turnover during the relevant previous year is in the nature of original equipment manufacturer sales; or</td>
</tr>
<tr>
<td>(vii)</td>
<td>is in receipt of low value-adding intra-group services from one or more members of its group</td>
</tr>
</tbody>
</table>
| (ii)  | Operating expense | The costs incurred in the previous year by the assessee in relation to the international transaction during the course of its normal operations including  
- costs relating to Employee Stock Option Plan or similar stock-based compensation provided for by the associated enterprises of the assessee to the employees of the assessee,  
- reimbursement to associated enterprises of expenses incurred by the associated enterprises on behalf of the assessee,  
- amounts recovered from associated enterprises on account of expenses incurred by the assessee on behalf of those associated enterprises and which relate to normal operations of the assessee and  
- depreciation and amortisation expenses relating to the assets used by the assessee, but not including the following, namely:—  
(i) interest expense;  
(ii) provision for unascertained liabilities;  
(iii) pre-operating expenses;  
(iv) loss arising on account of foreign currency fluctuations;  
(v) extraordinary expenses;  
(vi) loss on transfer of assets or investments;  
(vii) expense on account of income-tax; and  
(viii) other expenses not relating to normal operations of the assessee:  
However, reimbursement to associated enterprises of expenses incurred by the associated enterprises on behalf of the assessee shall be at cost.  
Further, amounts recovered from associated enterprises on account of expenses incurred by the assessee on behalf of the associated enterprises and which relate to normal operations of the assessee shall be at cost. |
| (iii) | Operating revenue | The revenue earned by the assessee in the previous year in relation to the international transaction during the course of its normal operations including costs relating to Employee Stock Option Plan or similar stock-based compensation provided for by the associated enterprises of the assessee to the employees of the assessee but not including the following, namely:—  
(i) interest income;  
(ii) income arising on account of foreign currency fluctuations;  
(iii) income on transfer of assets or investments;  
(iv) refunds relating to income-tax;  
(v) provisions written back;  
(vi) extraordinary incomes; and  
(vii) other incomes not relating to normal operations of the assessee |
| (iv)  | Operating profit margin | In relation to operating expense, means the ratio of operating profit, being the operating revenue in excess of operating expense, to the operating expense expressed in terms of percentage |
| Accountant | An accountant referred to in the Explanation below section 288(2) of the Act and includes any person recognised for undertaking cost certification by the Government of the country where the associated enterprise is registered or incorporated or any of its agencies, who fulfils the following conditions, namely:—  
| I | if he is a member or partner in any entity engaged in rendering accountancy or valuation services then,—  
| i | the entity or its affiliates have presence in more than two countries; and  
| ii | the annual receipt of the entity in the year preceding the year in which cost certification is undertaken exceeds Rs. 10 crore;  
| II | if he is pursuing the profession of accountancy individually or is a valuer then,—  
| i | his annual receipt in the year preceding the year in which cost certification is undertaken, from the exercise of profession, exceeds Rs. 1 crore; and  
| ii | he has professional experience of not less than 10 years. |
| Employee cost | It includes,—  
| i | salaries and wages;  
| ii | gratuities;  
| iii | contribution to Provident Fund and other funds;  
| iv | the value of perquisites as specified in clause (2) of section 17;  
| v | employment related allowances, like medical allowance, dearness allowance, travel allowance and any other allowance;  
| vi | bonus or commission by whatever name called;  
| vii | lump sum payments received at the time of termination of service or superannuation or voluntary retirement, such as gratuity, severance pay, leave encashment, voluntary retrenchment benefits, commutation of pension and similar payments;  
| viii | expenses incurred on contractual employment of persons performing tasks similar to those performed by the regular employees;  
| ix | outsourcing expenses, to the extent of employee cost, wherever ascertainable, embedded in the total outsourcing expenses. However, where the extent of employee cost embedded in the total outsourcing expenses is not ascertainable, 80% of the total outsourcing expenses shall be deemed to be the employee cost embedded in the total outsourcing expenses;  
| x | recruitment expenses;  
| xi | relocation expenses;  
| xii | training expenses;  
| xiii | staff welfare expenses; and  
| xiv | any other expenses related to employees or the employment. |
(vii) \hspace{1cm} \textbf{No tax or low tax country or territory} \hspace{1cm} A country or territory in which the maximum rate of income-tax is less than 15%.

(viii) \hspace{1cm} \textbf{Relevant previous year} \hspace{1cm} The previous year relevant to the assessment year in which the option for safe harbour is validly exercised.

**Procedure [Rule 10TE]**

**Furnishing of Form 3CEFA**

For exercising the option of safe harbor, the assessee has to furnish Form 3CEFA, complete in all respects, to the Assessing Officer on or before the due date specified in Explanation 2 to section 139(1) for furnishing the return of income for

- the relevant assessment year, in case the option is exercised only for that assessment year
- or
- the first of the assessment years, in case the option is exercised for more than one assessment year.

The return of income for the relevant assessment year or the first of the assessment years, as the case may be, should be furnished on or before the date of submitting the Form 3CEFA.

The option for safe harbour validly exercised would continue to apply for the period specified in the form or 3 years, whichever is less.

**Verification by the Assessing Officer**

Before treating the option for safe harbor by the assessee as validly exercised, the Assessing Officer shall verify whether the assessee exercising the option is an eligible assessee and the transaction in respect of which the option is exercised is an eligible international transaction.

**Reference to Transfer Pricing Officer by the Assessing Officer in case of a doubt on validity**

The Assessing Officer shall make a reference to the Transfer Pricing Officer for determination of the eligibility of the assessee or the international transaction or both for the purposes of the safe harbor, where he has doubts the valid exercise of the option for the safe harbour by an assessee.

**Time limit for reference to Transfer Pricing Officer by Assessing Officer**

No reference shall be made to the Transfer Pricing Officer by the Assessing Officer after the expiry of 2 months from the end of the month in which Form 3CEFA is received by him.

**Documents or information required by the Transfer Pricing Officer**

Transfer Pricing Office may issue a notice to the assessee to furnish such information or documents or other evidence as he may consider necessary. The assessee has to furnish the same within the specified time in such notice.

**Circumstances when option declared to be Invalid**

The Transfer Pricing Office shall, by order in writing, declare the option exercised by the assessee as invalid and cause a copy of the order has to be served on the assessee and the Assessing Officer, if –

(i) the assessee does not furnish the information or documents or other evidence required by the Transfer Pricing Office

(ii) the Transfer Pricing Office finds that the assessee is not an eligible assessee

(iii) the Transfer Pricing Office finds that the international transaction in respect of which option has been exercised is not an eligible international transaction
**Order by Transfer Pricing Officer**

The Transfer Pricing Officer shall pass the order declaring the option exercised by the assessee as invalid within a period of 2 months from the end of the month in which reference from the Assessing Officer is received by him.

No order can be passed declaring the option exercised by the assessee invalid unless an opportunity of being heard is given to him.

**Filling of objections against the order of Transfer Pricing Officer by the assessee**

If the assessee objects to the order of the Transfer Pricing Officer declaring the option to be invalid, he may file his objections with the Commissioner to whom the Transfer Pricing Officer is subordinate, within 15 days of receipt of the order of the Transfer Pricing Officer.

On receipt of objection, the Commissioner shall, after providing an opportunity of being heard to the assessee, pass appropriate orders, within a period of 2 months from the end of the month in which the objection filed by the assessee is received by him, in respect of the validity or otherwise of the option exercised by the assessee. A copy of the said order has to be served on the assessee and the Assessing Officer.

If the Assessing Officer or the Transfer Pricing Officer or the Commissioner, as the case may be, does not make a reference or pass an order within the specified time, then, the option for safe harbour exercised by the assessee shall be treated as valid.

**Notes:**

1. **The second proviso to section 92C(2) provides that if the variation between the arm’s length price determined and the price at which the transaction has been undertaken does not exceed such percentage, not exceeding 3%, as may be notified by the Central Government in the Official Gazette, the price at which the transaction has actually been undertaken shall be deemed to be the arm’s length price. However, no comparability adjustment and allowance under the second proviso to section 92C(2) shall be made to the transfer price declared by the eligible assessee and accepted under the Safe Harbour Rules given above.**

2. **Section 92D requiring every person who has entered into an international transaction to keep and maintain the prescribed information and documents and section 92E requiring such person to obtain a report from an accountant and furnish such report on or before the specified date in prescribed form and manner, shall apply irrespective of the fact that the assessee exercises his option for safe harbor in respect of such transaction.**

3. **Safe harbor rules shall not be applicable in respect of eligible international transaction entered into with an associated enterprise located in any country or territory notified under section 94A as notified jurisdictional area or in a no tax or low tax country or territory [Rule 10TF].**

4. **The assessee would not be entitled to invoke mutual agreement procedure (MAP) under a DTAA entered with a country outside India, if the transfer price in relation to eligible international transaction declared by an eligible assessee is accepted by the income-tax authority under safe harbour rules [Rule 10TG].**

**Note:**
If there are any changes in the aforementioned Rules, then I will explain you all the additional part through a youtube video.
After studying this Chapter, you will be able to –

- determine the residential status of different persons and examine the scope of income taxable in the hands of non-residents;
- determine the residential status of a company, other than an Indian company, based on Place of Effective Management (POEM);
- identify whether a particular income is exempt in the hands of a non-resident based on the provisions of the Income-tax Act, 1961;
- compute the profits and gains from shipping business, business of operation of aircraft, business of civil construction etc. in certain turnkey power projects in the case of non-corporate non-residents and foreign company applying the presumptive tax provisions under the Income-tax Act, 1961;
- determine the quantum of head office expenditure allowable as deduction, in the case of non-residents;
- determine the tax payable by non-residents on dividend, royalty and fees for technical service applying the special provisions of Chapter XII;
- determine the tax payable by non-residents applying the special provisions relating to certain incomes of non-residents prescribed under Chapter XII-A;
- **examine** the withholding tax provisions to determine the tax, if any, required to be deducted at source on certain payments made to non-residents;

- **compute** the total income of non-residents and tax payable thereon, applying the general provisions and special provisions applicable to non-residents under the Income-tax Act, 1961;

- **Integrate, analyse and apply** the relevant provisions of the Income-tax Act, 1961 to make computations and address related issues.
2.1 INTRODUCTION

Taxation of cross-border transactions are generally based on the two concepts:

1. Residence based taxation
2. Source based taxation

Residence based taxation: The concept of residence-based taxation asserts that natural persons or individuals are taxable in the country or tax jurisdiction in which they establish their residence or domicile, regardless of the source of income. In case of companies, the place of incorporation or the place of effective management is generally considered as its place of residence.

Source based taxation: According to this concept, a country considers certain income as taxable income, if such income arises within its jurisdiction. Such income is taxed in the country of source regardless of the residence of the taxpayer.

The overview of residence and source rules in India may largely be gathered from sections 5, 6 & 9 of the Income-tax Act, 1961. While residents are taxable on global income, non-residents are taxed on their India-source income or income that is received in India or has accrued or deemed to accrue in India.

2.2 IMPORTANT DEFINITIONS

Before we proceed further, it is important to have a recap of some basic definitions given in Section 2 of the Income-tax Act, 1961.

(1) Assessee [Section 2(7)]

"Assessee" means a person by whom any tax or any other sum of money is payable under this Act. In addition, it includes —

(i) every person in respect of whom any proceeding under the Income-tax Act, 1961 has been taken for the assessment of -

(a) his income; or
(b) the income of any other person in respect of which he is assessable; or
(c) the loss sustained by him or by such other person; or
(d) the amount of refund due to him or to such other person.

(ii) every person who is deemed to be an assessee under any provision of the Income-tax Act, 1961;

(iii) every person who is deemed to be an assessee-in-default under any provision of the Income-tax Act, 1961.
2.4 INTERNATIONAL TAXATION

(2) Person [Section 2(31)]

The definition of ‘assessee’ leads us to the definition of ‘person’ as the former is closely connected with the latter. The term ‘person’ is important from another point of view also viz., the charge of income-tax is on every ‘person’.

Person includes –

(i) an individual,
(ii) a Hindu undivided family (HUF),
(iii) a company,
(iv) a firm,
(v) an association of persons (AOPs) or a body of individuals (BOIs), whether incorporated or not,
(vi) a local authority, and
(vii) every artificial juridical person other than mentioned above e.g., idol, deity, University of Delhi, University of Calcutta.

(3) Assessment year [Section 2(9)]

"Assessment year" means the period of 12 months commencing on the 1st day of April every year. The year in which income is earned is previous year and such income is taxable in the immediately following year which is the assessment year.

Income earned in the previous year 2019-20 is taxable in the assessment year 2020-21.

(4) Previous year [Section 3]

“Previous year" means the financial year immediately preceding the assessment year.

Business or profession newly set up during the financial year - In such a case, the previous year shall be the period beginning on the date of setting up of the business or profession and ending with 31st March of the said financial year.

If a source of income comes into existence in the said financial year, then, the previous year will commence from the date on which the source of income newly comes into existence and will end with 31st March of the financial year.

(5) Domestic Company [Section 2(22A)]

“Domestic company” means an Indian company, or any other company which, in respect of its income liable to income-tax under this Act, has made the prescribed arrangements for the declaration and payment, within India, of the dividends (including dividends on preference shares) payable out of such income.
(6) **Foreign Company [Section 2(23A)]**

“Foreign company” means a company which is not a domestic company.

(7) **India [Section 2(25A)]**

"India" means the
- territory of India as referred to in article 1 of the Constitution,
- its territorial waters, seabed and subsoil underlying such waters,
- continental shelf,
- exclusive economic zone or
- any other specified maritime zone and the air space above its territory and territorial waters.

Specified maritime zone means the maritime zone as referred to in the Territorial Waters, Continental Shelf, Exclusive Economic Zone and other Maritime Zones Act, 1976.

(8) **Resident [Section 2(42)]**

Resident means a person who is resident in India within the meaning of section 6.

(9) **Non-resident [Section 2(30)]**

“Non-resident” means a person who is not a "resident", and for the purposes of sections 92, 93 and 168 includes a person who is not ordinarily resident within the meaning of section 6(6).

<table>
<thead>
<tr>
<th>Section</th>
<th>Provision</th>
</tr>
</thead>
<tbody>
<tr>
<td>92</td>
<td>Computation of income from international transaction having regard to Arm’s Length Price (ALP). International transaction means a transaction between two or more associated enterprises, either or both of whom are non-residents.</td>
</tr>
<tr>
<td>93</td>
<td>Avoidance of income-tax by transfer of assets resulting in transfer of income to non-residents.</td>
</tr>
<tr>
<td>168</td>
<td>Determination of residential status of an Executor depending on the residential status of deceased person.</td>
</tr>
</tbody>
</table>

(10) **Transfer [Section 2(47)]**

"Transfer" in relation to a capital asset, includes,—

(i) the sale, exchange or relinquishment of the asset; or
(ii) the extinguishment of any rights therein; or
(iii) the compulsory acquisition thereof under any law; or
(iv) the owner of a capital asset may convert the same into the stock-in-trade of a business carried on by him. Such conversion is treated as transfer; or

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(v) the maturity or redemption of a zero coupon bond; or
(vi) possession of an immovable property in consideration of part-performance of a contract referred to in section 53A of the Transfer of Property Act, 1882; or
(vii) any transaction (whether by way of becoming a member of, or acquiring shares in, a co-operative society, company or other association of persons or by way of any agreement or any arrangement or in any other manner whatsoever) which has the effect of transferring, or enabling the enjoyment of, any immovable property.

2.3 CHARGE OF INCOME TAX [SECTION 4]

Where any Central Act enacts that income-tax shall be charged for any assessment year at any rate or rates, income-tax at that rate or those rates shall be charged for that year in accordance with, and subject to the provisions (including provisions for the levy of additional income-tax) of this Act in respect of the total income of the previous year of every person [Section 4(1)].

However, where by virtue of any provision of this Act income-tax is to be charged in respect of the income of a period other than the previous year, income-tax shall be charged accordingly. Further, in respect of income chargeable under section 4(1), income-tax shall be deducted at source or paid in advance, where it is so deductible or payable under any provision of this Act.

Thus, the charging section provides that

(a) income-tax shall be charged at the rate or rates prescribed in the Finance Act for the relevant previous year

<table>
<thead>
<tr>
<th>Rates of tax, surcharge and cess for foreign companies</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Rate of Tax:</strong> Foreign companies are taxable at the rate of 40%. This would further be increased by surcharge, if applicable, and health and education cess (HEC)</td>
</tr>
<tr>
<td><strong>Surcharge:</strong> Surcharge at the rate of 2% of such income-tax would be attracted, where the total income exceeds ₹ 1 crore but does not exceed ₹ 10 crores. Surcharge at the rate of 5% of such income tax would be attracted, where the total income exceeds ₹ 10 crores.</td>
</tr>
<tr>
<td><strong>Health and Education Cess (HEC):</strong> Health and Education cess @4% of income-tax plus surcharge, if applicable, would be attracted irrespective of the level of total income.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Rates of tax, surcharge and cess for non-corporate non-residents</th>
</tr>
</thead>
<tbody>
<tr>
<td>For non-corporate non-residents, the rates of tax, surcharge and cess are same as the rates applicable to residents [Refer to Chapter 1 of Study Material of Final Paper 7: Direct Tax Laws and International Taxation]. However, the higher basic exemption limit for resident individuals of the age of 60 years and above and 80 years and above at any time during the previous year would not be available for non-resident individuals.</td>
</tr>
</tbody>
</table>
(b) the charge of tax is on various persons specified in Section 2(31).

(c) the income sought to be taxed is that of the previous year and not of the of assessment year (there are certain exceptions provided by sections 172, 174, 174A, 175 and 176); and

(d) the levy of tax on the assessee is on his total income computed in accordance with and subject to the appropriate provisions of the Income-tax Act, including provisions for the levy of additional income-tax.

2.4 RESIDENTIAL STATUS AND SCOPE OF TOTAL INCOME

(1) Residential Status [Section 6]

The tax incidence and imposition of tax is dependent upon the residential status of a person. Therefore, the identification and classification of the residence of a person is one of the first steps to be carried out in order to proceed with the assessing of income of a person. The rules for determining the residential status of a person is governed by section 6 of Income-tax Act. For all purposes of income-tax, taxpayers are classified into three broad categories on the basis of their residential status viz.

(i) Resident and ordinarily resident (ROR)

(ii) Resident but not ordinarily resident (RNOR)

(iii) Non-resident

[i] Residential status of an individual

As per section 6(1), 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.

If the individual satisfies any one of the conditions mentioned above he is a resident. If the individual does not satisfy both the conditions he is said to be non-resident.

Exceptions:

The following categories of individuals will be treated as resident in India only if the period of their stay during the relevant previous year amounts to 182 days. In other words, even if such persons were in India for 60 days or more (but less than 182 days) in the relevant previous year, they will not be treated as resident due to the reason that their stay in India was for 365 days or more during the 4 immediately preceding years.
(a) Indian citizen, who leaves India during the previous year as a member of the crew of an Indian ship or for the purposes of employment outside India, or

(b) Indian citizen or a person of Indian origin\(^1\), who, being outside India and comes on a visit\(^2\) to India during the previous year.

**Resident and ordinarily resident/ Resident but not ordinarily resident**

Only individuals and HUF can be resident but not ordinarily resident in India. All other classes of assesseses can be either a resident or non-resident. A not-ordinarily resident person is one who satisfies any one of the conditions specified under section 6(6).

(i) If such individual has been non-resident in India in any 9 out of the 10 previous years preceding the relevant previous year, or

(ii) If such individual has during the 7 previous years preceding the relevant previous year been in India for a period of 729 days or less.

**Note:** In simpler terms, an individual is said to be a resident and ordinarily resident, if he satisfies both the following conditions:

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

(ii) His total stay in India in the last 7 years preceding the relevant previous year is 730 days or more.

If the individual satisfies both the conditions mentioned above, he is a resident and ordinarily resident but if only one or none of the conditions are satisfied, the individual is a resident but not ordinarily resident.

**How to determine period of stay in India for an Indian citizen, being a crew member?**

In case of foreign bound ships where the destination of the voyage is outside India, there was uncertainty regarding the manner and the basis of determining the period of stay in India for an Indian citizen, being a crew member.

To remove this uncertainty, *Explanation 2* has been inserted in section 6(1) to provide that in the case of an Individual, being a citizen of India and a member of the crew of a foreign bound ship leaving India, the period or periods of stay in India shall, in respect of such voyage, be determined in the prescribed manner and subject to the prescribed conditions.

Accordingly, the CBDT has vide, *Notification No. 70/2015 dated 17.8.2015*, inserted Rule 126 in the Income-tax Rules, 1962 to compute the period of stay in such cases.

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\(^1\) A person is said to be of Indian origin if he or either of his parents or either of his grandparents were born in undivided India

\(^2\) If the individual returns to India permanently, then the additional condition of 60 days in PY + 365 in the four immediately preceding PYs would apply for determining his residential status.
According to Rule 126, for the purposes of section 6(1), in case of an individual, being a citizen of India and a member of the crew of a ship, the period or periods of stay in India shall, in respect of an eligible voyage, not include the following period:

### Period to be excluded

<table>
<thead>
<tr>
<th>Period commencing from</th>
<th>Period ending on</th>
</tr>
</thead>
<tbody>
<tr>
<td>the date entered into the Continuous Discharge Certificate in respect of joining the ship by the said individual for the eligible voyage</td>
<td>and the date entered into the Continuous Discharge Certificate in respect of signing off by that individual from the ship in respect of such voyage.</td>
</tr>
</tbody>
</table>

### Meaning of certain terms:

<table>
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</tr>
</thead>
<tbody>
<tr>
<td>(a) Continuous Discharge Certificate</td>
<td>This term has the meaning assigned to it in the Merchant Shipping (Continuous Discharge Certificate-cum Seafarer’s Identity Document) Rules, 2001 made under the Merchant Shipping Act, 1958.</td>
</tr>
</tbody>
</table>
| (b) Eligible voyage    | A voyage undertaken by a ship engaged in the carriage of passengers or freight in international traffic where –
                       | (i) for the voyage having originated from any port in India, has as its destination any port outside India; and
                       | (ii) for the voyage having originated from any port outside India, has as its destination any port in India. |

### Important points:

1. Residential status is to be determined on year to year basis

2. The term “stay in India” includes stay in the territorial waters of India (i.e. 12 nautical miles into the sea from the Indian coastline). Even the stay in a ship or boat moored in the territorial waters of India would be sufficient to make the individual resident in India.

3. The residence of an individual for income-tax purpose has nothing to do with citizenship, place of birth or domicile. An individual can, therefore, be resident in more countries than one even though he can have only one domicile.

4. For the purpose of counting the number of days stayed in India, both the date of departure as well as the date of arrival are considered to be in India.

5. It is not necessary that the period of stay must be continuous or active nor is it essential that the stay should be at the usual place of residence, business or employment of the individual.
(ii) Residential status of a HUF, firm, AOPs/BOIs, local authorities and artificial juridical persons

**Resident:** These persons would be resident in India if the control and management of their affairs is situated wholly or partly in India.

**Non-resident:** If the control and management of the affairs is situated wholly outside India, they would become a non-resident.

**Control and Management of HUF:** It is with Karta or its Manager.

**Control and Management of Firm/AOPs:** It is with Partners/Members.

**A HUF can be Resident and ordinarily resident (ROR) or Resident but not ordinarily resident (RNOR)**

If Karta of resident HUF satisfies both the following additional conditions (as applicable in case of individual) then, resident HUF will be Resident and ordinarily resident, otherwise it will be Resident but not ordinarily resident.

**Additional Conditions:**

(a) Karta of Resident HUF should be resident in at least 2 previous years out of 10 previous years immediately preceding relevant previous year.

(b) Stay of Karta during 7 previous year immediately preceding relevant previous year should be 730 days or more.

Firms, association of persons, local authorities and other artificial juridical persons can be either resident or non-resident but they cannot be resident but not ordinarily resident in India.

**Meaning of the term “control and management”:**

- The expression ‘control and management’ referred to under section 6 refers to the central control and management and not to the carrying on of day-to-day business by servants, employees or agents.

- The business may be done from outside India and yet its control and management may be wholly within India. Therefore, control and management of a business is said to be situated at a place where the head and brain of the adventure is situated.

- The place of control may be different from the usual place of running the business and sometimes even the registered office of the assessee. This is because the control and management of a business need not necessarily be done from the place of business or from the registered office of the assessee.

- But control and management do imply the functioning of the controlling and directing power at a particular place with some degree of permanence.
(iii) Residential status of a Company

With effect from assessment year 2017-18, a company would be resident in India in any previous year, if-

(i) it is an Indian company; or

(ii) its place of effective management, in that year, is in India.

“Place of effective management” means a place where key management and commercial decisions that are necessary for the conduct of the business of an entity as a whole are, in substance made [Explanation to section 6(3)].


Place of effective management’ (POEM) is an internationally recognised test for determination of residence of a company incorporated in a foreign jurisdiction. Most of the tax treaties entered into by India recognises the concept of ‘place of effective management’ for determination of residence of a company as a tie-breaker rule for avoidance of double taxation.

The CBDT has laid down the following guiding principles to be followed for determination of POEM.

Concept of Substance over form

Any determination of the POEM will depend upon the facts and circumstances of a given case. The POEM concept is one of substance over form. It may be noted that an entity may have more than one place of management, but it can have only one place of effective management at any point of time. Since “residence” is to be determined for each year, POEM will also be required to be determined on year to year basis.

Whether the company is engaged in active business outside India? - An important criterion for determination of POEM

The process of determination of POEM would be primarily based on the fact as to whether or not the company is engaged in active business outside India.

A company shall be said to be engaged in ‘active business outside India’

- if passive income is not more than 50% of its total income, and
- less than 50% of its total asset 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.
Meaning of certain terms:

<table>
<thead>
<tr>
<th>Term</th>
<th>Meaning</th>
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</table>
| Income             | (a) As computed for tax purpose in accordance with the laws of the country of incorporation; or  
                      (b) As per books of account, where the laws of the country of incorporation does not require such a computation. |
| Value of assets    | (a) In case of an individually depreciable asset                        |
|                    | The average of its value for tax purposes in the country of incorporation of the company at the beginning and at end of the previous year; and |
|                    | (b) 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; |
|                    | (c) In case of any other asset                                          |
|                    | Value as per books of account                                           |
| Number of employees| The average of the number of employees as at the beginning and at the end of the year and shall include persons, who though not employed directly by the company, perform tasks similar to those performed by the employees. |
| Pay roll           | This term includes the cost of salaries, wages, bonus and all other employee compensation including related pension and social costs borne by the employer. |
| Passive income     | It 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; |
|                    | However, any income by way of interest shall not be considered to be passive income in case of a company which is engaged in the business of banking or is a public financial institution, and its activities are regulated as such under the applicable laws of the country of incorporation. |

Place of Effective Management:

(i) In case of Companies engaged in Active Business outside India

POEM of a company engaged in active business shall be presumed to be outside India if the majority of the board meeting are held outside India.

However, in case the Board is not exercising its powers of management and such powers are being exercised by either the holding company or any other person, resident in India, then POEM shall be considered to be in India.
For this purpose, merely because the Board of Directors (BOD) follows general and objective principles of global policy of the group laid down by the parent entity which may be in the field of Pay roll functions, Accounting, Human resource (HR) functions, IT infrastructure and network platforms, Supply chain functions, Routine banking operational procedures, and not being specific to any entity or group of entities per se; would not constitute a case of BoD of companies standing aside.

CBDT Circular No. 25/2017, dated 23.10.2017 clarifies that so long as the Regional Headquarter operates for subsidiaries/ group companies in a region within the general and objective principles of global policy of the group laid down by the parent entity in the field of Pay roll functions, Accounting, HR functions, IT infrastructure and network platforms, Supply chain functions, Routine banking operational procedures, and not being specific to any entity or group of entities per se; it would, in itself, not constitute a case of BoD of companies standing aside and such activities of Regional Headquarter in India alone will not be a basis for establishment of PoEM for such subsidiaries/ group companies.

It is further mentioned in the said Circular that the provisions of General Anti-Avoidance Rule contained in Chapter X-A of the Income-tax Act, 1961 may get triggered in such cases where the above clarification is found to be used for abusive/ aggressive tax planning.

For the purpose of determining whether the company is engaged in active business outside India, the average of the data of the previous year and two years prior to that shall be taken into account. In case the company has been in existence for a shorter period, then data of such period shall be considered. Where the accounting year for tax purposes, in accordance with laws of country of incorporation of the company, is different from the previous year, then, data of the accounting year that ends during the relevant previous year and two accounting years preceding it shall be considered.

The final guidelines have clarified that mere following of global policies laid down by the Indian holding company would not constitute that Board is standing aside.

(ii) In case Companies not engaged in active business outside India

The guidelines provide a two stage process for determination of POEM in case of companies not engaged in active business.

(a) **First stage:** Identifying the person(s) who actually make the key management and commercial decisions for the conduct of the company as a whole.

(b) **Second stage:** Determine the place where these decisions are, in fact, being made.

The place where these management decisions are taken would be more important than the place where such decisions are implemented. For the purpose of determination of POEM, it is the substance which would be conclusive rather than the form.
The conditions specified in the circular are depicted in the flow charts below:

**The determination of POEM is based on the following categorization of foreign companies:**

**Active Business Outside India (Business Test)**

- Companies fulfilling the test of ABOI
  - POEM outside India, if majority BOD meetings are held outside India
  - If de facto decision making authority is not BOD but Indian parent or resident, POEM shall be in India

- Companies other than those fulfilling the test of ABOI
  - Stage 1: Identification of persons who actually make the key management and commercial decision for conduct of the company's business as a whole
  - Stage 2: Determination of place where these decisions are, in fact, made

**What is ABOI test?**

A company is said to be engaged in ABOI, if it fulfills the cumulative conditions of:

- Its passive income* (wherever earned) is 50% or less of its total income
- Less than 50% of its total assets situated in India
- Less than 50% of the total number of employees are situated in India or are residents in India
- Payroll expenses incurred on such employees are less than 50% of its total payroll expenditure

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Passive income of a company shall be 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 (except for banking companies and public financial institutions) or rental income whether or not involving associated enterprises

Some of the guiding principles which may be taken into account for determining the POEM are as follows:

(a) Location where the Board of Directors meet and makes decisions: This location may be the place of effective management of a company provided, the Board –

(i) retains and exercises its authority to govern the company; and

(ii) does, in substance, make the key management and commercial decisions necessary for the conduct of the company’s business as a whole.

It may be mentioned that mere formal holding of board meetings at a place would by itself not be conclusive for determination of POEM being located at that place. If the key decisions by the directors are in fact being taken in a place other than the place where the formal meetings are held then such other place would be relevant for POEM.

As an example this may be the case where the board meetings are held in a location distinct from the place where head office of the company is located or such location is unconnected with the place where the predominant activity of the company is being carried out.

If a Board has de facto delegated the authority to make the key management and commercial decisions for the company to the senior management or any other person including a shareholder, promoter, strategic or legal or financial advisor etc. and does nothing more than routinely ratifying the decisions that have been made, the company’s place of effective management will ordinarily be the place where these senior managers or the other person make those decisions.

“Senior Management” in respect of a company means the person or persons who are generally responsible for developing and formulating key strategies and policies for the company and for ensuring or overseeing the execution and implementation of those strategies on a regular and on-going basis. While designation may vary, these persons may include:

(i) Managing Director or Chief Executive Officer;

(ii) Financial Director or Chief Financial Officer;

(iii) Chief Operating Officer; and
(b) **Location of Executive Committee, in case powers are delegated by the Board**: A company’s board may delegate some or all of its authority to one or more committees such as an executive committee consisting of key members of senior management. In these situations, the location where the members of the executive committee are based and where that committee develops and formulates the key strategies and policies for mere formal approval by the full board will often be considered to be the company’s place of effective management.

The delegation of authority may be either *de jure* (by means of a formal resolution or Shareholder Agreement) or *de facto* (based upon the actual conduct of the board and the executive committee).

(c) **Location of Head Office**: The location of a company’s head office will be a very important factor in the determination of the company’s place of effective management because it often represents the place where key company decisions are made. The following points need to be considered for determining the location of the head office of the company:

- If the company’s senior management and their support staff are based in a single location and that location is held out to the public as the company’s principal place of business or headquarters then that location is the place where head office is located.
- If the company is more decentralized (for example where various members of senior management may operate, from time to time, at offices located in the various countries) then the company’s head office would be the location where these senior managers,-
  - (i) are primarily or predominantly based; or
  - (ii) normally return to following travel to other locations; or
  - (iii) meet when formulating or deciding key strategies and policies for the company as a whole.

Members of the senior management may operate from different locations on a more or less permanent basis and the members may participate in various meetings via telephone or video conferencing rather than by being physically present at meetings in a particular location. In such situation the head office would normally be the location, if any, where the highest level of management (for example, the Managing Director and Financial Director) and their direct support staff are located.

In situations where the senior management is so decentralized that it is not possible to determine the company’s head office with a reasonable degree of certainty, the location
of a company's head office would not be of much relevance in determining that company’s place of effective management.

**“Head Office”** of a company would be the place where the company's senior management and their direct support staff are located or, if they are located at more than one location, the place where they are primarily or predominantly located. A company’s head office is not necessarily the same as the place where the majority of its employees work or where its board typically meets.

(d) **Use of modern technology:** The use of modern technology impacts the place of effective management in many ways. It is no longer necessary for the persons taking decision to be physically present at a particular location. Therefore physical location of board meeting or executive committee meeting or meeting of senior management may not be where the key decisions are in substance being made. In such cases the place where the directors or the persons taking the decisions or majority of them usually reside may also be a relevant factor.

(e) **Decision via circular resolution or round robin voting:** In case of circular resolution or round robin voting the factors like, the frequency with which it is used, the type of decisions made in that manner and where the parties involved in those decisions are located etc. are to be considered. It cannot be said that proposer of decision alone would be relevant but based on past practices and general conduct; it would be required to determine the person who has the authority and who exercises the authority to take decisions. The place of location of such person would be more important.

(f) **Decisions made by Shareholders are not relevant factor in determination of POEM:** The decisions made by shareholder on matters which are reserved for shareholder decision under the company laws are not relevant for determination of a company’s place of effective management. Such decisions may include sale of all or substantially all of the company’s assets, the dissolution, liquidation or deregistration of the company, the modification of the rights attaching to various classes of shares or the issue of a new class of shares etc. These decisions typically affect the existence of the company itself or the rights of the shareholders as such, rather than the conduct of the company’s business from a management or commercial perspective and are therefore, generally not relevant for the determination of a company’s place of effective management.

However, the shareholder’s involvement can, in certain situations, turn into that of effective management. This may happen through a formal arrangement by way of shareholder agreement etc. or may also happen by way of actual conduct. As an example if the shareholders limit the authority of board and senior managers of a company and thereby remove the company’s real authority to make decision then the shareholder guidance transforms into usurpation and such undue influence may result in effective management being exercised by the shareholder.
Therefore, whether the shareholder involvement is crossing the line into that of effective management is one of fact and has to be determined on case-to-case basis only.

(g) **Day to day routine operational decisions are not relevant for determination of POEM:** It may be clarified that day to day routine operational decisions undertaken by junior and middle management shall not be relevant for the purpose of determination of POEM. The operational decisions relate to the oversight of the day-to-day business operations and activities of a company whereas the key management and commercial decision are concerned with broader strategic and policy decision. For example, a decision to open a major new manufacturing facility or to discontinue a major product line would be examples of key commercial decisions affecting the company’s business as a whole. By contrast, decisions by the plant manager appointed by senior management to run that facility, concerning repairs and maintenance, the implementation of company-wide quality controls and human resources policies, would be examples of routine operational decisions. In certain situations it may happen that person responsible for operational decision is the same person who is responsible for the key management and commercial decision. In such cases it will be necessary to distinguish the two type of decisions and thereafter assess the location where the key management and commercial decisions are taken.

If the above factors do not lead to clear identification of POEM then the final guidelines provide that following secondary factors may be considered:

- Place where main and substantial activity of the company is carried out; or
- Place where the accounting records of the company are kept.

It needs to be emphasized that the determination of POEM is to be based on all relevant facts related to the management and control of the company, and is not to be determined on the basis of isolated facts that by itself do not establish effective management, as illustrated by the following examples:

(i) The fact that a foreign company is completely owned by an Indian company will not be conclusive evidence that the conditions for establishing POEM in India have been satisfied.

(ii) The fact that there exists a Permanent Establishment of a foreign entity in India would itself not be conclusive evidence that the conditions for establishing POEM in India have been satisfied.

(iii) The fact that one or some of the Directors of a foreign company reside in India will not be conclusive evidence that the conditions for establishing POEM in India have been satisfied.
(iv) The fact of, local management being situated in India in respect of activities carried out by a foreign company in India will not, by itself, be conclusive evidence that the conditions for establishing POEM have been satisfied.

(v) The existence in India of support functions that are preparatory and auxiliary in character will not be conclusive evidence that the conditions for establishing POEM in India have been satisfied.

It is reiterated that the above principles for determining the POEM are for guidance only. No single principle will be decisive in itself. The above principles are not to be seen with reference to any particular moment in time rather activities performed over a period of time, during the previous year, need to be considered.

In other words, a “snapshot” approach is not to be adopted. Further, based on the facts and circumstances if it is determined that during the previous year the POEM is in India and also outside India then POEM shall be presumed to be in India if it has been mainly /predominantly in India.

The CBDT also clarified that the Assessing Officer (AO) shall, before initiating any proceedings for holding a company incorporated outside India, on the basis of its POEM, as being resident in India, seek prior approval of the Principal Commissioner or the Commissioner, as the case may be.

Further, in case the AO proposes to hold a company incorporated outside India, on the basis of its POEM, as being resident in India then any such finding shall be given by the AO after seeking prior approval of the collegium of three members consisting of the Principal Commissioners or the Commissioners, as the case may be, to be constituted by the Principal Chief Commissioner of the region concerned, in this regard. The collegium so constituted shall provide an opportunity of being heard to the company before issuing any directions in the matter.

**Example 1:** Company A Co. is a sourcing entity, for an Indian multinational group, incorporated in country X and is 100% subsidiary of Indian company (B Co.). The warehouses and stock in them are the only assets of the company and are located in country X. All the employees of the company are also in country X. The average income wise breakup of the company’s total income for three years is, -

(i) 30% of income is from transaction where purchases are made from parties which are non-associated enterprises and sold to associated enterprises;

(ii) 30% of income is from transaction where purchases are made from associated enterprises and sold to associated enterprises;

(iii) 30% of income is from transaction where purchases are made from associated enterprises and sold to non-associated enterprises; and

(iv) 10% of the income is by way of interest.
**Interpretation:** In this case, passive income is 40% of the total income of the company. The passive income consists of, -

(i) 30% income from the transaction where both purchase and sale is from/to associated enterprises; and

(ii) 10% income from interest.

The A Co. satisfies the first requirement of the test of active business outside India. Since no assets or employees of A Co. are in India the other requirements of the test is also satisfied. Therefore, company is engaged in active business outside India.

**Example 2:** The other facts remain same as that in Example 1 with the variation that A Co. has a total of 50 employees. 47 employees, managing the warehouse, storekeeping and accounts of the company, are located in country X. The Managing Director (MD), Chief Executive Officer (CEO) and sales head are resident in India. The total annual payroll expenditure on these 50 employees is of ₹ 5 crore. The annual payroll expenditure in respect of MD, CEO and sales head is of ₹ 3 crore.

**Interpretation:** Although the first limb of active business test is satisfied by A Co. as only 40% of its total income is passive in nature. Further, more than 50% of the employees are also situated outside India. All the assets are situated outside India. However, the payroll expenditure in respect of the MD, the CEO and the sales head being employees resident in India exceeds 50% of the total payroll expenditure. Therefore, A Co. is not engaged in active business outside India.

**Example 3:** The basic facts are same as in Example 1. Further facts are that all the directors of the A Co. are Indian residents. During the relevant previous year 5 meetings of the Board of Directors is held of which two were held in India and 3 outside India with two in country X and one in country Y.

**Interpretation:** The A Co. is engaged in active business outside India as the facts indicated in Example 1 establish. The majority of board meetings have been held outside India. Therefore, the POEM of A Co. shall be presumed to be outside India.

**Example 4:** The facts are same as in Example 3 but it is established by the Assessing Officer that although A Co.’s senior management team signs all the contracts, for all the contracts above ₹ 10 lakh the A Co. must submit its recommendation to B Co. and B Co. makes the decision whether or not the contract may be accepted. It is also seen that during the previous year more than 99% of the contracts are above ₹ 10 lakh and over past years also the same trend in respect of value contribution of contracts above ₹ 10 lakh is seen.

**Interpretation:** These facts suggest that the effective management of the A Co. may have been usurped by the parent company B Co. Therefore, POEM of A Co. may in such cases be not presumed to be outside India even though A Co. is engaged in active business outside India and majority of board meeting are held outside India.
Example 5: An Indian multinational group has a local holding company A Co. in country X. The A Co. also has 100% downstream subsidiaries B Co. and C Co. in country X and D Co. in country Y. The A Co. has income only by way of dividend and interest from investments made in its subsidiaries. The Place of Effective Management of A Co. is in India and is exercised by ultimate parent company of the group. The subsidiaries B, C and D are engaged in active business outside India. The meetings of Board of Director of B Co., C Co. and D Co. are held in country X and Y respectively.

Interpretation: Merely because the POEM of an intermediate holding company is in India, the POEM of its subsidiaries shall not be taken to be in India. Each subsidiary has to be examined separately. As indicated in the facts since B Co., C Co., and D Co. are independently engaged in active business outside India and majority of Board meetings of these companies are also held outside India. The POEM of B Co., C Co., and D Co. shall be presumed to be outside India.

Further, the CBDT vide Circular no. 8/2017 dated 23.02.2017 also clarified that POEM guidelines shall not apply to a company having turnover or gross receipts of ₹50 crores or less in a financial year.

Transition Mechanism for a company incorporated outside India and has not been assessed to tax earlier [Chapter XII-BC – Section 115JH]

A transition mechanism for a company which is incorporated outside India, which has not been assessed to tax in India earlier and has become resident in India for the first time due to application of POEM, has been provided in Chapter XII-BC comprising of section 115JH.

(a) Accordingly, the Central Government is empowered to notify exception, modification and adaptation subject to which, the provisions of the Act relating to computation of income, treatment of unabsorbed depreciation, set-off or carry forward and set off of losses, special provision relating to avoidance of tax and the collection and recovery of taxes shall apply in a case where a foreign company is said to be resident in India due to its POEM being in India for the first time and the said company has never been resident in India before.

(b) In a case where the determination regarding foreign company to be resident in India has been made in the assessment proceedings relevant to any previous year, then, these transition provisions would also cover any subsequent previous year, if the foreign company is resident in India in that previous year and the previous year ends on or before the date on which such assessment proceeding is completed. In effect, the transition provisions would also cover any subsequent amendment up to the date of determination of POEM in an assessment proceeding. However, once the transition is complete, then, normal provisions of the Act would apply.

(c) In the notification issued by the Central Government, certain conditions including procedural conditions subject to which these adaptations shall apply can be provided for...
and in case of failure to comply with the conditions, the benefit of such notification would not be available to the foreign company.

Accordingly, where in a previous year, any benefit, exemption or relief has been claimed and granted to the foreign company in accordance with the notification, and subsequently, there is failure to comply with any of the conditions specified therein, then –

(i) the benefit, exemption or relief shall be deemed to have been wrongly allowed;

(ii) the Assessing Officer may re-compute the total income of the assessee for the said previous year and make the necessary amendment as if the exceptions, modifications and adaptations as per the notification does not apply; and

(iii) the provisions of section 154 shall, so far as may be, apply thereto and the period of four years for rectification of mistake apparent from the record has to be reckoned from the end of the previous year in which the failure to comply with the condition stipulated in the notification takes place.

(d) Every notification issued in exercise of this power by the Central Government shall be laid before each house of the Parliament.

(e) Accordingly, in exercise of the power under section 115JH(1) of the Income-tax Act, 1961, the Central Government has, vide notification No. 29/2018, dated 22nd June, 2018, specified the exceptions, modifications and adaptations subject to which, the provisions of the Act relating to computation of income, treatment of unabsorbed depreciation, set-off or carry forward and set off of losses, special provision relating to avoidance of tax and the collection and recovery of taxes shall apply in a case where a foreign company is said to be resident in India in any previous year on account of its POEM being in India and the such foreign company has not been resident in India before the said previous year.

<table>
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<tr>
<th>Particulars</th>
<th>Provisions</th>
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| Determination of opening WDV | If the foreign company is assessed to tax in the foreign jurisdiction

Where depreciation is required to be taken into account for the purpose of computation of its taxable income, the WDV of the depreciable asset as per the tax record in the foreign country on the 1st day of the previous year shall be adopted as the opening WDV for the said previous year.

Where WDV is not available as per tax records, the WDV shall be calculated assuming that the asset was installed, utilised and the depreciation was actually allowed as per the provisions of the laws of that foreign jurisdiction. The WDV so arrived at as on the 1st day of the previous year shall be adopted to be the opening WDV for the said previous year. |
<table>
<thead>
<tr>
<th><strong>Brought forward loss and unabsorbed depreciation</strong></th>
<th><strong>If the foreign company is not assessed to tax in the foreign jurisdiction</strong></th>
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<tbody>
<tr>
<td></td>
<td>WDV of the depreciable asset as appearing in the books of account as on the 1st day of the previous year maintained in accordance with the laws of that foreign jurisdiction shall be adopted as the opening WDV for the said previous year.</td>
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<th><strong>If the foreign company is assessed to tax in the foreign jurisdiction</strong></th>
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<tr>
<td>Brought forward loss and unabsorbed depreciation as per the tax record shall be determined year wise on the 1st day of the said previous year.</td>
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<tr>
<th><strong>If the foreign company is not assessed to tax in the foreign jurisdiction</strong></th>
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<tbody>
<tr>
<td>Brought forward loss and unabsorbed depreciation as per the books of account prepared in accordance with the laws of that country shall be determined year wise on the 1st day of the said previous year.</td>
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<th><strong>Other provisions</strong></th>
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<tr>
<td>Such brought forward loss and unabsorbed depreciation shall be deemed as loss and unabsorbed depreciation brought forward as on the 1st day of the said previous year and shall be allowed to be set off and carried forward in accordance with the provisions of the Act for the remaining period calculated from the year in which they occurred for the first time taking that year as the first year.</td>
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<tr>
<td>However, the losses and unabsorbed depreciation of the foreign company shall be allowed to be set off only against such income of the foreign company which has become chargeable to tax in India on account of it becoming resident in India due to application of POEM.</td>
</tr>
<tr>
<td>In cases where the brought forward loss and unabsorbed depreciation originally adopted in India are revised or modified in the foreign jurisdiction due to any action of the tax or legal authority, the amount of the loss and unabsorbed depreciation shall be revised or modified for the purposes of set off and carry forward in India.</td>
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<tr>
<th><strong>Period of profit and loss account and balance sheet in cases</strong></th>
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<tr>
<td>The foreign company is required to prepare profit and loss account and balance sheet for the period starting from the date on which the accounting year immediately following said accounting year begins, upto 31st March of the year immediately preceding the period</td>
</tr>
</tbody>
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where accounting year of foreign company does not end on 31st March

beginning with 1st April and ending on 31st March during which the foreign company has become resident.

The foreign company is also required to prepare profit and loss account and balance sheet for succeeding periods of twelve months, beginning from 1st April and ending on 31st March, till the year the foreign company remains resident in India on account of its POEM.

Examples:

Example 1: If the accounting year of the foreign company is a calendar year and the company becomes resident in India during P.Y. 2019-20 for the first time due to its POEM being in India, then, the company is required to prepare profit and loss account and balance sheet for the period 1st January, 2019 to 31st March, 2019. It is also required to prepare profit and loss account and balance sheet for the period 1st April, 2019 to 31st March, 2020.

For the purpose of carry forward of loss and unabsorbed depreciation in this case, since the period 1st January, 2019 to 31st March, 2019 is less than 6 months, it is to be included in the accounting year immediately preceding the accounting year in which the foreign company is held to be resident in India for the first time. Accordingly, the profit and loss and balance sheet of the 15 month period from 1 January, 2018 to 31st March, 2019 is to be prepared.

Example 2: If the accounting year of the foreign company is from 1st July to 30th June and the company becomes resident in India during P.Y. 2019-20 for the first time due to its POEM being in India, then, the company is required to prepare profit and loss account and balance sheet for the period 1st July, 2018 to 31st March, 2019. It is also required to prepare profit and loss account and balance sheet for the period 1st April, 2019 to 31st March, 2020.

For the purpose of carry forward of loss and unabsorbed depreciation in this case, since the period is more than 6 months, it is to be treated as a separate accounting year.

The loss and unabsorbed depreciation as per tax record or books of account, as the case may be, of the foreign company shall, be allocated on proportionate basis.

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<tr>
<th>Applicability of provisions of Chapter XVII-B</th>
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<tr>
<td>Where more than one provision of Chapter XVII-B of the Act applies to the foreign company as resident as well as foreign company, the provision applicable to the foreign company alone shall apply.</td>
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<tr>
<td><strong>(TDS provisions)</strong></td>
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<tr>
<td><strong>Availability of deduction under section 90 or 91 (Foreign tax credit)</strong></td>
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<tr>
<td><strong>Non applicability of the notification</strong></td>
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<tr>
<td><strong>Applicability of the notification where foreign company becomes resident in the subsequent previous year also</strong></td>
</tr>
<tr>
<td><strong>No effect on other transactions</strong></td>
</tr>
<tr>
<td><strong>Applicability of other provisions relating to foreign company</strong></td>
</tr>
</tbody>
</table>
(i) a foreign company, shall continue to apply to it; 
(ii) non-resident persons, shall not apply to it; and 
(iii) the provisions specifically applicable to resident, shall apply to it.

### Applicability of tax rate on foreign company

In case of conflict between the provision applicable to the foreign company as resident and the provision applicable to it as foreign company, the later shall generally prevail. Therefore, the rate of tax in case of foreign company i.e., 40% shall remain the same, i.e., rate of income-tax applicable to the foreign company even though residency status of the foreign company changes from non-resident to resident on the basis of POEM.

### Applicability of notification

This notification shall be deemed to have come into force from 1st April, 2017.

### Meaning of foreign jurisdiction

The place of incorporation of the foreign company.


The rate of exchange for conversion into rupees of value expressed in foreign currency, wherever applicable, shall be in accordance with provision of rule 115 of the Income-tax Rules, 1962. [Given as Annexure 2 at the end of this material]

---

**Determination of Residential Status: A summary**

**Abbreviations used in the Flow Charts in pages 2.27 & 2.28**

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>IC</td>
<td>Indian Citizen</td>
</tr>
<tr>
<td>R</td>
<td>Resident</td>
</tr>
<tr>
<td>IPPYs</td>
<td>Immediately Preceding Previous Years</td>
</tr>
<tr>
<td>N &amp; OR</td>
<td>Resident but Not Ordinarily Resident</td>
</tr>
<tr>
<td>ROR</td>
<td>Resident and Ordinarily Resident</td>
</tr>
<tr>
<td>RPY</td>
<td>Relevant Previous Year</td>
</tr>
<tr>
<td>NR</td>
<td>Non-resident</td>
</tr>
<tr>
<td>AOP</td>
<td>Association of Persons</td>
</tr>
<tr>
<td>HUF</td>
<td>Hindu Undivided Family</td>
</tr>
</tbody>
</table>
Determination of Residential Status of HUF/ Firm/ AOP/ Company

HUF / FIRM / AOP

Control & Management

Is it wholly or partly in India?

Yes
R

No
NR

Is the Karta NR in any 9 PPY out of 10 PPY?

Yes
RNOR

No

Is the Karta’s stay in India ≤ 729 days during the 7 PPYs?

Yes

No

Resident HUF

Is it an Indian Company?

Yes

No

Is the Place of Effective Management in India?

Yes

No

NR

Company

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(2) Scope of Total Income [Section 5]

Section 5 provides the scope of total income in terms of the residential status of the assessee because the incidence of tax on any person depends upon his residential status. The scope of total income of an assessee depends upon the following three important considerations:

(i) the residential status of the assessee;
(ii) the place of accrual or receipt of income, whether actual or deemed; and
(iii) the point of time at which the income had accrued to or was received by or on behalf of the assessee.

A non-resident’s total income under section 5(2) includes:

(i) income received or deemed to be received in India in the previous year; and
(ii) income which accrues or arises or is deemed to accrue or arise in India during the previous year.


Income by way of salary, received by non-resident seafarers, for services rendered outside India on-board foreign ships, is being subjected to tax in India for the reason that the salary has been received by the seafarer into the NRE bank account maintained in India by the seafarer. On receiving representations in this regard, the CBDT examined the matter and noted that section 5(2)(a) of the income-tax act, 1961 provides that only such income of a non-resident shall be subjected to tax in India that is either received or is deemed to be received in India.

Accordingly, the CBDT has, vide this circular, clarified that that salary accrued to a non-resident seafarer for services rendered outside India on a foreign going ship (with Indian flag or foreign flag) shall not be included in the total income merely because the said salary has been credited in the NRE account maintained with an Indian bank by the seafarer.

Note: All assesses, whether resident or not, are chargeable to tax in respect of their income accrued, arisen, received or deemed to accrue, arise or to be received in India.

(i) Meaning of “Income received or deemed to be received”

All assesses are liable to tax in respect of the income received or deemed to be received by them in India during the previous year irrespective of -

(i) their residential status, and
(ii) the place of its accrual.
Income is to be included in the total income of the assessee immediately on its actual or deemed receipt. The receipt of income refers to only the first occasion when the recipient gets the money under his control. Therefore, when once an amount is received as income, remittance or transmission of that amount from one place or person to another does not constitute receipt of income in the hands of the subsequent recipient or at the place of subsequent receipt.

**Income deemed to be received in India [Section 7]**

- Contribution in excess of 12% of salary to Recognised provident fund or interest credited in excess of 9.5% p.a (Annual accretion to the credit of RPF)
- Contribution by the Central Government or other employer under a pension scheme referred u/s 80CCD
- Amount transferred from unrecognised provident fund to recognised provident fund (being the employer’s contribution and interest thereon)

**(ii) Meaning of income ‘accruing’ and ‘arising’**

Accrue refers to the right to receive income, whereas due refers to the right to enforce payment of the same. For e.g. salary for work done in December will accrue throughout the month, day to day, but will become due on the salary bill being passed on 31\(^{st}\) December or 1\(^{st}\) January.

Similarly, on Government securities, interest payable on specified dates arise during the period of holding, day to day, but will become due for payment on the specified dates.

**Example:** Interest on Government securities is usually payable on specified dates, say on 1\(^{st}\) January and 1\(^{st}\) July. In all such cases, the interest would be said to accrue from 1\(^{st}\) July to 31\(^{st}\) December on 1\(^{st}\) January, it will fall due for payment.

It must be noted that income which has been taxed on accrual basis cannot be assessed again on receipt basis, as it will amount to double taxation.

With a view to removing difficulties and clarifying doubts in the taxation of income, *Explanations* 1 to section 5 specifically provides that an item of income accruing or arising outside India shall not be deemed to be received in India merely because it is taken into account in a balance sheet prepared in India.

Further, *Explanation* 2 to section 5 makes it clear that once an item of income is included in the assessee’s total income and subjected to tax on the ground of its accrual/deemed accrual, it cannot again be included in the person’s total income and subjected to tax either in the same or in a subsequent year on the ground of its receipt - whether actual or deemed.

**(iii) Income deemed to accrue or arise in India [Section 9]**

Under section 9, certain types of income are deemed to accrue or arise in India even though they may actually accrue or arise outside India.
Income deemed to accrue or arise in India [Clause (i), (ii), (iii) & (iv) Section 9(1)]

- Income accruing or arising outside India, directly or indirectly through or from
  - Any Business Connection in India

- Salary earned for services rendered in India

- Salary payable by the Government to Indian Citizen for services rendered outside India

- Dividend paid by Indian Company Outside India

Income deemed to accrue or arise in India [Clause (v), (vi) (vii) & (viii) of Section 9(1)]

- Interest, if payable by
  - Person resident in India

- Royalty, if payable by
  - Government

- Fees for technical service, if payable by
  - A non-resident

Exception

- If the money borrowed and used or technical services or royalty services are utilised for the purpose of business or profession carried on outside India
- If the money borrowed and used or technical services or royalty services are utilised for making income from any source outside India
- If money is borrowed and used for the purpose of business or profession carried on in India
- If technical services or royalty services are utilised for the purpose of business or profession carried on in India or making income from any source in India

Income arising outside India, being any sum of money paid without consideration, by a resident Indian to a non-corporate non-resident or foreign company on or after 5.7.2019, where aggregate of such sum > ₹ 50,000
The categories of income which are deemed to accrue or arise in India are:

(1) Any income accruing or arising to an assessee in any place outside India whether directly or indirectly

(i) through or from any business connection in India,
(ii) through or from any property in India,
(iii) through or from any asset or source of income in India or
(iv) through the transfer of a capital asset situated in India would be deemed to accrue or arise in India. [Section 9(1)(i)]

(i) What is Business Connection?

'Business connection' shall include any business activity carried out through a person acting on behalf of the non-resident [Explanation 2 to section 9(1)(i)]

For a business connection to be established, the person acting on behalf of the non-resident –

(a) must have an authority, which is habitually exercised in India, to conclude contracts on behalf of the non-resident or

habitually concludes contracts or plays the principal role leading to conclusion of contracts by that non-resident and such contracts are

- in the name of the non-resident; or
- for the transfer of the ownership of, or for the granting of the right to use, property owned by that non-resident or that non-resident has the right to use; or
- for the provision of services by that non-resident.

(b) in a case, where he has no such authority, but habitually maintains in India a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the non-resident, or

(c) habitually secures orders in India, mainly or wholly for the non-resident.

Further, there may be situations when the person acting on behalf of the non-resident secure order for other non-residents. In such situation, business connection for other non-residents is established if,

i. such other non-resident controls the non-resident or

ii. such other non-resident is controlled by the non-resident or
such other non-resident is subject to same control as that of non-resident.

In all the three situations, business connection is established, where a person habitually secures orders in India, mainly or wholly for such non-residents.

Agents having independent status are not included in Business Connection: Business connection, however, shall not be established, where the non-resident carries on business through a broker, general commission agent or any other agent having an independent status, if such a person is acting in the ordinary course of his business.

A broker, general commission agent or any other agent shall be deemed to have an independent status where he does not work mainly or wholly for the non-resident.

He will, however, not be considered to have an independent status in the three situations explained above, where he is employed by such a non-resident.

Where a business is carried on in India through a person referred to in (a), (b) or (c) of (i) above, only so much of income as is attributable to the operations carried out in India shall be deemed to accrue or arise in India [Explanation 3 to section 9(1)(i)].

Significant economic presence [Explanation 2A to section 9(1)(i)]

Significant economic presence of a non-resident in India shall also constitute business connection in India.
Significant economic presence means-

<table>
<thead>
<tr>
<th>Nature of transaction</th>
<th>Condition</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) transaction in respect of any goods, services or property carried out by a non-resident in India including provision of download of data or software in India,</td>
<td>Aggregate of payments arising from such transaction or transactions during the previous year exceeds such amount as may be prescribed</td>
</tr>
<tr>
<td>(b) systematic and continuous soliciting of business activities or engaging in interaction with users in India through digital means</td>
<td>The users should be of such number as may be prescribed</td>
</tr>
</tbody>
</table>

The threshold of “aggregate of payments” in (a) and “users” in India in (b) would be prescribed by Rules. Further, the above transactions or activities shall constitute significant economic presence in India, whether or not,—

(i) the agreement for such transactions or activities is entered in India;
(ii) the non-resident has a residence or place of business in India; or
(iii) the non-resident renders services in India:

However, where a business connection is established by reason of significant economic presence in India, only so much of income as is attributable to the transactions or activities referred to in (a) or (b) above shall be deemed to accrue or arise in India.

In the case of a non-resident the following shall not, however, be treated as business connection in India [Explanation 1 to section 9(1)(i)]:

(a) In the case of a business, in respect of which all the operations are not carried out in India [Explanation 1(a) to section 9(1)(i)]: In the case of a business of which all the operations are not carried out in India, the income of the business deemed to accrue or arise in India shall be only such part of income as is reasonably attributable to the operations carried out in India. Therefore, it follows that such part of income which cannot be reasonably attributed to the operations in India, is not deemed to accrue or arise in India.

(b) Purchase of goods in India for export [Explanation 1(b) to section 9(1)(i)]: In the case of a non-resident, no income shall be deemed to accrue or arise in India to him through or from operations which are confined to the purchase of goods in India for the purpose of export.

(c) Collection of news and views in India for transmission out of India [Explanation 1(c) to section 9(1)(i)]: In the case of a non-resident, being a person engaged in the business of running a news agency or of publishing newspapers, magazines or journals, no income
shall be deemed to accrue or arise in India to him through or from activities which are confined to the collection of news and views in India for transmission out of India.

(d) **Shooting of cinematograph films in India [Explanation 1(d) to section 9(1)(i)]:** In the case of a non-resident, no income shall be deemed to accrue or arise in India through or from operations which are confined to the shooting of any cinematograph film in India, if such non-resident is:

- an individual, who is not a citizen of India or
- a firm which does not have any partner who is a citizen of India or who is resident in India; or
- a company which does not have any shareholder who is a citizen of India or who is resident in India.

(e) **Activities confined to display of rough diamonds in SNZs [Explanation 1(e) to section 9(1)(i)]:** In case of a foreign company engaged in the business of mining of diamonds, no income shall be deemed to accrue or arise in India to it through or from the activities which are confined to display of uncut and unassorted diamonds in any special zone notified by the Central Government in the Official Gazette in this behalf.

(ii) & (iii) **Income from property, asset or source of income in India**

Any income which arises from any property in India (movable, immovable, tangible and intangible property) would be deemed to accrue or arise in India.

**Examples:**
- *Hire charges or rent paid outside India for the use of the machinery or buildings situated in India,*
- *deposits with an Indian company for which interest is received outside India etc.*

(iv) **Income through transfer of a capital asset situated in India**

Capital gains arising through or from the transfer of a capital asset situated in India would be deemed to accrue or arise in India in all cases irrespective of the fact whether

- The capital asset is movable or immovable, tangible or intangible;
- The place of registration of the document of transfer etc., is in India or outside; and
- The place of payment of the consideration for the transfer is within India or outside.

Accordingly, the expression “through” shall mean and include and shall be deemed to have always meant and included “by means of”, “in consequence of” or “by reason of”. **[Explanation 4 to section 9(1)(i)]**
Further, an asset or a capital asset being any share or interest in a company or entity registered or incorporated outside India shall be deemed to be and shall always be deemed to have been situated in India, if the share or interest derives, directly or indirectly, its value substantially from the assets located in India. [Explanation 5 to section 9(1)(i)]

However, an asset or capital asset, which is held by a non-resident by way of investment, directly or indirectly, in Category-I or Category-II foreign portfolio investor under the Securities and Exchange Board of India (Foreign Portfolio Investors) Regulations, 2014, made under the Securities and Exchange Board of India Act, 1992, shall not deemed to be or deemed to have been situated in India [Proviso to Explanation 5 to section 9(1)(i)]

The CBDT has, vide Circular No. 28/2017, dated 07.11.2017, clarified that the provisions of section 9(1)(i) read with Explanation 5, shall not apply in respect of income accruing or arising to a non-resident on account of redemption or buyback of its share or interest held indirectly (i.e. through upstream entities registered or incorporated outside India) in the specified funds (namely, investment funds, venture capital company and venture capital funds) if such income accrues or arises from or in consequence of transfer of shares or securities held in India by the specified funds and such income is chargeable to tax in India.

However, the above benefit shall be applicable only in those cases where the proceeds of redemption or buyback arising to the non-resident do not exceed the pro-rata share of the non-resident in the total consideration realized by the specified funds from the said transfer of shares or securities in India. It is further clarified that a non-resident investing directly in the specified funds shall continue to be taxed as per the extant provisions of the Act.

**Declaration of dividend by a foreign company** outside India does not have the effect of transfer of any underlying assets located in India. Circular No. 4/2015, dated 26-03-2015, therefore, clarifies that the dividends declared and paid by a foreign company outside India in respect of shares which derive their value substantially from assets situated in India would NOT be deemed to be income accruing or arising in India by virtue of the provisions of section 9(1)(i).

**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 ₹ 10 crore; and
- represents at least 50% of the value of all the assets owned by the company or entity, as the case may be;

**Meaning of certain terms:**

<table>
<thead>
<tr>
<th>Term</th>
<th>Meaning</th>
</tr>
</thead>
<tbody>
<tr>
<td>Value of an asset</td>
<td>The fair market value as on the specified date, of such asset without reduction of liabilities, if any, in respect of the asset, determined in prescribed manner.</td>
</tr>
</tbody>
</table>
Specified date

The date on which the accounting period of the company or, as the case may be, the entity ends preceding the date of transfer of a share or an interest. However, the date of transfer shall be the specified date of valuation, in a case where 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.

Accounting period

Each period of 12 months ending with 31st March. However, where a company or an entity, referred to in Explanation 5, regularly adopts a period of 12 months ending on a day other than 31st March for the purpose of—
(a) complying with the provisions of the tax laws of the territory, of which it is a resident, for tax purposes; or
(b) reporting to persons holding the share or interest,
then, the period of twelve months ending with the other day shall be the accounting period of the company or, as the case may be, the entity:

First Accounting Period

First accounting period of the company or, as the case may be, the entity shall begin from the date of its registration or incorporation and end with the 31st March or such other day, as the case may be, following the date of such registration or incorporation.

Later accounting period

Later accounting period shall be the successive periods of twelve months.

Accounting period of an entity which ceases to exist

If the company or the entity ceases to exist before the end of accounting period, as aforesaid, then, the accounting period shall end immediately before the company or, as the case may be, the entity, ceases to exist.

Note - The manner of determination of fair market value of the assets of the foreign company is given in Rule 11UB. Determination of income attributable to assets in India is given in Rule 11UC.

Students may note that the Rule 11UB and Rule 11UC have been given as Annexure – 1 at the end of this Study Material.

Explanation 7 to section 9(1)(i) provides that no income shall be deemed to accrue or arise to a non-resident from transfer, outside India, of any share of, or interest in, a company or an entity, registered or incorporated outside India, in the following cases;

<table>
<thead>
<tr>
<th></th>
<th>Foreign company or entity directly owns the assets situated in India</th>
<th>AND</th>
<th>the transferor (whether individually or along with its associated enterprises), at any time in the twelve months preceding the date of transfer, does not hold</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1)</td>
<td></td>
<td></td>
<td>the right of management or control in relation to foreign company or entity; or</td>
</tr>
<tr>
<td>(2)</td>
<td>Foreign company or entity <strong>indirectly</strong> owns the assets situated in India</td>
<td><strong>AND</strong></td>
<td>the transferor (whether individually or along with its associated enterprises), at any time in the twelve months preceding the date of transfer, <strong>does not hold</strong></td>
</tr>
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</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>the right of management or control in relation to foreign company or entity; or</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>any right in, or in relation to, such foreign company or entity which would entitle him to the right of management or control in the company or entity that directly owns the assets situated in India; or</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>such percentage of voting power or share capital or interest in foreign company or entity which results in holding of (either individually or along with associated enterprises) a voting power or share capital or interest exceeding 5% of the total voting power or total share capital or total interest, as the case may be, of the company or entity that directly owns the assets situated in India;</td>
</tr>
</tbody>
</table>

In effect, the exemption shall be available to the transferor of a share of, or interest in, a foreign entity if he along with its associated enterprises, -

- neither holds the right of control or management,
- nor holds voting power or share capital or interest exceeding 5% of the total voting power or total share capital or total interest,

in the foreign company or entity directly holding the Indian assets (direct holding company).

In case the transfer is of shares or interest in a foreign entity which does not hold the Indian assets directly then the exemption shall be available to the transferor if he along with its associated enterprises,-

- neither holds the right of management or control in relation to such company or the entity,
- nor holds any rights in such company which would entitle it to either exercise control or management of the direct holding company or entity or entitle it to voting power or share capital or total interest exceeding 5% in the direct holding company or entity.

Further, where all the assets owned, directly or indirectly, by a company or, as the case may be, an entity registered or incorporated outside India, are not located in India, the income of the non-resident transferor, from transfer outside India of a share of, or interest in the foreign company or
entity, deemed to accrue or arise in India under this clause, shall be only such part of the income as is reasonably attributable to assets located in India and determined in the prescribed manner.

“Associated enterprise”, in relation to another enterprise, means an enterprise—

- which participates, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise; or
- in respect of which one or more persons who participate, directly or indirectly, or through one or more intermediaries, in its management or control or capital, are the same persons who participate, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise.

(2) Income from salaries earned in India [Section 9(1)(ii)]

Income, which falls under the head “Salaries”, deemed to accrue or arise in India, if it is earned in India. Salary payable for service rendered in India would be treated as earned in India.

Further, any income under the head “Salaries” payable for rest period or leave period which is preceded and succeeded by services rendered in India, and forms part of the service contract of employment, shall be regarded as income earned in India.

(3) Income from salaries payable by the Government for services rendered outside India [Section 9(1)(iii)]

Income from ‘Salaries’ which is payable by the Government to a citizen of India for services rendered outside India would be deemed to accrue or arise in India.

However, allowances and perquisites paid or allowed outside India by the Government to an Indian citizen for services rendered outside India is exempt, by virtue of section 10(7).

(4) Dividend paid by a Indian company outside India [Section 9(1)(iv)]

All dividends paid by an Indian company would be deemed to accrue or arise in India. Under section 10(34), income from dividends referred to in section 115-O i.e., dividend distributed by a domestic company on which DDT is leviable in the hands of the company, is exempt from tax in the hands of the shareholder. However, it will not be exempt if such dividend is chargeable to tax under section 115BBDA. Section 115BBDA, which brings to tax dividend in excess of ₹10 lakh in the hands of the shareholder @10%, does not apply to the non-residents.

(5) Interest [Section 9(1)(v)]

Under section 9(1)(v), an interest is deemed to accrue or arise in India if it is payable by -

(i) the Government;
(ii) a person resident in India;

Exception: Where it is payable in respect of any debt incurred or money borrowed and used, for the purposes of a business or profession carried on by him outside India or for
the purposes of making or earning any income from any source outside India, it will not be deemed to accrue or arise in India.

(iii) a non-resident, when it is payable in respect of any debt incurred or moneys borrowed and used, for the purpose of a business or profession carried on in India by him.

**Exception:** Interest on money borrowed by the non-resident for any purpose other than a business or profession, will not be deemed to accrue or arise in India.

**Example:** If a non-resident ‘A’ borrows money from a non-resident ‘B’ and invests the same in shares of an Indian company, interest payable by ‘A’ to ‘B’ will not be deemed to accrue or arise in India.

**Meaning of interest:** Interest means 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.

**Taxability of interest payable by the Permanent Establishment of a non-resident engaged in banking business to the head office**

In order to provide clarity and certainty, on the issue of taxability of interest payable by the PE of a non-resident engaged in banking business to the head office, an Explanation has been inserted in section 9(1)(v). Accordingly, in the case of a non-resident, being a person engaged in the business of banking, any interest payable by the PE in India of such non-resident to the head office or any PE or any other part of such non-resident outside India, shall be deemed to accrue or arise in India.

Such interest shall be chargeable to tax in addition to any income attributable to the PE in India.

Further, the PE in India shall be deemed to be a person separate and independent of the non-resident person of which it is a PE and the provisions of the Act relating to computation of total income, determination of tax and collection and recovery would apply accordingly.

Also, the PE in India has to deduct tax at source on any interest payable to either the head office or any other branch or PE, etc. of the non-resident outside India. Non-deduction would result in disallowance of interest claimed as expenditure by the PE and may also attract levy of interest and penalty in accordance with relevant provisions of the Act.

**Permanent establishment** includes a fixed place of business through which the business of the enterprise is wholly or partly carried on.

(6) **Royalty [Section 9(1)(vi)]**

Royalty will be deemed to accrue or arise in India when it is payable by -

(i) the Government;
(ii) a person who is a resident in India

**Exception:** Where it is payable for the transfer of any right or the use of any property or information or for the utilization of services 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, or

(iii) a non-resident only when the royalty is payable in respect of any right, property or information used or services utilised for purposes of a business or profession carried on by such person in India or for the purposes of making or earning any income from any source in India.

**Important points:**

1. **Lumpsum royalty not deemed to accrue arise in India:** Lumpsum royalty payments made by a resident for the transfer of all or any rights (including the granting of a licence) in respect of computer software supplied by a non-resident manufacturer along with computer hardware under any scheme approved by the government under the policy on computer software export, software development and training, 1986 shall not be deemed to accrue or arise in India.

2. **Meaning of Computer software:** “Computer software” means any computer programme recorded on any disc, tape, perforated media or other information storage device and includes any such programme or any customised electronic data.

3. **Meaning of Royalty:** The term ‘royalty’ means consideration (including any lumpsum consideration but excluding any consideration which would be the income of the recipient chargeable under the head ‘capital gains’) for:

   (i) the transfer of all or any rights (including the granting of licence) in respect of a patent, invention, model, design, secret formula or process or trade mark or similar property;

   (ii) the imparting of any information concerning the working of, or the use of, a patent, invention, model, design, secret formula or process or trade mark or similar property;

   (iii) the use of any patent, invention, model, design, secret formula or process or trade mark or similar property;

   (iv) the imparting of any information concerning technical, industrial, commercial or scientific knowledge, experience or skill;

   (v) the use or right to use any industrial, commercial or scientific equipment but not including the amounts referred to in section 44BB;

   (vi) the transfer of all or any rights (including the granting of licence) in respect of any copyright, literary, artistic or scientific work including films or video tapes for use in connection with television or tapes for use in connection with radio broadcasting, but
not including consideration for the sale, distribution or exhibition of cinematographic films;

(vii) the rendering of any service in connection with the activities listed above.

The definition of ‘royalty’ for this purpose is wide enough to cover both industrial royalties as well as copyright royalties. The deduction specially excludes income which should be chargeable to tax under the head ‘capital gains’.

4. **Consideration for use or right to use of computer software is royalty within the meaning of section 9(1)(vi)**

The consideration for use or right to use of computer software is royalty by clarifying that, transfer of all or any rights in respect of any right, property or information includes and has always included transfer of all or any right for use or right to use a computer software (including granting of a licence) irrespective of the medium through which such right is transferred [*Explanation 4*]

Consequently, the provisions of tax deduction at source under section 194J and section 195 would be attracted in respect of consideration for use or right to use computer software since the same falls within the definition of royalty.

**Note** - The Central Government has, vide *Notification No. 21/2012 dated 13.6.2012* to be effective from 1st July, 2012, exempted certain software payments from the applicability of tax deduction under section 194J. Accordingly, where payment is made by the transferee for acquisition of software from a resident-transferor, the provisions of section 194J would not be attracted if –

(1) the software is acquired in a subsequent transfer without any modification by the transferor;

(2) tax has been deducted either under section 194J or under section 195 on payment for any previous transfer of such software; and

(3) the transferee obtains a declaration from the transferor that tax has been so deducted along with the PAN of the transferor.

5. **Consideration in respect of any right, property or information – Is it royalty?**

Royalty includes and has always included consideration in respect of any right, property or information, whether or not,

(a) the possession or control of such right, property or information is with the payer;

(b) such right, property or information is used directly by the payer;

(c) the location of such right, property or information is in India [*Explanation 5*]
6. **Meaning of Process**

The term “process” includes and shall be deemed to have always included transmission by satellite (including up-linking, amplification, conversion for down-linking of any signal), cable, optic fibre or by any other similar technology, whether or not such process is secret.

**Explanation 6**

(7) **Fees for technical services [Section 9(1)(vii)]**

Any fees for technical services will be deemed to accrue or arise in India if they are payable by:

(i) the Government.

(ii) a person who is resident in India.

**Exception:** Where the fees is payable in respect of technical services utilised in a business or profession carried on by such person outside India or for the purpose of making or earning any income from any source outside India.

(iii) a person who is a non-resident, only where the fees are payable in respect of services utilised in a business or profession carried on by the non-resident in India or where such services are utilised for the purpose of making or earning any income from any source in India.

**Fees for technical services** mean any consideration (including any lumpsum consideration) for the rendering of any managerial, technical or consultancy services (including providing the services of technical or other personnel). However, it does not include consideration for any construction, assembly, mining or like project undertaken by the recipient or consideration which would be income of the recipient chargeable under the head ‘Salaries’.

**Income deemed to accrue or arise in India to a non-resident by way of interest, royalty and fee for technical services to be taxed irrespective of territorial nexus [Explanation to section 9]**

Income by way of interest, royalty or fee for technical services which is deemed to accrue or arise in India by virtue of clauses (v), (vi) and (vii) of section 9(1), shall be included in the total income of the non-resident, whether or not –

(i) the non-resident has a residence or place of business or business connection in India; or

(ii) the non-resident has rendered services in India.

In effect, the income by way of fee for technical services, interest or royalty, from services utilized in India would be deemed to accrue or arise in India in case of a non-resident and be included in his total income, whether or not such services were rendered in India.

(8) **Any sum of money paid by a resident Indian to a non-corporate non-resident or foreign company [Section 9(1)(viii)]**

Income arising outside India, being any sum of money paid without consideration, by a Indian resident person to a non-corporate non-resident or foreign company on or after 5.7.2019 would be
deemed to accrue or arise in India if the same is chargeable to tax under section 56(2)(x) i.e., if
the aggregate of such sum received by a non-corporate non-resident or foreign company exceeds
₹ 50,000.

(3) Presence of Eligible Fund Manager in India not to constitute Business Connection in
India of such Eligible Investment Fund on behalf of which he undertakes Fund
Management Activity [Section 9A]

(i) **Fund Management Activity through an eligible fund manager not to constitute
business connection:** In the case of an eligible investment fund, the fund management
activity carried out through an eligible fund manager acting on behalf of such fund shall not
constitute business connection in India of the said fund, subject to fulfillment of certain
conditions.

(ii) **Location of Fund Manager in India not to affect residential status of an eligible
investment fund:** An eligible investment fund shall not be said to be resident in India
merely because the eligible fund manager undertaking fund management activities on its
behalf, is located in India.

(iii) **Conditions to be fulfilled by an Eligible Investment Fund:** The eligible investment fund
means a fund established or incorporated or registered outside India, which collects funds
from its members for investing it for their benefit. Further, it should fulfill the following
conditions:

(a) the fund should not be a person resident in India;

(b) the fund should be a resident of a country or a specified territory with which an
agreement referred to in section 90(1) or section 90A(1) has been entered into or
should be established or incorporated or registered outside India in a country or a
specified territory notified by the Central Government in this behalf;

(c) the aggregate participation or investment in the fund, directly or indirectly, by
persons being resident in India should not exceed 5% of the corpus of the fund;

(d) the fund and its activities should be subject to applicable investor protection
regulations in the country or specified territory where it is established or
incorporated or is a resident;

(e) the fund should have a minimum of 25 members who are, directly or indirectly, not
connected persons;

(f) any member of the fund along with connected persons shall not have any
participation interest, directly or indirectly, in the fund exceeding 10%;

(g) the aggregate participation interest, directly or indirectly, of ten or less members
along with their connected persons in the fund, shall be less than 50%;
(h) the investment by the fund in any entity shall not exceed 20% of the corpus of the fund;

(i) no investment shall be made by the fund in its associate entity;

(j) the monthly average of the corpus of the fund shall not be less than ₹ 100 crore. If the fund has been established or incorporated in the previous year, the corpus of fund should not be less than ₹ 100 crore rupees **at the end of a period of six months from the last day of the month of its establishment or incorporation, or the end of such previous year, whichever is later**;

However, this condition shall not be applicable to a fund which has been wound up in the previous year.

(k) the fund shall not carry on or control and manage, directly or indirectly, any business in India;

(l) the fund should neither be engaged in any activity which constitutes a business connection in India nor should have any person acting on its behalf whose activities constitute a business connection in India other than the activities undertaken by the eligible fund manager on its behalf.

(m) the remuneration paid by the fund to an eligible fund manager in respect of fund management activity undertaken on its behalf should not be less than the amount calculated in the prescribed manner.

(iv) **Certain conditions not to apply to investment fund set up by the Government or the Central Bank of a foreign State or a Sovereign Fund or other notified fund [Proviso to Section 9A(3)]:** The following conditions would, however, not be applicable in case of an investment fund set up by the Government or the Central Bank of a foreign State or a sovereign fund or such other fund notified by the Central Government (i.e., an investment fund set up by a Category-I or Category-II Foreign Portfolio Investor registered under the Securities and Exchange Board of India (Foreign Portfolio Investors) Regulations, 2014, made under the Securities and Exchange Board of India Act, 1992:

(e) the fund should have a minimum of 25 members who are, directly or indirectly, not connected persons;

(f) any member of the fund along with connected persons shall not have any participation interest, directly or indirectly, in the fund exceeding 10%;

(g) the aggregate participation interest, directly or indirectly, of ten or less members along with their connected persons in the fund, shall be less than 50%.
(v) **Eligible Fund Manager [Section 9A(4)]:** The eligible fund manager, in respect of an eligible investment fund, means any person who is engaged in the activity of fund management and fulfills the following conditions:

(a) the person should not be an employee of the eligible investment fund or a connected person of the fund;

(b) the person should be registered as a fund manager or investment advisor in accordance with the specified regulations;

(c) the person should be acting in the ordinary course of his business as a fund manager;

(d) the person along with his connected persons shall not be entitled, directly or indirectly, to more than 20% of the profits accruing or arising to the eligible investment fund from the transactions carried out by the fund through such fund manager.

The CBDT has, vide **Circular No.8/2019 dated 10.5.2019**, clarified that a fund manager includes an Asset Management Company (AMC) approved by SEBI under the SEBI (Mutual Funds) Regulations, 1996. This is because AMCs are engaged in the activity of fund management of Mutual Funds and hence are, in substance, Fund Managers.

(vi) **Furnishing of Statement in prescribed form [Section 9A(5)]:** Every eligible investment fund shall, in respect of its activities in a financial year, furnish within 90 days from the end of the financial year, a statement in the prescribed form to the prescribed income-tax authority. The statement should contain information relating to –

(a) the fulfillment of the above conditions; and

(b) such other relevant information or document which may be prescribed.

If any eligible investment fund fails to furnish such statement or information or document within 90 days from the end of the financial year, the income-tax authority prescribed under the said sub-section may direct that such fund shall pay, by way of penalty, a sum of `5,00,000. [Section 271FAB]

(vii) **Non-applicability of special taxation regime under section 9A [Section 9A(6)]:** This special taxation regime would not have any impact on taxability of any income of the eligible investment fund which would have been chargeable to tax irrespective of whether the activity of the eligible fund manager constituted business connection in India of such fund or not.

Further, the said regime shall not have any effect on the scope of total income or determination of total income in the case of the eligible fund manager.
(viii) CBDT to prescribe guidelines for the manner of application of the provisions of this section.

(ix) **Meaning of certain terms:**

<table>
<thead>
<tr>
<th>Term</th>
<th>Meaning</th>
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<tbody>
<tr>
<td>Associate</td>
<td>An entity in which a director or a trustee or a partner or a member or a fund manager of the investment fund or a director or a trustee or a partner or a member of the fund manager of such fund, holds, either individually or collectively, share or interest, being more than 15% of its share capital or interest, as the case may be.</td>
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<tr>
<td>Corpus</td>
<td>The total amount of funds raised for the purpose of investment by the eligible investment fund as on a particular date.</td>
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<td>Connected person</td>
<td>Any person who is connected directly or indirectly to another person and includes,—   ()   ()</td>
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<td>(a) any relative of the person, if such person is an individual;</td>
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<td></td>
<td>(b) any director of the company or any relative of such director, if the person is a company;</td>
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<td></td>
<td>(c) any partner or member of a firm or association of persons or body of individuals or any relative of such partner or member, if the person is a firm or association of persons or body of individuals;</td>
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<td></td>
<td>(d) any member of the Hindu undivided family or any relative of such member, if the person is a Hindu undivided family;</td>
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<td></td>
<td>(e) any individual who has a substantial interest in the business of the person or any relative of such individual;</td>
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<td></td>
<td>(f) a company, firm or an association of persons or a body of individuals, whether incorporated or not, or a Hindu undivided family having a substantial interest in the business of the person or any director, partner, or member of the company, firm or association of persons or body of individuals or family, or any relative of such director, partner or member;</td>
</tr>
<tr>
<td></td>
<td>(g) a company, firm or association of persons or body of individuals, whether incorporated or not, or a Hindu undivided family, whose director, partner, or member has a substantial interest in the business of the person, or family or any relative of such director, partner or member;</td>
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<td>(h) any other person who carries on a business, if -   ()   ()</td>
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<tr>
<td></td>
<td>(i) the person being an individual, or any relative of such person, has a substantial interest in the business of that other person; or</td>
</tr>
</tbody>
</table>
|                    | (ii) the person being a company, firm, association of persons, body of individuals, whether incorporated or not, or a Hindu undivided family, or any director, partner or member of such }
company, firm or association of persons or body of individuals or family, or any relative of such director, partner or member, has a substantial interest in the business of that other person;

2.5 EXEMPT INCOME OF NON RESIDENTS

Section 10 of the Income-tax Act, 1961 exempts from tax various incomes including the following in the hands of a non-resident:

(1) **Interest on moneys standing to the credit of individual in his NRE A/c** [Section 10(4)(ii)]

As per section 10(4)(ii), in the case of an individual, any income by way of interest on moneys standing to his credit in a Non-resident (External) Account (NRE A/c) in any bank in India in accordance with the Foreign Exchange Management Act, 1999 (FEMA, 1999), and the rules made thereunder, would be exempt, provided such individual;

- is a person resident outside India, as defined in FEMA, 1999, or
- is a person who has been permitted by the Reserve Bank of India to maintain such account.

In this context, it may be noted that the joint holders of the NRE Accounts do not constitute an AOP by merely having these accounts in joint names. The benefit of exemption under section 10(4)(ii) will be available to such joint account holders, subject to fulfillment of other conditions contained in that section by each of the individual joint account holders.

**Example:** Mrs. Neena Kansal, is resident of Singapore since year 2000. She holds an NRE account with Bank of Baroda, New Delhi Branch. Interest of ₹10,000 was credited to such account during financial year 2019-20. Such interest income earned by her shall be exempt from income-tax while she files her tax return for A.Y 2020-21.

(2) **Interest income of a non-corporate non-resident or foreign company on specified offshore Rupee Denominated Bonds issued by an Indian company or business trust** [Section 10(4C)]

Interest payable by an Indian company or business trust to a non-corporate non-resident or a foreign company in respect of money borrowed from a source outside India by way of issue of rupee denominated bond during the period from 17.9.2018 to 31.3.2019 would be exempt.

(3) **Income of a specified fund on transfer of certain specified asset on recognized stock exchange, to the extent such income accrues or arises to, or is received in respect of units held by a non-resident** [Section 10(4D)]

Income accrued or arising to or received by specified fund on transfer of a capital asset, being a bond of an Indian Company or a public sector company (sold by the Government and purchased
by the specified fund in foreign currency), GDR or rupee denominated bond or derivative or any other notified security, on a recognized stock exchange located in any IFSC would be exempt –

(i) where the consideration is paid or payable in convertible foreign exchange,

(j) to the extent such income accrues or arises to, or is received in respect of units held by a non-resident.

**Meaning of certain terms:**

<table>
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<tr>
<th>S. No.</th>
<th>Term</th>
<th>Meaning</th>
</tr>
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</table>
| 1     | Specified fund | A fund established or incorporated in India in the form of a trust or a company or a LLP or a body corporate, –
          | (i) which has been granted a certificate of registration as a Category III Alternative Investment Fund and is regulated under the SEBI (Alternative Investment Fund) Regulation, 2012, made under the SEBI Act, 1992 |
          | (ii) which is located in any IFSC |
          | (iii) of which all the units are held by non-residents other than units held by a sponsor or manager |
| 2     | Trust      | A trust established under the Indian Trust Act, 1882 or under any other law for the time being in force.                                                                                             |
| 3     | Unit       | Unit means beneficial interest of an investor in the fund and shall include shares or partnership interests.                                                                                       |
| 4     | Manager    | Any person or entity who is appointed by the Alternative Investment Fund to manage its investment by whatever name called. Manager may also be same as the sponsor of the Fund. |
| 5     | Sponsor    | Any person or persons who set up the Alternative Investment Fund and includes promoter in case of a company and designated partner in case of LLP.                                                 |

**(4) Remuneration received by individuals, who are not citizens of India [Section 10(6)]**

(i) **Remuneration received by officials of Embassies etc. of Foreign States [Section 10(6)(ii)]:** The remuneration received by an individual, who is not a citizen of India, for services as an official by whatever name called of an embassy, high commission, legation, commission, consulate or trade representation of foreign state, or a member of staff of any of these official is exempt.

**Conditions**

(a) The remuneration received by our corresponding Government officials resident in such foreign countries should be exempt.
(b) The above-mentioned member of the staff of such officials should be the subjects of the respective countries and should not be engaged in any other business or profession or employment in India.

**Examples:**

1. Mr. A, a citizen of India but resident of USA since year 2012, was appointed as a senior official of the US embassy in India. He earned a remuneration of ₹ 10 lakhs during F.Y. 2019-20. **Being an Individual who is a citizen of India, though fulfilling other conditions of the section, such remuneration shall not be exempt in his hands for A.Y. 2020-21.**

2. Mr. Vikram Kohli, an Indian born person but currently the resident and Citizen of USA, was appointed as a senior official of the US embassy in India. He earned a remuneration of ₹ 10 lakhs during F.Y. 2019-20. **Being an Individual who is not a citizen of India and also fulfilling other conditions of the section, such remuneration shall be exempt in his hands for A.Y. 2020-21.**

3. Mr. Frank D’Souza, an Irish Citizen but currently the resident of USA, was appointed as a senior official of the US embassy in India. He earned a remuneration of ₹ 10 lakhs during F.Y. 2019-20. **Being an Individual who is not a citizen of India, such remuneration shall be exempt in his hands for A.Y. 2020-21, subject to fulfilment of the conditions.**

(ii) **Remuneration received for services rendered in India by a Foreign National employed by foreign enterprise [Section 10(6)(vi)]:** The remuneration received by a foreign national as an employee of a foreign enterprises, for services rendered by him during his stay in India is exempt from tax.

**Conditions**

(a) The foreign enterprise is not engaged in any business or trade in India:

(b) The employee’s stay in India does not exceed in the aggregate a period of 90 days in such previous year and

(c) The remuneration is not liable to be deducted from the income of the employer chargeable under the Income-tax Act, 1961.

**Examples:**

1. Mr. A, citizen of India but resident of USA since year 2012, was appointed in India in October, 2018 as an employee of a US enterprise. Such US enterprise is not engaged in any business in India. A’s job requires him to visit his US office every twenty five (25) days for reporting purposes.

   During F.Y. 2019-20, Mr. A earned a remuneration of ₹ 10 lakhs for his India related assignment and his stay in India in aggregate was 85 days. Further, such US
enterprise has not claimed any deduction of such remuneration under the Income-tax Act, 1961.

Being an Individual who is a citizen of India, such remuneration shall not be exempt in his hands for A.Y. 2020-21 under this section i.e., section 10(6)(vi), though he may get exemption under any other provision of the Income-tax Act, 1961, subject to fulfilment of conditions stipulated thereunder.

2. In the above case, let’s consider that Mr. A is a citizen of USA. All other facts remaining same, his remuneration shall be exempt from tax in his hands for A.Y. 2020-21 under this section.

3. Let’s take another variation, Mr. A is a citizen of USA but the remuneration paid to him is borne by the permanent establishment of such US enterprise in India. ₹ 10 lakhs paid to A is cross charged by the US enterprise to its Indian permanent establishment (PE).

In this case, the remuneration shall not be exempt from taxation in the hands of Mr. A as the same is getting deducted from the income of the Indian PE of such foreign enterprise.

(iii) **Salary received by a non-citizen for services rendered in connection with employment on foreign ship [Section 10(6)(viii)]:** Any income chargeable under the head “Salaries” received by or due to, non-citizen of India who is also a non-resident as remuneration for services rendered in connection with his employment on a foreign ship is exempt provided his total stay in India does not exceed 90 days during the previous year.

(iv) **Remuneration received by Foreign Government employees during their stay in India for specified training [Section 10(6)(xi)]:** Any remuneration received by employee of the Government of a foreign state from their respective Government during his stay in India, is exempt from tax, if remuneration is received in connection with training in any establishment or office of or in any undertaking owned by,-

(a) the Government, or
(b) any company owned by the Central Government or any State Government or partly by the Central Government and partly by one or more State Government
(c) any company which is subsidiary of a company referred to in (b) above, or
(d) any statutory corporation; or
(e) any society registered under Societies Registration Act, 1860 or under any law and wholly financed by the Central Government or any State Government(s) or partly by the Central Government and partly by one or more State Governments.

*It may be carefully noted that exemption is available under section 10(6) only to an individual who is not a citizen of India.*
## Exempt Income of Non-Residents

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<thead>
<tr>
<th>Section</th>
<th>Income</th>
<th>Available to</th>
</tr>
</thead>
<tbody>
<tr>
<td>10(4)(ii)</td>
<td>Interest on money standing to the credit in a Non-resident (External) account of an Individual in any bank in India as per the FEMA Act, 1999.</td>
<td>Individual resident outside India (under FEMA Act) or an individual who has been permitted to maintain said account by RBI</td>
</tr>
<tr>
<td>10(4C)</td>
<td>Interest payable by an Indian company or business trust in respect of moneys borrowed from a source outside India by way of issue of rupee denominated bond during the period from 17.9.2018 to 31.3.2019</td>
<td>A non-corporate non-resident or foreign company</td>
</tr>
</tbody>
</table>
| 10(4D) | Income on transfer of a capital asset, being a bond of an Indian Company or a public sector company (sold by the Government and purchased by the specified fund in foreign currency), GDR or rupee denominated bond or derivative or any other notified security, on a recognized stock exchange located in any IFSC is exempt –

  (i) where the consideration is paid or payable in convertible foreign exchange;
  (ii) to the extent such income accrues or arises to, or is received in respect of units held by a non-resident | A specified fund |
| 10(6)(ii) | Remuneration received by Foreign Diplomats/Consulate and their staff (Subject to conditions) | Individual (not being a citizen of India) |
| 10(6)(vi) | Remuneration received as an employee of a foreign enterprise for services rendered by him during his stay in India, if:

  a) Foreign enterprise is not engaged in any trade or business in India;
  b) His stay in India does not exceed the aggregate a period of 90 days in such previous year; and
  c) Such remuneration is not liable to deducted from the income of employer chargeable under this Act | Individual - Salaried Employee (not being a citizen of India) of a foreign enterprise |
<p>| 10(6)(viii) | Salary received by or due for services rendered in connection with his employment on a foreign ship if | Individual Salaried Employee (Non-resident who is not a |</p>
<table>
<thead>
<tr>
<th>Section</th>
<th>Description</th>
<th>Taxability</th>
</tr>
</thead>
<tbody>
<tr>
<td>10(6)(xi)</td>
<td>Remuneration received as an employee of the Government of a foreign state during his stay in India in connection with his training in any Government Office/ Statutory Undertaking/ corporation/ registered society etc.</td>
<td>Individual - Salaried Employee (not being a citizen of India) of Government of foreign state</td>
</tr>
<tr>
<td>10(6A)</td>
<td>Tax paid by Government or Indian concern (under terms of agreement entered into after 31-3-1976 but before 1-6-2002 by the Government or Indian concern with the foreign company) on income derived by way of royalty or fees for technical services by the foreign company from Government or Indian concern.</td>
<td>Foreign Company</td>
</tr>
<tr>
<td>10(6B)</td>
<td>Tax paid by Government or Indian concern under terms of agreement entered into before 1-6-2002 by Central Government with Government of foreign State or international organization on income derived by a non-corporate non-resident or foreign company from the Government or Indian concern, other than income by way of salary, royalty or fees for technical services.</td>
<td>Non-corporate non-resident or foreign company</td>
</tr>
<tr>
<td>10(6BB)</td>
<td>Tax paid by Indian company, engaged in the business of operation of aircraft, which has acquired an aircraft or an aircraft engine on lease, under an approved (by Central Government) agreement entered into between 1-4-1997 and 31-3-1999, or after 31-3-2007, on lease rental/income derived (other than payment for providing spares or services in connection with the operation of leased aircraft) by the Government of a Foreign State or foreign enterprise.</td>
<td>Government of foreign State or foreign enterprise (i.e., a person who is a non-resident)</td>
</tr>
<tr>
<td>10(6C)</td>
<td>Royalty income or fees for technical services under an agreement with the Central Government for providing services in or outside India in projects connected with security of India.</td>
<td>Foreign company (notified by the Central Government)</td>
</tr>
<tr>
<td>10(6D)</td>
<td>Royalty income from or fees from technical services rendered in or outside India to, the National Technical Research Organisation (NTRO).</td>
<td>Non-corporate non-resident or foreign company</td>
</tr>
<tr>
<td>10(8)</td>
<td>Foreign income; and Remuneration received by an individual from the Government of a foreign State, in connection with duties in India.</td>
<td>Individual who is assigned to duties in India</td>
</tr>
</tbody>
</table>
any co-operative technical assistance programme and project under agreement between Central Government and the Government of a foreign State.

| 10(8A) | Foreign income; and Any remuneration or fee received by such person (agreement relating to his engagement must be approved) out of funds made available to an international organization (agency like World Bank or any other multi-lateral agency) under a technical assistance grant agreement between that agency and the Government of a foreign State (such technical assistant should be in accordance with an agreement between the Central Government and the agency). | Consultant, being (i) An individual: a) not being an Indian citizen; or b) being an Indian citizen who is not ordinarily resident in India, or (ii) any other person, being a non-resident engaged by the agency for rendering technical services in India in connection with any technical assistance programme or project in accordance with the approved agreement. |
| 10(8B) | Foreign income; and Remuneration received, directly or indirectly, by an individual who is assigned to duties in India in connection with any technical assistance programme and project in accordance with an agreement entered into by the Central Government and the agency from a consultant referred to in section 10(8A) | Employee of a consultant, being an individual: a) not being an Indian citizen; or b) being an Indian citizen who is not ordinarily resident in India. Contract of service must be approved by the prescribed authority before commencement of service. |
| 10(9) | Foreign income | Any family member of individual as referred to in section 10(8)/(8A)/(8B), accompanying him to India. |

Foreign income referred in section 10(8)/(8A)/(8B)/(9) above refers to the other income accruing or arising outside India. Such income would be exempt provided:

(i) it is not deemed to accrue or arise in India; and
(ii) the individual is required to pay any income tax or social security tax of such income to the Government of that Foreign State or Country of origin of such member.
<table>
<thead>
<tr>
<th>Section</th>
<th>Description</th>
<th>Type</th>
</tr>
</thead>
<tbody>
<tr>
<td>10(15)(iiia)</td>
<td>Interest on deposits made by a foreign bank with scheduled bank with approval of RBI.</td>
<td>Bank incorporated outside India and authorised to perform Central Banking functions in that country.</td>
</tr>
</tbody>
</table>
| 10(15)(iv)(fa)| Interest payable by scheduled bank on deposits in foreign currency where acceptance of such deposits is duly approved by RBI. [Scheduled bank does not include co-operative bank] | a) Non-resident  
b) Individual or HUF being a resident but not ordinary resident |
| 10(15)(viii) | Interest on deposit on or after 01.04.2005 in an Offshore Banking Unit                          |                       |
| 10(15)(ix)  | **Interest payable by a unit located in an IFSC in respect of monies borrowed by it on or after 1.9.2019** | Non-resident          |
| 10(15A)     | Lease rental paid by Indian company, engaged in the business of operation of aircraft, to acquire an aircraft or an aircraft engine on lease (other than payment for providing spares or services in connection with the operation of leased aircraft) under an approved (by Central Government) agreement not entered into between 1-4-1997 and 31-3-1999, or after 31-3-2007. | Government of foreign State or foreign enterprise (i.e., a person who is a non-resident) |
| 10(23BBB)   | Income of European Economic Community derived in India from interest, dividends or capital gains from investment out of its funds under notified scheme of Central Government. | European Economic Community |
| 10(23BBC)   | Income of SAARC Fund for Regional Projects set up by Colombo Declaration.                      | SAARC Fund for Regional Projects. |
| 10(48)      | Income received in India in Indian currency on account of sale of Crude oil or any other goods or rendering of services as may be notified by the Central Government in this behalf. Foreign company and agreement should be notified by the Central Government in national interest. | Foreign company on account of sale of crude oil, any other goods or rendering of services. It should not be engaged in any other activity in India. |
| 10(48A)     | Income accruing or arising on account of storage of crude oil in a facility in India and sale of crude oil therefrom to any person resident in India. Foreign company and agreement should be notified by the Central Government in national interest. | Foreign company on account of storage of crude oil in a facility in India and sale of crude oil therefrom. |
### 10(48B) Income from sale of leftover stock of crude oil from facility in India after the expiry of agreement or arrangement referred to in section 10(48A) or on termination of the said agreement or arrangement, in accordance with the terms mentioned therein, as the case may be, subject to such conditions, as may be notified by the Central Government.

<table>
<thead>
<tr>
<th>2.56</th>
<th>INTERNATIONAL TAXATION</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>2.6</strong> PRESUMPTIVE TAXATION FOR NON RESIDENTS</td>
<td></td>
</tr>
</tbody>
</table>

Section 28 details the income chargeable to tax under the head “Profits and Gains of Business or Profession”. Certain provisions have been incorporated in the Income-tax Act, 1961, whereby the “Profits and gains of business or profession” of certain non-resident assessee is computed on the basis of certain percentage of the amount accrued or arisen and received in India.

#### (1) Special provision for computing the profits and gains of shipping business in the case of non-residents [Section 44B]

Section 44B is a non-obstante clause. Accordingly, sections 28 to 43A are not applicable in the case of a non-resident engaged in the business of operation of ships.

Section 44B provides that profits and gains of a non-resident engaged in the business of operation of ships are to be taken @ 7.5% of the aggregate of the following amounts:

- (i) paid or payable, whether in or out of India, to the assessee or to any person on his behalf on account of carriage of passengers, livestock, mail or goods shipped at any port in India; and
- (ii) received or deemed to be received in India by or on behalf of the assessee on account of the carriage of passengers, livestock mail or goods shipped at any port outside India.

The amounts referred to in (i) and (ii) shall include demurrage charges or handling charges or any other amount of similar nature.

The amounts paid or payable or the amounts received or deemed to be received will also include the amount paid or payable or received or deemed to be received by way of demurrage charges or handling charges or any other amount of similar nature [CIT v. Japan Lines Ltd. 260 ITR 656 (Mad)]. Thus 7.5% of the gross amounts mentioned above would be liable to tax and no deduction would be allowed for any expenditure, (i.e. the provisions of section 28 to 43A are not to be taken into account) however carried forward losses would be allowed to be set off from such income.
Analysis of section 44B and section 172:

<table>
<thead>
<tr>
<th>Section 44B</th>
<th>Section 172</th>
</tr>
</thead>
<tbody>
<tr>
<td>Presumptive tax provisions for non-residents engaged in shipping business. It does not, however, contain any procedure for assessment and collection of tax.</td>
<td>Complete code for taxation of occasional shipping business of non-residents, including assessment and collection of tax.</td>
</tr>
</tbody>
</table>

**Manner of computation of presumptive Income:**

Notwithstanding anything to the contrary contained in sections 28 to 43A, in the case of an assessee, being a non-resident, engaged in the business of operation of ships, a sum equal to 7.5% of the aggregate of the:

- amount paid or payable (whether in or outside India) to the non-resident or to any other person on his behalf on account of the carriage of passengers, livestock, mail or goods shipped at any Indian port and

- the amount received or deemed to be received in India on account of the carriage of passengers, livestock, mail or goods shipped at any port outside India.

shall be deemed to be the profits and gains of such business chargeable to tax under the head "Profits and gains of business or profession".

Where a ship carries passengers, livestock, mail or goods shipped at a port in India, a sum equal to 7.5% of

- the amount paid or payable on account of such carriage to the owner or the charterer or to any person on his behalf, whether that amount is paid or payable in or out of India,

shall be deemed to be income accruing in India to the owner or charterer on account of such carriage.

**Other provisions of section 172**

(i) **Furnish a return of the amount paid to the owner:** Section 172(3) imposes an obligation on the master of the ship to prepare and furnish to the Assessing Officer a return of the full amount paid or payable to the owner or charterer or any person on this behalf, on account of the carriage of all passengers, livestock, mail or goods shipped at any port in India since the last arrival of the ship thereat. Such return is, ordinarily, to be furnished by the master of the ship before the departure, from that port in India, of the ship.

A return may, however, be filed by the person authorized by the master of the ship within 30 days of the departure of the ship from the port, if:
(a) the Assessing Officer is satisfied that it is not possible for the master of the ship to furnish the return required by section 172(3) before the departure of the ship from the port and

(b) the master of the ship has made satisfactory arrangement for the filing of the return and payment of tax by any other person on this behalf.

(ii) **Assessment [Section 172(4)]:** This section provides for a summary procedure of assessment. On receipt of the return filed by the master of the ship or by any person on his behalf, the Assessing Officer has to determine the tax payable on the taxable income. By virtue of the provisions of section 172(2), the taxable income is a sum equal to 7.5% of the amount paid or payable on account of carriage of passengers etc. to the owner or charterer or to any person on his behalf, whether that amount is paid or payable in or out of India. The tax payable on such taxable income is to be calculated at the **rate or rates in force applicable to the total income of a foreign company.** The master of the ship is liable for payment of such tax.

(iii) **Time limit for passing the assessment order [Section 172(4A)/(5)]:** It is incumbent on the Assessing Officer to pass the order of assessment within 9 months from the end of the financial year in which the return of income under section 172(3) is filed.

For the purpose of determining the tax payable, Assessing Officer is empowered to call for such accounts and documents as he may require.

(iv) **Grant of port of clearance to the ship [Section 172(6)]:** A port clearance shall not be granted to the ship until the Collector of customs or other authorized officer, is satisfied that the tax assessable under section 172 has been duly paid or that satisfactory arrangements have been made for the payment thereof.

(v) **Option to pay tax as per normal provisions of the Income-tax Act, 1961 on the income chargeable to tax under section 172 [Section 172(7)]:** The owner or charterer has the option to claim before the expiry of the assessment year relevant to the previous year in which the date of departure of the ship from the Indian port falls, that an assessment in respect of his total income for the previous year and the tax payable on the basis thereof be determined in accordance with the other provisions of this Act. In such a case, any payment made under section 172 is to be treated as a payment in advance of the tax leviable for that assessment year and the difference between the sum so paid and the amount of tax found payable by him on such assessment is to be paid by him or refunded to him, as the case may be.

The sum chargeable to tax under this section shall include amounts payable by way of **demurrage charge or handling charge** or any other amount of similar nature [Section 172(8)].
Section 172 vis-à-vis section 44B

In case the assessee is covered under section 172, 7.5 per cent of the amount paid or payable on account of the carriage of the passengers, livestock, mail or goods to the owner or the chartered or to any person on his behalf is deemed as his income and tax is levied on such income at a rate applicable to a foreign company i.e., 40% plus surcharge, if any, and plus health and education cess @4%.

Under the provisions of section 172(7), the non-resident owner or charterer is allowed an option to be assessed on his total income of the previous year in accordance with other provisions of the Act i.e., as per section 44B.

When such option is exercised, a regular assessment is made. In such a case, the tax already paid under the provisions of section 172(4) by the non-resident owner or charterer would be treated as tax paid in advance for that assessment year before determining the amount of tax finally due. The difference between the sum so paid and the amount of tax payable by him on such assessment shall be paid by the assessee or refunded to him (See Note below).

In that case, the non-resident assessee is liable to pay interest under sections 234B and 234C and also entitled to receive interest under section 244A of the Income-tax Act, 1961 as the case may be. [Circular No. 9/2001, dated 9-7-2001]

Note – Refund may arise in case of non-corporate non-residents, since they are liable to pay tax at a rate lower than the rate of 40% (plus surcharge, if any, and cess@4%) applicable to a foreign company.

The Supreme Court, in A.S. Glitrite v CIT (1997) 225 ITR 739 (SC), held that the assessment made under section 172(4) shall be an ‘adhoc’ assessment and it will be superceded if a regular assessment is opted as per the provisions of the Act.

ILLUSTRATION 1

Sea Port Shipping Line, a non-resident foreign company ships is engaged in the business of carriage of goods shipped at Mumbai port. During the previous year ended on 31.3.2020, it had collected freight of 100 lakhs, demurrages of ₹20 lakhs and handling charges of ₹10 lakhs. The expenses of operating its fleet during the year for the Indian Ports were ₹110 lakhs. Compute its income applying the presumptive provisions under section 44B.

SOLUTION

Section 44B provides that in the case of an assessee, being a non-resident, engaged in the business of operation of ships, a sum equal to 7.5% of the aggregate of the following amounts would be deemed to be the profits and gains of such business chargeable to tax under the head “Profits and gains of business or profession”.

(i) The amount paid or payable, whether within India or outside, to the assessee or to any person on his behalf on account of the carriage of passengers, livestock, mail or goods shipped at any port in India; and
(ii) The amount received or deemed to be received in India by the assessee himself or by any other person on behalf of or on account of the carriage of passengers, livestock, mail or goods shipped at any port outside India.

The above amounts will include demurrage charges and handling charges.

These provisions for computation of income from the shipping business in case of non-residents would apply notwithstanding anything to the contrary contained in the provisions of sections 28 to 43A of the Income-tax Act, 1961.

Therefore, in this case, M/s. Sea Port Shipping Line is required to pay tax in India on the basis of presumptive scheme as per the provisions of section 44B. The assessee shall not be entitled to set off any of the expenses incurred for earning of such income. Therefore, the Shipping Line is required to pay tax on deemed profit of ₹ 9.75 lacs (7.50% on the total receipts of ₹ 130 lacs). The tax payable would be reduced by the amount of tax paid under section 172(4).

(2) Special provision for computing profits and gains in connection with the business of exploration etc. of mineral oils [Section 44BB]

Section 44BB is a non-obstante clause. Accordingly, sections 28 to 41 and section 43 and 43A are not applicable in the case of a non-resident engaged in the business of providing services of facilities in connection with, or supplying plant and machinery on hire used, or to be used in the prospecting for, or extraction or production of, mineral oils.

(i) Eligible assessee: Section 44BB provides for determination of income of taxpayer being a non-resident engaged in the business of providing services and facilities in connection with, or supplying plant and machinery on hire used or to be used in the prospecting for, or extraction or production of mineral oils.

(ii) Presumptive rate: In such case, the profits and gains shall be deemed to be equal to 10% of the following amounts:

- paid or payable to the taxpayer or to any person on his behalf whether in or out of India, 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 or on behalf of 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.

(iii) Non-applicability of presumptive taxation under section 44BB: The provisions of section 44BB shall not apply to any income to which the provisions of section 42 or section 44DA, 115A or 293A apply for the purpose of computing profit or gains or any other income referred to in these sections.

<table>
<thead>
<tr>
<th>Section</th>
<th>Provision</th>
</tr>
</thead>
<tbody>
<tr>
<td>42</td>
<td>Special provision for deductions in the case of business for prospecting, etc., for mineral oil</td>
</tr>
</tbody>
</table>
44DA | Special provisions for computing income by way of royalties, etc., in case of non-residents.
---|---
115A | Tax on dividends, royalty and fees for technical services in the case of foreign companies
293A | Power to make exemption, etc., in relation to participation in the business of prospecting for, extraction, etc., of mineral oils.

(iv) **Option to claim lower profits:** An assessee may claim lower income than the presumptive rate of 10%, if he keeps and maintains books of account under section 44AA(2) and get them audited and furnish a report of such audit under section 44AB. The assessment in all such cases shall be done by the Assessing Officer under section 143(3).

(v) **Meaning of certain terms:** For the purposes of this section,-

(a) “Plant” includes ships, aircraft, vehicles, drilling units, scientific apparatus and equipment, used for the purposes of the said business;

(b) “Mineral oil” includes petroleum and natural gas.

*Note* - *If the income of a non-resident is in the nature of fees for technical services, it shall be taxable under the provisions of either section 44DA or section 115A irrespective of the business to which it relates. Section 44BB would apply only in a case where consideration is for services and other facilities relating to exploration activity which are not in the nature of technical services.*

### Illustration 2

Mr. Q, a non-resident, operates an aircraft between Singapore and Chennai. He received the following amounts while carrying on the business of operation of aircrafts for the year ended 31.3.2020:

(i) `2 crores in India on account of carriage of passengers from Chennai.

(ii) `1 crore in India on account of carriage of goods from Chennai.
The total expenditure incurred by Mr. Q for the purposes of the business during the year ending 31.3.2020 was ₹6.75 crores.

Compute the income of Mr. Q chargeable to tax in India under the head “Profits and gains of business or profession” for the assessment year 2020-21.

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

**SOLUTION**

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

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

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

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

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amount received in India on account of carriage of passengers from Chennai</td>
<td>2,00,00,000</td>
</tr>
<tr>
<td>Amount received in India on account of carriage of goods from Chennai</td>
<td>1,00,00,000</td>
</tr>
<tr>
<td>Amount received in India on account of carriage of passengers from Singapore</td>
<td>3,00,00,000</td>
</tr>
<tr>
<td>Amount received in Singapore on account of carriage of passengers from Chennai</td>
<td>1,00,00,000</td>
</tr>
</tbody>
</table>

Income from business under section 44BBA at 5% of ₹ 7,00,00,000 is ₹ 35,00,000, which is the income of Mr. Q chargeable to tax in India under the head “Profits and gains of business or profession” for the A.Y. 2020-21.

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

(4) Special provision for computing profits and gains of foreign companies engaged in the business of civil construction etc. in certain turnkey power projects [Section 44BBB]

(i) **Eligible assessees:** A foreign company engaged in the business of civil construction or the business of erection of plant or machinery or testing or commissioning thereof in connection with a turnkey power project approved by the Central Government in this behalf.

(ii) **Presumptive rate:** A sum equal to 10% of the amount paid or payable (whether in or out of India) to the said assessees or to any person on his behalf on account of such civil construction, erection, testing or commissioning shall be deemed to be the profits and gains
of such business chargeable to tax under the head 'profits and gains of business or profession'.

(iii) **Option to claim lower profits:** An assessee may claim lower income than the presumptive rate of 10%, if he keeps and maintains books of account under section 44AA(2) and get them audited and furnish a report of such audit under section 44AB. The assessment in all such cases shall be done by the Assessing Officer under section 143(3).

### SUMMARY OF PRESumptive PROvisions APPLICABLE TO NON RESIDENTS

<table>
<thead>
<tr>
<th>Particulars</th>
<th>44B</th>
<th>44BBA</th>
<th>44BB</th>
<th>44BBB</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Nature of business</strong></td>
<td>Shipping business</td>
<td>Operation of aircraft</td>
<td>Business of providing services or facilities in connection with, or supplying P &amp; M on hire used, or to be used, in the prospecting for, or extraction or production of, mineral oils</td>
<td>Business of civil construction or the business of erection of P&amp;M or testing or commissioning thereof, in connection with turnkey power projects approved by the Central Government.</td>
</tr>
<tr>
<td><strong>Eligible assessee</strong></td>
<td>Non-resident</td>
<td>Non-resident</td>
<td>Non-resident</td>
<td>Only Foreign Co.</td>
</tr>
<tr>
<td><strong>Presumptive income</strong></td>
<td>7.5% of specified sum</td>
<td>5% of specified sum</td>
<td>10% of specified sum</td>
<td>10% of specified sum</td>
</tr>
<tr>
<td><strong>Specified sum</strong></td>
<td>(i) Amount paid or payable on account of carriage of passengers, livestock, mail or goods shipped at/ from any port/place in India; and (ii) Amount received or deemed to be received in India on account of the carriage of passengers, livestock mail or goods shipped at/ from any port/place outside India</td>
<td>(i) Amount paid or payable on account of the provision of such services or facilities for the aforesaid purposes in India; and (ii) Amount received or deemed to be received in India on account of the provisions of services or facilities for the aforesaid purpose outside India</td>
<td>Amount paid or payable on a/c of such civil construction, erection, testing or commissioning</td>
<td></td>
</tr>
<tr>
<td><strong>Option to declare lower profits</strong></td>
<td>Not available</td>
<td>Lower profits may be claimed u/s 44BB and u/s 44BBB provided the assessee maintains Books of account u/s 44AA and gets them audited u/s 44AB.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
(5) Deduction in respect of head office expenses in case of non-residents [Section 44C]

In case of a non-resident, head office expenditure is allowed in accordance with the provision of section 44C. This section is a non-obstante provision and anything contrary contained in sections 28 to 43A is not applicable.

Deduction in respect of head office expenditure is restricted to the least of the following:

(a) an amount equal to 5% of "adjusted total income" or in the case of loss, 5% of the "average" adjusted total income; or

(b) the amount of so much of the expenditure in the nature of head office expenditure incurred by the assessee as is attributable to the business or profession of the assessee in India.

Meaning of certain terms:

<table>
<thead>
<tr>
<th>Term</th>
<th>Meaning</th>
</tr>
</thead>
<tbody>
<tr>
<td>Adjusted total income</td>
<td>Total income computed in accordance with the provisions of the Act without giving effect to the following:-</td>
</tr>
<tr>
<td></td>
<td>- Allowance under this section</td>
</tr>
<tr>
<td></td>
<td>- Unabsorbed depreciation allowance under section 32(2).</td>
</tr>
<tr>
<td></td>
<td>- Expenditure incurred by a company for the purpose of promoting family planning amongst its employees under first proviso to section 36(1)(ix).</td>
</tr>
<tr>
<td></td>
<td>- Business loss brought forward under section 72(1).</td>
</tr>
<tr>
<td></td>
<td>- Speculation loss brought forward under section 73(2).</td>
</tr>
<tr>
<td></td>
<td>- Loss under the head Capital Gain under section 74(1).</td>
</tr>
<tr>
<td></td>
<td>- Loss from certain specified source brought forward under Section 74A(3).</td>
</tr>
<tr>
<td></td>
<td>- Deduction under Chapter VI-A.</td>
</tr>
</tbody>
</table>

| Average adjusted total income | (a) The total income of the assessee, assessable for each of the three assessment years immediately preceding the relevant assessment year, one third of the aggregate amount of the adjusted total income in respect of previous years relevant to the aforesaid three assessment years is average adjusted total income. |
|                             | (b) When the total income of the assessee is assessable only for two of the aforesaid three assessment years, one half of the aggregate amount of the adjusted total income in respect of the previous year’s relevant to the aforesaid two assessment years is taken on average adjusted total income. |
|                             | (c) Where the total income of the assessee is assessable only for one of the aforesaid three assessment years, the amount of the adjusted total income in respect of the previous year relevant to that assessment year is average adjusted total income. |

| Head office expenditure      | Executive and general administration expenditure incurred by the assessee outside India, including expenditure incurred in respect of: |
|                             | a. rent, rates, taxes, repairs or insurance of any premises outside India |
used for the purpose of the business or profession.

b. salary, wages, annuity, pension, fees, bonus, commission, gratuity, perquisites or profit in lieu of or in addition to salary, whether paid or allowed to any employee or other person employed in, or managing the affairs of, any office outside India;

c. traveling by any employee or other person employed in, or managing the affairs, of any office outside India; and

d. such other matters connected with executive and general administrative as may be prescribed.

### Deduction of Head Office expenditure in case of Non-residents while computing Profit and gains from business or profession

**Lower of**

- **5% of adjusted Total Income**
- **Amount of Head Office expenditure incurred by the Non-resident attributable to the business or profession in India**

#### Meaning of Adjusted Total Income

Total Income, without giving effect to:

(i) Head Office expenditure

(ii) Unabsorbed depreciation

(iii) Capital expenditure on family planning

(iv) Losses carry forward:
   - Business loss u/s 72(1)
   - Speculative business Loss u/s 73(2)
   - LTCL/STCL u/s 74(1)
   - Loss from owning and maintaining race horses u/s 74A(3)

(v) Deductions under Chapter VI-A from GTI

#### Meaning of Head Office expenditure

Executive and general administration expenditure incurred by the NR outside India, including:

(a) Rent, rates, taxes, repairs or insurance of any premises outside India used for business or profession

(b) Salary, wages, perquisites etc. to any employee or other person managing the affairs of any office outside India

(c) Travelling expenditure by any employee or other person managing the affairs of any office outside India

(d) Such other executive and general administration expenditure prescribed
ILLUSTRATION 3

The net result of the business carried on by a branch of foreign company in India for the year ended 31.03.2020 was a loss of ₹ 100 lakhs after charge of head office expenses of ₹ 200 lakhs allocated to the branch. Explain with reasons the income to be declared by the branch in its return for the assessment year 2020-21.

SOLUTION

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

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

The amount of income to be declared by the assessee for A.Y. 2020-21 will be as under:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net loss for the year ended 31.03.2020</td>
<td>(100 lakhs)</td>
</tr>
<tr>
<td>Add: Amount of head office expenses to be considered separately as per section 44C</td>
<td>200 lakhs</td>
</tr>
<tr>
<td>Adjusted total income</td>
<td>100 lakhs</td>
</tr>
<tr>
<td>Less: Head Office expenses allowable under section 44C is the lower of -</td>
<td></td>
</tr>
<tr>
<td>(i) ₹ 5 lakhs, being 5% of ₹ 100 lakhs, or</td>
<td>5 lakhs</td>
</tr>
<tr>
<td>(ii) ₹ 200 lakhs.</td>
<td></td>
</tr>
<tr>
<td>Income to be declared in return</td>
<td>95 lakhs</td>
</tr>
</tbody>
</table>

(6) Special provision for computing income by way of royalties etc. in case of non-residents [Section 44DA]

(i) Eligible assessee: Section 44DA provides the method of computation of income by way of royalty or fees for technical services arising from the agreement made by the non-resident with the Indian company or Government of India after 31.03.2003 where:

(a) such non-resident carries business/profession in India through permanent establishment or fixed place of profession; and

(b) the right, property or contract in respect of which the royalty or fees for technical services are paid is effectively connected with such permanent establishment or fixed place of service.

(ii) Expenses not allowed as deduction: While computing the income chargeable to tax under this section, the following expenses are not allowed as deduction:
- expenditure or allowance incurred which is not wholly and exclusively for such permanent establishment or fixed place of service in India
- amount paid (otherwise than Reimbursement of actual expenses) by the permanent establishment to head office or to any of its other offices.

(iii) **Non-applicability of section 44BB:** The provisions of section 44BB do not apply in respect of income covered by this section.

(iv) **Mandatory requirement to maintain books of account and get them audited:** Under this section, the non-resident is mandatorily required to keep and maintain the books of account under section 44AA and get them audited and furnish a report of such audit.

### 2.7 CAPITAL GAINS TAXATION FOR NON RESIDENTS

Any person including a foreign company or non-corporate non-resident is liable to capital gains tax in India, if there is a transfer of a property (capital asset) in India which results in profit or gain.

**Section 45** provides that any profits or gains arising from transfer of a **capital asset** effected in the previous year shall be chargeable to income tax under the head “**Capital gain**” and shall be deemed to be the income of the previous year in which the transfer took place.

**The requisites of a charge to income-tax, of capital gains under Section 45(1) are:**

(i) There must be a capital asset.

(ii) The capital asset must have been transferred.

(iii) The transfer must have been effected in the previous year.

There must be a gain arising on such transfer of a capital asset. Such capital gain should not be exempt under Sections 54, 54B, 54D, 54EC, 54EE, 54F, 54G, 54GA or 54GB.

#### (1) Meaning of Capital Asset

**Definition:** According to section 2(14), a capital asset means –

(a) property of any kind held by an assessee, whether or not connected with his business or profession;

(b) any securities held by a Foreign Institutional Investor which has invested in such securities in accordance with the SEBI regulations.

However, it does not include—

(i) **Stock-in trade:** Any stock-in-trade [other than securities referred to in (b) above], consumable stores or raw materials held for the purpose of the business or profession of the assessee;
The exclusion of stock-in-trade from the definition of capital asset is only in respect of sub-clause (a) above and not sub-clause (b). This implies that even if the nature of such security in the hands of the Foreign Portfolio Investor is stock in trade, the same would be treated as a capital asset and the profit on transfer would be taxable as capital gains.

Further, the Explanatory Memorandum to the Finance (No.2) Bill, 2014 clarifies that the income arising from transfer of such security by a Foreign Portfolio Investor (FPI) would be in the nature of capital gain, irrespective of the presence or otherwise in India, of the Fund manager managing the investments of the assessee.

(ii) **Personal effects**: Personal effects, that is to say, movable property (including wearing apparel and furniture) held for personal use by the assessee or any member of his family dependent on him.

**EXCLUSIONS:**

(a) jewellery;
(b) archaeological collections;
(c) drawings;
(d) paintings;
(e) sculptures; or
(f) any work of art.

**Definition of Jewellery** - Jewellery is a capital asset and the profits or gains arising from the transfer of jewellery held for personal use are chargeable to tax under the head “capital gains”. For this purpose, the expression ‘jewellery’ includes the following:

(i) Ornaments made of gold, silver, platinum or any other precious metal or any alloy containing one or more of such precious metals, whether or not containing any precious or semi-precious stones and whether or not worked or sewn into any wearing apparel;

(ii) Precious or semi-precious stones, whether or not set in any furniture, utensil or other article or worked or sewn into any wearing apparel.

(iii) **Rural agricultural land** in India i.e., agricultural land in India which is not situated in any specified area.

As per the definition that only rural agricultural lands in India are excluded from the purview of the term ‘capital asset’. Hence urban agricultural lands constitute capital...
assets. Accordingly, the agricultural land described in (a) and (b) below, being land situated within the specified urban limits, would fall within the definition of “capital asset”, and transfer of such land would attract capital gains tax -

(a) agricultural land situated in any area within the jurisdiction of a municipality or cantonment board having population of not less than ten thousand, or

(b) agricultural land situated in any area within such distance, measured aerially, in relation to the range of population as shown hereunder –

<table>
<thead>
<tr>
<th>Shortest aerial distance from the local limits of a municipality or cantonment board referred to in item (a)</th>
<th>Population according to the last preceding census of which the relevant figures have been published before the first day of the previous year.</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) ≤ 2 kilometers</td>
<td>&gt; 10,000 ≤ 1,00,000</td>
</tr>
<tr>
<td>(ii) ≤ 6 kilometers</td>
<td>&gt; 1,00,000 ≤ 10,00,000</td>
</tr>
<tr>
<td>(iii) ≤ 8 kilometers</td>
<td>&gt; 10,00,000</td>
</tr>
</tbody>
</table>

**Explanation regarding gains arising on the transfer of urban agricultural land** -

*Explanation* to section 2(1A) clarifies that capital gains arising from transfer of any agricultural land situated in any non-rural area (as explained above) will not constitute agricultural revenue within the meaning of section 2(1A).

In other words, the capital gains arising from the transfer of such urban agricultural lands would not be treated as agricultural income for the purpose of exemption under section 10(1). Hence, such gains would be exigible to tax under section 45.

(iv) **Specified Gold Bonds**: 6½% Gold Bonds, 1977, or 7% Gold Bonds, 1980, or National Defence Gold Bonds, 1980, issued by the Central Government;

(v) **Special Bearer Bonds, 1991** issued by the Central Government;

(vi) **Gold Deposit Bonds** issued under the Gold Deposit Scheme, 1999 or deposit certificates issued under the Gold Monetisation Scheme, 2015 notified by the Central Government.

**Note** – ‘Property’ includes and shall be deemed to have always included any rights in or in relation to an Indian company, including rights of management or control or any other rights whatsoever.
(2) **Short term and Long term Capital Asset**

**Definition** – As per section 2(42A), short-term capital asset means a capital asset held by an assessee for not more than 36 months immediately preceding the date of its transfer.

As per section 2(29A), long-term capital asset means a capital asset which is not a short-term capital asset.

Thus, a capital asset held by an assessee for more than 36 months immediately preceding the date of its transfer is a long-term capital asset.
(ii) **Exceptions** - A security (other than a unit) listed in a recognized stock exchange, or a unit of an equity oriented fund or a unit of the Unit Trust of India or a Zero Coupon Bond will be considered as a long-term capital asset if the same is held for more than 12 months immediately preceding the date of its transfer.

Further, a share of a company (not being a share listed in a recognized stock exchange in India) or an immovable property, being land or building or both would be treated as a short-term capital asset if it was held by an assessee for not more than 24 months immediately preceding the date of its transfer.

Thus, the period of holding of unlisted shares or an immovable property, being land or building or both, for being treated as a long-term capital asset would be “more than 24 months” instead of “more than 36 months”.

**Period of holding: A summary**

<table>
<thead>
<tr>
<th>STCA, if held for</th>
<th>LTCA, if held for</th>
</tr>
</thead>
<tbody>
<tr>
<td>≤ 12 month</td>
<td>&gt; 12 months</td>
</tr>
<tr>
<td>• Security (other than unit) listed in a recognized stock exchange</td>
<td></td>
</tr>
<tr>
<td>• Unit of equity oriented fund/ unit of UTI</td>
<td></td>
</tr>
<tr>
<td>• Zero Coupon bond</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>STCA, if held for</th>
<th>LTCA, if held for</th>
</tr>
</thead>
<tbody>
<tr>
<td>≤ 24 month</td>
<td>&gt; 24 months</td>
</tr>
<tr>
<td>• Unlisted shares</td>
<td></td>
</tr>
<tr>
<td>• Land or building or both</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>STCA, if held for</th>
<th>LTCA, if held for</th>
</tr>
</thead>
<tbody>
<tr>
<td>≤ 36 month</td>
<td>&gt; 36 months</td>
</tr>
<tr>
<td>• Unit of debt oriented fund</td>
<td></td>
</tr>
<tr>
<td>• Unlisted securities other than shares</td>
<td></td>
</tr>
<tr>
<td>• Other capital assets</td>
<td></td>
</tr>
</tbody>
</table>

(iii) **Meaning of certain terms:**

<table>
<thead>
<tr>
<th>Term</th>
<th>Meaning</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Equity oriented fund</strong></td>
<td>A fund set up under a scheme of a mutual fund specified under section 10(23D).</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Circumstances</th>
<th>Condition</th>
</tr>
</thead>
<tbody>
<tr>
<td>In a case where the fund invested in the units of another fund which is traded on a recognised stock exchange</td>
<td>(k) a minimum of 90% of the total proceeds of such fund is invested in the units of such other fund; and</td>
</tr>
<tr>
<td></td>
<td>(l) such other fund also invests a minimum of 90% of its total proceeds in the equity shares of domestic companies listed on a recognised stock exchange; and</td>
</tr>
</tbody>
</table>
In any other case a minimum of 65% of the total proceeds of such fund is invested in the equity shares of domestic companies listed on a recognised stock exchange. However, the percentage of equity shareholding or unit held in respect of the fund, as the case may be, shall be computed with reference to the annual average of the monthly averages of the opening and closing figures.

| Zero Coupon Bond  
| [Section 2(48)] |
| A bond |
| - issued by any infrastructure capital company or infrastructure capital fund or a public sector company or a scheduled bank on or after 1st June, 2005, |
| - in respect of which no payment and benefit is received or receivable before maturity or redemption from such issuing entity and |
| - which the Central Government may notify in this behalf. |

**Note:** The income from transfer of a Zero coupon bond (not being held as stock-in-trade) is to be treated as capital gains. Section 2(47)(iva) provides that maturity or redemption of a Zero coupon bond shall be treated as a transfer for the purposes of capital gains tax.

**(iv) Period of holding of shares acquired on redemption of GDRs -** Where share(s) of a company is acquired by the non-resident assessee on redemption of Global Depository Receipts referred to in clause (b) of section 115AC(1) held by such assessee, the period shall be reckoned from the date on which a request for such redemption was made. [Refer sub para 3 of para 2.9 on page 2.101 for discussion on section 115AC]

**(v) Period of holding of capital asset acquired by Indian subsidiary company in consequence to conversion of a branch of a foreign company into a subsidiary company** – In the case of a capital asset which became the property of the Indian subsidiary company in consequence to conversion of a branch of a foreign company referred to in section 115JG(1), the period for which the asset was held by the said branch of the foreign company and by the previous owner, if any, who has acquired the capital asset by a mode of acquisition referred to in clause (i)/(ii)/(iii)/(iv) of section 49(1) or section 115JG(1) shall be included [Notification No.86/2018 – Rule 8AA(4)]. Section 115JG has been discussed at length later on in this Chapter.

**(3) Transactions not regarded as transfer [Section 47]**

Section 47 specifies certain transactions which will not be regarded as transfer for the purpose of capital gains tax in respect of non-residents and foreign companies.
<table>
<thead>
<tr>
<th>Clause of section 47</th>
<th>Particulars of transfer of capital asset referred to in column (3)</th>
<th>Capital Asset transferred</th>
<th>Conditions to be fulfilled</th>
</tr>
</thead>
<tbody>
<tr>
<td>47(via)</td>
<td>Any transfer in a scheme of amalgamation of two foreign companies. Capital asset is transferred by the amalgamating foreign company to the amalgamated foreign company.</td>
<td>Shares held in an Indian company</td>
<td>(a) At least 25% of the shareholders of the amalgamating foreign company must continue to remain shareholders of the amalgamated foreign company; (b) Such transfer should not attract capital gains in the country in which the amalgamating company is incorporated.</td>
</tr>
<tr>
<td>47(viab)</td>
<td>Any transfer in a scheme of amalgamation of two foreign companies. Capital asset is transferred by the amalgamating foreign company to the amalgamated foreign company.</td>
<td>Share of a foreign company, referred to in Explanation 5 to section 9(1)(i), which derives, directly or indirectly, its value substantially from the share or shares of an Indian company</td>
<td>(a) At least 25% of the shareholders of the amalgamating foreign company must continue to remain shareholders of the amalgamated foreign company; (b) Such transfer should not attract capital gains in the country in which the amalgamating company is incorporated.</td>
</tr>
<tr>
<td>47(vic)</td>
<td>Any transfer in a scheme of demerger of a foreign company. Capital asset is transferred by the demerged foreign company to the resulting foreign company.</td>
<td>A share or shares held in an Indian company</td>
<td>(a) The shareholders holding at least three-fourths in value of the shares of the demerged foreign company continue to remain shareholders of the resulting foreign company; (b) Such transfer does not attract tax on capital gains in the country, in which the demerged foreign company is incorporated.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>---</td>
<td>---</td>
<td>---</td>
<td></td>
</tr>
<tr>
<td><strong>47(vicc)</strong></td>
<td>Any transfer, in a scheme of demerger of a foreign company Capital asset is transferred by the demerged foreign company to the resulting foreign company.</td>
<td>A share of a foreign company referred to in Explanation 5 to section 9(1)(i), which derives, directly or indirectly, its value substantially from the share or shares of an Indian company</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>(a) The shareholders holding at least three-fourths in value of the shares of the demerged foreign company continue to remain shareholders of the resulting foreign company; (b) Such transfer should not attract capital gains in the country in which the demerged foreign company is incorporated.</td>
<td></td>
</tr>
</tbody>
</table>

However, the provisions of sections 391 to 394 of the Companies Act, 1956[^1], should not apply in case of demergers referred to in this clause.

<table>
<thead>
<tr>
<th><strong>47(viia)</strong></th>
<th>Any transfer by a non-resident to another non-resident outside India.</th>
<th>Bonds or Global Depository Receipts (GDRs) referred to in section 115AC(1)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Conditions laid down in section 115AC(1) should be fulfilled: (a) Bonds should be of: (i) an Indian company (issued in accordance with Notified scheme of Central Government) (ii) a public sector company sold by the Government and purchased by the non-resident in foreign currency (c) GDRs should be issued: (i) in accordance with notified scheme of</td>
</tr>
</tbody>
</table>

[^1]: Sections 230 to 232 of the Companies Act, 2013
### NON RESIDENT TAXATION

<table>
<thead>
<tr>
<th>Section</th>
<th>Description</th>
<th>Example</th>
</tr>
</thead>
<tbody>
<tr>
<td>2.75</td>
<td>Central Government against initial issue of shares of an Indian company and</td>
<td><strong>(ii)</strong> against the shares of a public sector company sold by the Government and purchased by him in foreign currency through an approved intermediary; or</td>
</tr>
<tr>
<td></td>
<td>purchased by the non-resident in foreign currency; or</td>
<td><strong>(iii)</strong> or reissued in accordance with Notified Scheme of Central Government against the existing shares of an Indian company purchased by him in foreign currency through an approved intermediary.</td>
</tr>
<tr>
<td>47(viia)</td>
<td>Any transfer, made outside India, by a non-resident to another non-resident.</td>
<td>Rupee denominated bond of an Indian company issued outside India</td>
</tr>
<tr>
<td>47(viib)</td>
<td>Any transfer of a capital asset by a non-resident on a recognised stock</td>
<td>- A bond or GDR referred to in section 115AC(1) (or)</td>
</tr>
<tr>
<td></td>
<td>exchange located in any International Financial Services Centre (IFSC)</td>
<td>- A rupee denominated bond of an Indian company (or)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>- A derivative (or)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>- Any other security</td>
</tr>
</tbody>
</table>

The consideration for such transaction is paid or payable in foreign currency.
(4) **Mode of computation of capital gains [Section 48]**

(i) **Amounts deductible while computing capital gains:** The income chargeable under the head ‘Capital gains’ shall be computed by deducting from the full value of consideration received or accruing as a result of the transfer of the capital asset the following amounts viz:

   i) expenditure incurred wholly and exclusively in connection with such transfer; and
   
   ii) the cost of acquisition of the asset and the cost of any improvement thereto.

(ii) **No deduction in respect of STT paid:** No deduction shall, however, be allowed in computing the income chargeable under the head “Capital Gains” in respect of any amount paid on account of securities transaction tax (STT) under Chapter VII of the Finance (No.2) Act, 2004.

(iii) **Cost inflation index:** Under section 48, for computation of long term capital gains, the cost of acquisition and cost of improvement increased by applying the cost inflation index
(CII). Once the cost inflation index is applied to the cost of acquisition and cost of improvement, it becomes indexed cost of acquisition and indexed cost of improvement.

This means an amount which bears to the cost of acquisition, the same proportion as CII for the year in which the asset is transferred bears to the CII for the first year in which the asset was held by the assessee or for the year beginning on 1st April, 2001, whichever is later.

Similarly, indexed cost of any improvement means an amount which bears to the cost of improvement, the same proportion as CII for the year in which the asset is transferred bears to the CII for the year in which the improvement to the asset took place.

The cost inflation indices for the financial years so far have been notified as under:

<table>
<thead>
<tr>
<th>Financial Year</th>
<th>Cost Inflation Index</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001-02</td>
<td>100</td>
</tr>
<tr>
<td>2002-03</td>
<td>105</td>
</tr>
<tr>
<td>2003-04</td>
<td>109</td>
</tr>
<tr>
<td>2004-05</td>
<td>113</td>
</tr>
<tr>
<td>2005-06</td>
<td>117</td>
</tr>
<tr>
<td>2006-07</td>
<td>122</td>
</tr>
<tr>
<td>2007-08</td>
<td>129</td>
</tr>
<tr>
<td>2008-09</td>
<td>137</td>
</tr>
<tr>
<td>2009-10</td>
<td>148</td>
</tr>
<tr>
<td>2010-11</td>
<td>167</td>
</tr>
<tr>
<td>2011-12</td>
<td>184</td>
</tr>
<tr>
<td>2012-13</td>
<td>200</td>
</tr>
<tr>
<td>2013-14</td>
<td>220</td>
</tr>
<tr>
<td>2014-15</td>
<td>240</td>
</tr>
<tr>
<td>2015-16</td>
<td>254</td>
</tr>
<tr>
<td>2016-17</td>
<td>264</td>
</tr>
<tr>
<td>2017-18</td>
<td>272</td>
</tr>
<tr>
<td>2018-19</td>
<td>280</td>
</tr>
<tr>
<td><strong>2019-20</strong></td>
<td><strong>289</strong></td>
</tr>
</tbody>
</table>
Special provisions of computation in case of non-residents

(i) First Proviso to Section 48 read with Rule 115A:-

In order to give protection to non-residents who invest foreign exchange to acquire capital assets, the first proviso to section 48 provides that capital gains arising from the transfer of shares or debentures of an Indian company is to be computed as follows:

- The cost of acquisition, the expenditure incurred wholly and exclusively in connection with the transfer and the full value of the consideration are to be converted into the same foreign currency with which such shares or debentures were acquired.

- The resulting capital gains shall be reconverted into Indian currency.

The aforesaid manner of computation of capital gains shall be applied for every purchase and sale of shares or debentures in an Indian company.

Benefit of indexation will not be applied in this case.

Rule 115A of the Income-tax Rules, 1962 provides that the average of the telegraphic transfer buying rate and telegraphic transfer selling rate of the foreign currency initially utilized in purchase of the capital asset as on the date specified in column (3) in the table below, shall be used to convert rupees into foreign currency for the purpose of computation of capital gains.

<table>
<thead>
<tr>
<th>(1)</th>
<th>(2)</th>
<th>(3)</th>
</tr>
</thead>
<tbody>
<tr>
<td>S. No.</td>
<td>Item</td>
<td>Date</td>
</tr>
<tr>
<td>(a)</td>
<td>Cost of acquisition of capital asset</td>
<td>Date of acquisition of capital asset</td>
</tr>
<tr>
<td>(b)</td>
<td>Expenditure incurred wholly and exclusively in connection with transfer of capital asset</td>
<td>Date of transfer of capital asset</td>
</tr>
<tr>
<td>(c)</td>
<td>Full value of consideration received or accruing as a result of transfer of a capital asset</td>
<td>Date of transfer of capital asset</td>
</tr>
</tbody>
</table>

For reconverting capital gains computed in the foreign currency initially utilized in the purchase of the capital asset into rupees, the telegraphic transfer buying rate of such currency, as on the date of transfer of the capital asset, is to be considered.

Meaning of certain terms

<table>
<thead>
<tr>
<th>Term</th>
<th>Meaning</th>
</tr>
</thead>
<tbody>
<tr>
<td>Telegraphic transfer buying rate</td>
<td>The rate or rates of exchange adopted by the State Bank of India for buying foreign currency having regard to the guidelines specified from time to time by the RBI for buying foreign currency where such currency, made available to that bank through a telegraphic transfer.</td>
</tr>
</tbody>
</table>
Telegraphic transfer selling rate

The rate of exchange adopted by the State Bank of India for selling foreign currency where such currency is made available by that bank through telegraphic transfer.

However, the benefit of indexation and currency fluctuation would not be available in respect of capital gains arising from the transfer of the following long term capital assets referred to in section 112A –

(i) equity share in a company on which STT is paid both at the time of acquisition and transfer

(ii) unit of equity oriented fund or unit of business trust on which STT is paid at the time of transfer.

Other Important Points:

a. It is also provided that the aforesaid manner of computation of capital gains shall be applicable in respect of capital gains accruing or arising from every re-investment thereafter in and sale of shares in or debentures of an Indian company.

b. If the total income of an assessee includes any income chargeable under the head ‘Capital Gains’ arising from transfer of a capital asset being an equity share in a company or unit of an equity oriented fund or unit of a business trust, then, tax on short term capital gains shall be payable at the rates specified in section 111A if transaction of sale of such security has been entered on or after October 1, 2004 on which STT is chargeable; and tax on long-term capital gains shall be payable on such securities as per section 112A, if STT has been paid both at the time of acquisition and transfer of equity share or at the time of transfer of unit of equity oriented fund or unit of business trust.

c. Section 50CA provides that where the consideration received or accruing as a result of transfer of a capital asset, being share of a company other than a quoted share, is less than the fair market value of such share determined in such manner as may be prescribed, such fair market value shall be deemed to be the full value of consideration received or accruing as a result of such transfer.

*This provision would, however, not be applicable to any consideration received or accruing as a result of transfer by such class of persons and subject to such conditions as may be prescribed.*

d. Section 50D provides that, in case where the consideration received or accruing as a result of the transfer of a capital asset by an assessee is not ascertainable or cannot be determined, then, for the purpose of computing income chargeable to tax as capital gains, the fair market value of the said asset on the date of transfer shall be deemed to be the full value of consideration received or accruing as a result of such transfer.
The shares and debentures (whether listed or non-listed) of Indian companies only are covered under this proviso. Indian company shall include Government company. However, bonds of Central Government/State Government and RBI are not covered for this purpose.

**ILLUSTRATION 4**

Mr. A, a non-resident Indian remits US $ 40,000 to India on 16.09.2005. The amount is partly utilised on 3.10.2005 for purchasing 10,000 equity shares in A Ltd, an Indian Company, at the rate of ₹ 12 per share. These shares are sold for ₹ 48 per share on 30.03.2020. Fair Market value of these shares on 31.01.2018 was ₹ 35 per share.

The telegraphic transfer buying and selling rate of US dollars adopted by the State Bank of India is as follows:

<table>
<thead>
<tr>
<th>Date</th>
<th>Buying Rate (1 US$)</th>
<th>Selling Rate (1 US $)</th>
</tr>
</thead>
<tbody>
<tr>
<td>16.09.2005</td>
<td>18</td>
<td>20</td>
</tr>
<tr>
<td>3.10.2005</td>
<td>19</td>
<td>21</td>
</tr>
<tr>
<td>30.3.2020</td>
<td>59</td>
<td>61</td>
</tr>
</tbody>
</table>

Compute Capital gain chargeable to tax for the A.Y. 2020-21 on the assumption that –

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

(b) These shares have been purchased and sold through a recognised stock exchange.

**SOLUTION**

(a) Where the shares are not sold through recognised stock exchange

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

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

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

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

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

(ii) **Fourth Proviso to Section 48**

As a measure to enable Indian companies to raise funds from outside India, the RBI has permitted them to issue rupee denominated bonds outside India. Accordingly, in case of non-resident assessees, any gains arising on account of appreciation of rupee between the date of purchase and the date of redemption of rupee denominated bond of an Indian company held by him against foreign currency in which investment is made shall not be included in computation of full value of consideration. This would provide relief to the non-resident investor who bears the risk of currency fluctuation.

**Note** - Non-corporate non-residents and foreign companies to be subject to tax at a concessional rate of 10% (without indexation benefit or currency fluctuation) on long-term capital gains arising from transfer of unlisted securities or shares of a company in which public are not substantially interested [Section 112]

(6) **Ascertained of cost in specified circumstances [Section 49]**

Section 49 provides for the guidelines for computing the cost of under different circumstances.

(i) **Cost of previous owner deemed as cost of acquisition of asset [Section 49(1)]:** In the following cases, the cost of acquisition of the asset shall be deemed to be cost for which the previous owner of the property acquired it. To this cost, the cost of improvement to the asset incurred by the previous owner or the assessee must be added:

Where capital asset became the property of the assessee:

<table>
<thead>
<tr>
<th>Capital asset</th>
<th>Transfer ref. to in section</th>
<th>Details of transfer</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share(s) held in an Indian company</td>
<td>47(via)</td>
<td>In a scheme of amalgamation, by the amalgamating foreign company to the amalgamated foreign company</td>
</tr>
<tr>
<td></td>
<td>47(vic)</td>
<td>In a scheme of demerger, by the demerged foreign company to the resulting foreign company</td>
</tr>
<tr>
<td>A share in a foreign company, which derives, directly or indirectly, its</td>
<td>47(viab)</td>
<td>In a scheme of amalgamation, by the amalgamating foreign company to the amalgamated foreign company</td>
</tr>
</tbody>
</table>
value substantially from the share(s) of an Indian company

| 47(vicc) | In a scheme of demerger, by the demerged foreign company to the resulting foreign company |

Accordingly, section 2(42A) provides that in all such cases, for determining the period for which the capital asset is held by the transferee, the period of holding of the asset by the previous owner shall also be considered.

**Note:** The issue as to whether indexation benefit in respect of a gifted asset shall apply from the year in which the asset was first held by the assessee or from the year in which the same was first acquired by the previous owner was taken up by the Bombay High Court in CIT v. Manjula J. Shah (2013) 355 ITR 474 (Bom.).

As per **Explanation 1** to section 2(42A), in case the capital asset becomes the property of the assessee in the circumstances mentioned in section 49(1), **inter alia**, by way of gift by the previous owner, then for determining the nature of the capital asset, the aggregate period for which the capital asset is held by the assessee and the previous owner shall be considered.

As per the provisions of section 48, the profit and gains arising on transfer of a long-term capital asset shall be computed by reducing the indexed cost of acquisition from the net sale consideration.

The indexed cost of acquisition means the amount which bears to the cost of acquisition the same proportion as Cost Inflation Index (CII) for the year in which the asset is transferred bears to the CII for the year in which the asset was first held by the assessee transferring it i.e., the year in which the asset was gifted to the assessee in case of transfer by the previous owner by way of gift.

The issue under consideration was whether, in a case where the assessee had acquired a capital asset by way of gift from the previous owner, the said asset can be treated as a long-term capital asset considering the period of holding by the assessee as well as the previous owner.

The Bombay High Court held that the indexed cost of acquisition in case of gifted asset has to be computed with reference to the year in which the previous owner first held the asset and not the year in which the assessee became the owner of the asset.

As per the plain reading of the provisions of section 48, however, the indexed cost of acquisition would be determined by taking CII for the year in which in which asset is first held by the assessee.

(ii) **Cost of acquisition of shares or debentures acquired on conversion of bonds [Section 49(2ABB)]:** The cost of acquisition of the capital asset, being share or debenture of a company acquired by the assessee consequent to conversion of bonds
[referred to in section 115AC(1)(a)] would be that part of the cost of bond in relation to which such asset is acquired by that person.

(iii) **Cost of acquisition of shares acquired on redemption of Global Depository Receipts [Section 49(2ABB)]:** The cost of acquisition of the capital asset, being share or shares of a company acquired by a non-resident assessee, consequent to redemption of GDRs [referred to in section 115AC(1)(b)] held by him would be the price of such share or shares prevailing on any recognized stock exchange on the date on which a request for such redemption was made.

### (7) Tax on Short term capital gains in respect of equity shares/ units of an equity oriented fund/ units of a business trust [Section 111A]

(i) **Concessional rate of tax in respect of STCG on transfer of certain assets:** This section provides for a concessional rate of tax (i.e. 15%) on the short-term capital gains on transfer of –

- an equity share in a company or
- a unit of an equity oriented fund or
- a unit of a business trust.

(ii) **Conditions:** The conditions for availing the benefit of this concessional rate are–

a) the transaction of sale of such equity share or unit should be entered into on or after 1.10.2004, being the date on which Chapter VII of the Finance (No. 2) Act, 2004 came into force; and

b) such transaction should be chargeable to securities transaction tax under the said chapter.

However, short-term capital gains arising from transactions undertaken in foreign currency on a recognized stock exchange located in an International Financial Services Centre (IFSC) would be taxable at a concessional rate of 15% even though STT is not leviable in respect of such transaction.

(iii) **Adjustment of unexhausted basic exemption limit:** The benefit of adjusting the unexhausted basic exemption limit is **not** available in the case of non-residents.

(iv) **No deduction under Chapter VI-A against STCG taxable under section 111A:** Deductions under Chapter VI-A cannot be availed in respect of such short-term capital gains on equity shares of a company or units of an equity oriented fund or units of a business trust included in the gross total income of the assessee.

**Note** - The Finance (No. 2) Act, 2019 has levied an enhanced surcharge of 25% and 37%, where the total income of an individual/HUF/AOP/BOI exceeds ₹2 crores and ₹5 crores, respectively. However, the enhanced surcharge has been withdrawn on tax payable at special rates under section 111A and
112A by both resident and non-resident assessees on short-term and long-term capital gains arising from the transfer of equity share in a company or unit of an equity-oriented fund/business trust, which has been subject to securities transaction tax [Press Release dated 24-8-2019]

(8) Tax on long term capital gains [Section 112]

(i) Where the total income of a non-corporate non-resident or a foreign company includes any income, arising from the transfer of a long-term capital asset, which is chargeable under the head "Capital gains", the tax payable by the non-resident or foreign company on the total income shall be the aggregate of —

(a) Long-term capital gains arising from the transfer of a capital asset, being unlisted securities, or shares of a company not being a company in which the public are substantially interested would be calculated at the rate of 10% on the capital gains in respect of such asset without giving effect to the indexation benefit provided under second proviso to section 48 and currency fluctuation under first proviso to section 48.

(b) In respect of other long-term capital gains, the applicable rate of tax would be 20%.

(ii) Lower rate of tax for transfer of listed securities and zero coupon bonds: Where the tax payable in respect of any income arising from the transfer of a listed security (other than a unit) or a zero coupon bond, being a long-term capital asset, exceeds 10% of the amount of capital gains before indexation, then such excess shall be ignored while computing the tax payable by the assessee.

(iii) No deduction under Chapter VI-A against LTCG: The provisions of section 112 make it clear that the deductions under Chapter VIA cannot be availed in respect of the long-term capital gains included in the gross total income of the assessee.

(iv) Rate of tax on long-term capital gains for non-corporate non-residents or foreign companies [Section 112]:

<table>
<thead>
<tr>
<th>Capital Asset</th>
<th>Period of holding to qualify as a long-term capital asset</th>
<th>Rate of tax on long-term capital gains</th>
</tr>
</thead>
<tbody>
<tr>
<td>Listed securities (other than unit) or Zero coupon bond</td>
<td>&gt; 12 months</td>
<td>10% (without indexation benefit) or 20% (with indexation benefit) whichever is more beneficial to the assessee</td>
</tr>
<tr>
<td>Unlisted securities or shares of closely held companies</td>
<td>&gt; 24 months</td>
<td>10% (without benefit of indexation or foreign currency fluctuation)</td>
</tr>
<tr>
<td>Other capital assets</td>
<td>&gt; 36 months</td>
<td>20% (with indexation)</td>
</tr>
</tbody>
</table>

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(9) **Tax on long term capital gains on certain assets [Section 112A]**

(i) **Concessional rate of tax in respect of LTCG on transfer of certain assets:** In order to minimize economic distortions and curb erosion of tax base, section 112A provides that notwithstanding anything contained in section 112, a concessional rate of tax @10% will be leviable on the long-term capital gains exceeding ₹ 1,00,000 on transfer of –

(a) an equity share in a company or
(b) a unit of an equity oriented fund or
(c) a unit of a business trust.

**Note** - The Finance (No. 2) Act, 2019 has levied an enhanced surcharge of 25% and 37%, where the total income of an individual/HUF/AOP/BOI exceeds ₹ 2 crores and ₹ 5 crores, respectively. However, the enhanced surcharge has been withdrawn on tax payable at special rates under section 111A and 112A by both resident and non-resident assessees on short-term and long-term capital gains arising from the transfer of equity share in a company or unit of an equity-oriented fund/business trust, which has been subject to securities transaction tax. [Press Release dated 24-8-2019]

(ii) **Conditions:** The conditions for availing the benefit of this concessional rate are–

(a) In case of equity share in a company, STT has been paid on acquisition and transfer of such capital asset
(b) In case of unit of an equity oriented fund or unit of business trust, STT has been paid on transfer of such capital asset.

However, the Central Government may, by notification in the Official Gazette, specify the nature of acquisition of equity share in a company on which the condition of payment of STT on acquisition would not be applicable.

In view of the above, the Central Government has, vide notification No. 60/2018, dated 1<sup>st</sup> October, 2018, notified that the condition of chargeability of STT shall not apply to the acquisition of equity shares entered into–

- before 1<sup>st</sup> October, 2004 or
- on or after 1<sup>st</sup> October, 2004 which are not chargeable to STT, other than the following transactions.

In effect, only in respect of the following transactions mentioned in column (2), the requirement of paying STT at the time of acquisition for availing the benefit of concessional rate of tax under section 112A would apply. In may be noted that the exceptions are listed in column (3) against the transaction. The requirement of payment of STT at the time of acquisition for availing benefit of concessional tax rate under section 112A will not apply to acquisition transactions mentioned in column (3).
<table>
<thead>
<tr>
<th>(1)</th>
<th>(2)</th>
<th>(3)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Transaction</strong></td>
<td><strong>Non-applicability of condition of chargeability of STT</strong></td>
<td></td>
</tr>
<tr>
<td>(a) Where acquisition of existing listed equity share in a company whose equity shares are not frequently traded in a recognised stock exchange of India is made through a preferential issue</td>
<td>Where acquisition of listed equity share in a company –</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(i) has been approved by the Supreme Court, High Court, National Company Law Tribunal, Securities and Exchange Board of India or Reserve Bank of India in this behalf;</td>
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</tr>
<tr>
<td></td>
<td>(ii) is by any non-resident in accordance with foreign direct investment guidelines issued by the Government of India;</td>
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<tr>
<td></td>
<td>(iii) is by an investment fund referred to in clause (a) of Explanation 1 to section 115UB or a venture capital fund referred to in section 10(23FB) or a Qualified Institutional Buyer;</td>
<td></td>
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<tr>
<td></td>
<td>(iv) is through preferential issue to which the provisions of chapter VII of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009 does not apply.</td>
<td></td>
</tr>
<tr>
<td>(b) Where transaction for acquisition of existing listed equity share in a company is not entered through a recognised stock exchange in India</td>
<td>Following acquisitions of listed equity share in a company made in accordance with the provisions of the Securities Contracts (Regulation) Act, 1956:</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(i) acquisition through an issue of share by a company other than through preferential the issue referred to in (a);</td>
<td></td>
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<tr>
<td></td>
<td>(ii) acquisition by scheduled banks, reconstruction or securitisation companies or public financial institutions during their ordinary course of business;</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(iii) acquisition by the Supreme Court, High Courts, National Company Law Tribunal, Securities and Exchange Board of India or Reserve Bank of India in this behalf;</td>
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<tr>
<td></td>
<td>(iv) acquisition under employee stock option scheme or employee stock purchase scheme framed under the Securities and Exchange Board of India (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999;</td>
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<td></td>
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<td></td>
</tr>
<tr>
<td>(v)</td>
<td>acquisition by any non-resident in accordance with foreign direct investment guidelines of the Government of India;</td>
<td></td>
</tr>
<tr>
<td>(vi)</td>
<td>acquisition in accordance with Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulation, 2011;</td>
<td></td>
</tr>
<tr>
<td>(vii)</td>
<td>acquisition from the Government;</td>
<td></td>
</tr>
<tr>
<td>(viii)</td>
<td>acquisition by an investment fund referred to in clause (a) to Explanation 1 to section 115UB or a venture capital fund referred to in section 10(23FB) or a Qualified Institutional Buyer;</td>
<td></td>
</tr>
<tr>
<td>(ix)</td>
<td>acquisition by mode of transfer referred to in section 47 (e.g., transfer of capital asset under a gift, an irrevocable trust, transfer of capital asset between holding company and its subsidiary, transfer pursuant to amalgamation, demerger, etc.) or section 50B (slump sale) or section 45(3) (Introduction of capital asset as capital contribution in firm/ AOPs/ BOIs) or section 45(4) (Distribution of capital assets on dissolution of firm/ AOPs/ BOIs) of the Income-tax Act, if the previous owner or the transferor, as the case may be, of such shares has not acquired them by any mode referred to in (a), (b) or (c) listed in column (2) [other than the exceptions listed in column (3)]</td>
<td></td>
</tr>
<tr>
<td>(c)</td>
<td>acquisition of equity share of a company during the period beginning from the date on which the company is delisted from a recognised stock exchange and ending on the date immediately preceding the date on which the company is again listed on a recognised stock exchange in accordance with the Securities Contracts (Regulation) Act, 1956 read</td>
<td></td>
</tr>
</tbody>
</table>
with Securities and Exchange Board of India Act, 1992 and the rules made thereunder;

### Meaning of certain terms:

<table>
<thead>
<tr>
<th>S.No.</th>
<th>Term</th>
<th>Particulars</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Frequently traded shares</td>
<td>Shares of a company, in which the traded turnover on a recognised stock exchange during the twelve calendar months preceding the calendar month in which the acquisition and transfer is made, is at least 10 percent of the total number of shares of such class of the company. However, where the share capital of a particular class of shares of the company is not identical throughout such period, the weighted average number of total shares of such class of the company would represent the total number of shares.</td>
</tr>
<tr>
<td>2</td>
<td>“Preferential issue” and “Qualified Institutional Buyer”</td>
<td>“Preferential issue” means an issue of specified securities by a listed issuer to any select person or group of persons on a private placement basis and does not include an offer of specified securities made through a public issue, rights issue, bonus issue, employee stock option scheme, employee stock purchase scheme or an issue of sweat equity shares or depository receipts issued in a country outside India or foreign securities. “Qualified Institutional Buyer” means (i) a mutual fund, venture capital fund, alternative investment fund and foreign venture capital investor registered with the SEBI; (ii) a foreign portfolio investor other than Category III foreign portfolio investor, registered with the SEBI; (iii) a public financial institution; (iv) a scheduled commercial bank; (v) a multilateral and bilateral development financial institution.</td>
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<td></td>
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<tr>
<td>---</td>
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<td></td>
</tr>
<tr>
<td>(vi)</td>
<td>a state industrial development corporation;</td>
<td></td>
</tr>
<tr>
<td>(vii)</td>
<td>an insurance company registered with the Insurance Regulatory and Development Authority of India;</td>
<td></td>
</tr>
<tr>
<td>(viii)</td>
<td>a provident fund with minimum corpus of ₹ 25 crore;</td>
<td></td>
</tr>
<tr>
<td>(ix)</td>
<td>a pension fund with minimum corpus of ₹ 25 crore;</td>
<td></td>
</tr>
<tr>
<td>(xi)</td>
<td>insurance funds set up and managed by army, navy or air force of the Union of India; and</td>
<td></td>
</tr>
<tr>
<td>(xii)</td>
<td>insurance funds set up and managed by the Department of Posts, India; and</td>
<td></td>
</tr>
<tr>
<td>(xiii)</td>
<td>systemically important non-banking financial companies.</td>
<td></td>
</tr>
</tbody>
</table>

Further, long-term capital gains arising from transaction undertaken on a recognized stock exchange located in an International Financial Service Centre (IFSC) would be taxable at a concessional rate of 10%, where the consideration for transfer is received or receivable in foreign currency, even though STT is not leviable in respect of such transaction.

(iii) **Adjustment of Unexhausted Basic Exemption Limit:** The benefit of adjustment of unexhausted basic exemption limit is **not** available in the case of non-residents.

(iv) **No deduction under Chapter VI-A against LTCG taxable under section 112A:** Deductions under Chapter VI-A cannot be availed in respect of such long-term capital gains on equity shares of a company or units of an equity oriented fund or unit of a business trust included in the gross total income of the assessee.

Subsequent to insertion of section 112A, the CBDT has issued clarification F. No. 370149/20/2018-TPL dated 04.02.2018 in the form of a Question and Answer format to clarify certain issues raised in different fora on various issues relating to the new tax regime for taxation of long-term capital gains. The relevant questions raised and answers to such questions as per the said Circular are given hereunder:

**Q 1. What is the meaning of long term capital gains under the new tax regime for long term capital gains?**

**Ans.** Long term capital gains mean gains arising from the transfer of long-term capital asset.

It provides for a new long-term capital gains tax regime for the following assets—
i. Equity Shares in a company listed on a recognised stock exchange;  
ii. Unit of an equity oriented fund; and  
iii. Unit of a business trust.  

The new tax regime applies to the above assets, if–  

a. the assets are held for a minimum period of twelve months from the date of acquisition; and  

b. the Securities Transaction Tax (STT) is paid at the time of transfer. However, in the case of equity shares acquired after 1.10.2004, STT is required to be paid even at the time of acquisition (subject to notified exemptions).  

Q 2. What is the point of chargeability of the tax?  

Ans. The tax will be levied only upon transfer of the long-term capital asset on or after 1st April, 2018, as defined in clause (47) of section 2 of the Act.  

Q 3. What is the method for calculation of long-term capital gains?  

Ans. The long-term capital gains will be computed by deducting the cost of acquisition from the full value of consideration on transfer of the long-term capital asset.  

Q 4. How do we determine the cost of acquisition for assets acquired on or before 31st January, 2018?  

Ans. The cost of acquisition for the long-term capital asset acquired on or before 31st of January, 2018 will be the actual cost.  

However, if the actual cost is less than the fair market value of such asset as on 31st of January, 2018, the fair market value will be deemed to be the cost of acquisition.  

Further, if the full value of consideration on transfer is less than the fair market value, then such full value of consideration or the actual cost, whichever is higher, will be deemed to be the cost of acquisition.  

Q 5. Please provide illustrations for computing long-term capital gains in different scenarios, in the light of answers to questions 4.  

Ans. The computation of long-term capital gains in different scenarios is illustrated as under  

**Scenario 1** – An equity share is acquired on 1st of January, 2017 at ₹100, its fair market value is ₹200 on 31st of January, 2018 and it is sold on 1st of April, 2019 at ₹250. As the actual cost of acquisition is less than the fair market value as on 31st of January, 2018, the fair market value of ₹200 will be taken as the cost of acquisition and the long-term capital gain will be ₹50 (₹250 – ₹200).
**Scenario 2** – An equity share is acquired on 1st of January, 2017 at ₹100, its fair market value is ₹200 on 31st of January, 2018 and it is sold on 1st of April, 2019 at ₹150. In this case, the actual cost of acquisition is less than the fair market value as on 31st of January, 2018. However, the sale value is also less than the fair market value as on 31st of January, 2018. Accordingly, the sale value of ₹150 will be taken as the cost of acquisition and the long-term capital gain will be NIL (₹150 – ₹150).

**Scenario 3** – An equity share is acquired on 1st of January, 2017 at ₹100, its fair market value is ₹50 on 31st of January, 2018 and it is sold on 1st of April, 2019 at ₹150. In this case, the fair market value as on 31st of January, 2018 is less than the actual cost of acquisition, and therefore, the actual cost of ₹100 will be taken as actual cost of acquisition and the long-term capital gain will be ₹50 (₹150 – ₹100).

**Scenario 4** – An equity share is acquired on 1st of January, 2017 at ₹100, its fair market value is ₹200 on 31st of January, 2018 and it is sold on 1st of April, 2019 at ₹50. In this case, the actual cost of acquisition is less than the fair market value as on 31st January, 2018. The sale value is less than the fair market value as on 31st of January, 2018 and also the actual cost of acquisition. Therefore, the actual cost of ₹100 will be taken as the cost of acquisition in this case. Hence, the long-term capital loss will be ₹50 (₹50 – ₹100) in this case.

**Q 6. Whether the cost of acquisition will be inflation indexed?**

**Ans.** Third proviso to section 48, provides that the long-term capital gain will be computed without giving effect to the provisions of the second provisos of section 48. Accordingly, it is clarified that the benefit of inflation indexation of the cost of acquisition would not be available for computing long-term capital gains under the new tax regime.

**Q 7. What will be the tax treatment of transfer made on or after 1st April 2018?**

**Ans.** The long-term capital gains exceeding ₹1 Lakh arising from transfer of these assets made on or after 1st April, 2018 will be taxed at 10 per cent. However, there will be no tax on gains accrued upto 31st January, 2018.

**Q 8. What is the date from which the holding period will be counted?**

**Ans.** The holding period will be counted from the date of acquisition.

**Q 9. Whether tax will be deducted at source in case of gains by resident tax payer?**

**Ans.** No. There will be no deduction of tax at source from the payment of long-term capital gains to a resident tax payer.

**Q 10. What will be the cost of acquisition in the case of bonus shares acquired before 1st February 2018?**

**Ans.** The cost of acquisition of bonus shares acquired before 31st January, 2018 will be determined as per section 55(2)(ac). Therefore, the fair market value of the bonus shares
as on 31st January, 2018 will be taken as cost of acquisition (except in some typical situations explained in Ans 5), and hence, the gains accrued upto 31st January, 2018 will continue to be exempt.

Q 11. What will be the cost of acquisition in the case of right share acquired before 1st February 2018?

Ans. The cost of acquisition of right share acquired before 31st January, 2018 will be determined as per section 55(2)(ac). Therefore, the fair market value of right share as on 31st January, 2018 will be taken as cost of acquisition (except in some typical situations explained in Ans 5), and hence, the gains accrued upto 31st January, 2018 will continue to be exempt.

Q 12. What will be the treatment of long-term capital loss arising from transfer made on or after 1st April, 2018?

Ans. Long-term capital loss arising from transfer made on or after 1st April, 2018 will be allowed to be set-off and carried forward in accordance with existing provisions of the Act. Therefore, it can be set-off against any other long-term capital gains and unabsorbed loss can be carried forward to subsequent eight years for set-off against long-term capital gains.

**2.8 SPECIAL PROVISIONS PRESCRIBED UNDER CHAPTER XII-A**

Chapter XII-A, introduced in the Income-tax Act 1961 with effect from June 01, 1983, contains seven sections viz. 115C, 115D, 115E, 115F, 115G, 115H and 115-I. The provisions of this Chapter are applicable to a non-resident Indian who derives investment income from a foreign exchange asset and/or long term capital gains in respect thereof.

<table>
<thead>
<tr>
<th>Terms</th>
<th>Meaning</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) Convertible foreign exchange</td>
<td>Foreign exchange which is for the time being treated by the Reserve Bank of India as convertible foreign exchange for the purposes of the Foreign Exchange Management Act, 1999, and any rules made thereunder.</td>
</tr>
<tr>
<td>(b) Foreign exchange asset</td>
<td>Any specified asset which the assessee has acquired or purchased with, or subscribed to in, convertible foreign exchange</td>
</tr>
<tr>
<td>(c) Investment income</td>
<td>Any income derived (other than dividends referred to in section 115-O) from a foreign exchange asset.</td>
</tr>
</tbody>
</table>

Subject to the notification issued by the Central Government to specify the nature of acquisition of equity share in a company on which the condition of payment of STT on acquisition would not be applicable.
(d) Long-term capital gains

Income chargeable under the head “Capital gains” relating to a capital asset, being a foreign exchange asset which is not a short-term capital asset.

(e) Non-resident Indian

An individual, being a citizen of India or a person of Indian origin who is not a “resident.

A person shall be deemed to be of Indian origin if he, or either of his parents or any of his grand-parents, was born in undivided India

(f) Specified asset

Any of the following assets, namely:

(i) Shares in an Indian company;
(ii) Debentures issued by an Indian company which is not a private company
(iii) Deposits in an Indian Company which is not a private company
(iv) Any security of the Central Government
(v) Any other asset which the Central Government may notify

(2) Special provisions relating to taxation of investment income and on long term capital gains of a non-resident [Sections 115D to 115F]

(i) On gross basis [Section 115D(1)]: Section 115D deals with the computation of total income of non-residents. 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 thereabout.

(ii) No deduction allowed [Section 115D(2)]: No deduction under Chapter VI-A shall be allowed and indexation benefit will not be available, where the gross total income of a non-resident Indian consists only of investment income or/and long term capital gain.

However, where the gross total income includes investment incomes or/and long term capital gain, the deduction under Chapter VI-A shall be allowed only on that portion of gross total income which does not include the investment income and long term capital gain.

(iii) Tax rate on investment income and long term capital gains [Section 115E]: Under section 115E, the investment income and long-term capital gains of non-resident Indians are to be treated as a separate block and charged to tax at flat rates.

Tax payable by shall be aggregate of –

(a) income-tax on Investment income at 20%;
(b) income-tax on long term capital gains from transfer of specified assets (i.e., purchased in foreign currency) at 10%; and
(c) income-tax on his other total income
(iv) **Exemption for long-term capital gains [Section 115F]**

Where a non-resident Indian has transferred a long-term foreign exchange asset and has within a period of six months after the date of such transfer, invested the whole or part of the net consideration in any specified asset then

(a) If the cost of the new asset is not less than the net consideration in respect of the original asset, the whole of the capital gains shall not be charged to tax under section 45

(b) If the cost of the new asset is less than the net consideration in respect of the original asset, the amount as calculated below shall not be charged to tax under section 45

\[
\text{Capital Gains} \times \frac{\text{Cost of acquisition of new asset}}{\text{Net Consideration}}
\]

**Important points:**

1. Net consideration means the full value of consideration from transfer less expenditure incurred wholly and exclusively in connection with transfer.

2. Where the new asset is transferred or converted into money within a period of 3 years from the date of its acquisition, the amount of capital gains arising from the transfer of original asset not charged to tax earlier shall be deemed to be the income under the head “Capital Gains” relating to long term capital assets. The same shall be charged to tax in the previous year in which new asset is transferred or converted into money.

**ILLUSTRATION 5**

A non-resident Indian acquired shares in an Indian company, A Ltd., on 1.1.2009 for ₹ 1,00,000 in foreign currency. These shares are sold by him on 1.1.2019 for ₹ 3,00,000. He invests ₹ 3,00,000 in shares on 31.03.2019 and these shares are sold by him on 30.06.2019 for ₹ 3,50,000. Discuss the tax implications. Ignore the effect of first proviso to section 48.
**SOLUTION**

**Computation of Long term Capital Gain for Assessment Year 2019-20**

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

**Capital Gain for Assessment Year 2020-21:**

1. LTCG of ₹ 2,00,000 which was exempt in A.Y.2019-20 becomes taxable this year.
2. STCG of ₹ 50,000 is also taxable this year.

**ILLUSTRATION 6**

Mr. John, a non-resident Indian, purchased unlisted shares of an Indian Company at a cost of ₹ 70,000 on 01.07.20010 in foreign currency. Mr. John sold the said shares for a consideration of ₹ 2,50,000 on 01.08.2019 and the expenditure incurred wholly or exclusively in connection with the transfer is ₹ 10,000. Compute the taxable capital gain if he deposited in specified assets ₹ 1,50,000 out of sale consideration. Ignore the effect of first proviso to section 48.

**SOLUTION**

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

\[ \frac{1,70,000 \times 1,50,000}{2,40,000} = ₹ 1,06,250 \]

(v) **Option not to file income-tax return [Section 115G]**

A non-resident Indian need not furnish a return of income under section 139(1) if he satisfies the following two conditions:-
(a) His total income consists only of investment income or income by way of long-term capital gains or both; and
(b) Tax deductible at source has been deducted from such income.

(vi) **Continuance of benefits after the non-resident becomes a resident [Section 115H]**

(a) Where a person who is NRI in any previous year becomes assessable as a resident in any subsequent year, then he may furnish a declaration in writing along with the return of income under section 139 for the year in which he is so assessable.

(b) The declaration shall be to the effect that the provisions of this chapter shall continue to apply to him in respect of the investment income derived from foreign exchange assets being debentures, deposits, securities of Central Government and such other notified assets as specified under section 115C.

(c) If he does so, the provisions of this chapter shall continue to apply to him in relation to such income for that assessment year and every subsequent year until the transfer or conversion into money of such assets.

(vii) **Option to opt out of Chapter XII-A [Section 115-I]**

This section gives an option to a non-resident Indian to elect that he should not be governed by the special provisions of Chapter XII-A for any particular assessment year by furnishing his return of income for that assessment year under section 139 declaring therein that the provisions of Chapter XII-A shall not apply to him for that assessment year. In case where such an option is exercised by a non-resident Indian, his total income for that assessment year would be charged to tax under the general provisions of the Act.

**Summary**

**Meaning of Foreign Exchange Asset (FEA)**

- **Specified asset**
  - Shares in an Indian Company
  - Debentures issued by an Indian Co. (other than a Pvt. Co.)
  - Deposits with an Indian Co. (other than a Pvt. Co.)
  - Any security of the CG
  - Other assets notified by the CG

- **Acquired/purchased/ subscribed to in convertible foreign exchange**
Special Provisions relating to certain incomes of non-resident individual, being a citizen of India or person of Indian Origin

<table>
<thead>
<tr>
<th>Income Type</th>
<th>Rate of tax</th>
<th>Deduction for expenses or allowance</th>
<th>Deduction under Chapter VI-A</th>
<th>Exemption u/s 115F</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment Income from FEA</td>
<td>20%</td>
<td>Not allowable</td>
<td>Not allowable</td>
<td>Allowable</td>
</tr>
<tr>
<td>LTCG relating to FEA, being a LTCA</td>
<td>10%</td>
<td>Allowable. However, benefit of indexation of COA is not available.</td>
<td>Not allowable</td>
<td>Allowable</td>
</tr>
<tr>
<td>LTCG of an asset, other than a specified asset</td>
<td>20%</td>
<td>Allowable. Benefit of indexation of COA is available.</td>
<td>Not allowable</td>
<td>Allowable</td>
</tr>
<tr>
<td>Other Income</td>
<td>Normal rates of tax</td>
<td>Allowable</td>
<td>Allowable</td>
<td></td>
</tr>
</tbody>
</table>

5 Other than dividend referred to in section 115-O
Sections 111A, 112 and 112A have already been discussed under para 2.7 Capital gains taxation for non-residents. The special provisions contained in other sections under Chapter XII are discussed hereunder -

(1) Special provisions for computing tax on income by way of royalty, fees for technical service, interest etc. [Section 115A]

(i) Tax on dividend and interest in case of non-corporate non-residents and foreign companies:

<table>
<thead>
<tr>
<th>Where the total income of a foreign company or a non-corporate non-resident includes any income by way of</th>
<th>Rate of Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) Dividends [other than dividend referred to in section 115-O]</td>
<td>20%</td>
</tr>
<tr>
<td>(2) Interest received from the Government or an Indian concern on moneys borrowed or debt incurred by the Government /Indian concern in foreign currency, other than 3 and 4 mentioned below</td>
<td>20%</td>
</tr>
<tr>
<td>(3) Interest received from an infrastructure debt fund referred to in section 10(47)</td>
<td>5%</td>
</tr>
<tr>
<td>(4) Interest referred to in section 194LC received from an Indian company or business trust –</td>
<td></td>
</tr>
<tr>
<td>- in respect of monies borrowed by an Indian company or business trust in foreign currency from sources outside India</td>
<td></td>
</tr>
<tr>
<td>- Under a loan agreement between 1.7.2012 and 30.6.2020 or</td>
<td></td>
</tr>
<tr>
<td>- by way of issue of long-term infrastructure bonds between 1.7.2012 and 30.9.2014 or</td>
<td></td>
</tr>
<tr>
<td>- by way of issue of long-term bonds including long term infrastructure bond between 1.10.2014 and 30.6.2020 as approved by the Central Government</td>
<td></td>
</tr>
<tr>
<td>- in respect of monies borrowed from sources outside India by way of rupee denominated bond before 1.7.2020</td>
<td>5%</td>
</tr>
<tr>
<td>(5) Interest referred to in section 194LD payable between 1.6.2013 and 30.6.2020 to a Foreign Institutional Investor or Qualified Foreign Investor on investment made in –</td>
<td></td>
</tr>
<tr>
<td>- Rupee denominated bond of an Indian company</td>
<td></td>
</tr>
<tr>
<td>- Government security</td>
<td>5%</td>
</tr>
</tbody>
</table>
(6) Interest referred to in section 194LBA(2), being interest income of a business trust from a SPV, distributed by business trust to non-resident unit holders of a business trust | 5%

(7) Income received in respect of units purchased in foreign currency of a mutual fund specified under section 10(23D) or of the Unit Trust of India | 20%

(ii) Tax on royalty or fees for technical services in case of non-residents

<table>
<thead>
<tr>
<th>Where the total income of a foreign company or a non-corporate non-resident includes any income by way of royalty or fees for technical services (FTS) other than the income referred to in section 44DA</th>
<th>Applicable Rate of Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) Received from the Government in pursuance of an agreement made by the non-resident/foreign company with the Government</td>
<td>10% of such royalty or FTS. However, if DTAA provides for a rate lower than 10%, then, the provisions of DTAA would apply.</td>
</tr>
<tr>
<td>(2) Received from the Indian concern in pursuance of an agreement made by the non-resident/foreign company with the Indian concern and the agreement is approved by the Central Government or where it relates to industrial policy of Government of India, the agreement in accordance with that policy.</td>
<td></td>
</tr>
</tbody>
</table>

Important Points:

1. Special rate of tax is applicable on the above mentioned incomes. The remaining income of the assessee will be chargeable to tax at normal rates applicable to assessee.

2. No deduction in respect of any expenditure or allowance shall be allowed to the assessee under sections 28 to 44C and section 57 in computing the above income.

3. Deduction under Chapter VI-A is not available in respect of dividend and interest referred to in (i) above. However, this condition would not be applicable to deduction allowed to a unit of an International Financial Services Centre (IFSC) under section 80LA i.e., a unit of an IFSC can claim deduction under section 80LA against dividend and interest referred to in (i) above.

4. It shall not be necessary for the assessee to furnish a return of income if the following conditions are satisfied:
   (a) The total income consists of only the interest or dividend income referred to in (i) above
   (b) Tax deductible at source has been deducted from such income.
Summary

Tax treatment of Royalty & Fees for technical service received from Government / Indian concern in pursuance of approved agreement

Is right, property or contract effectively connected with PE/Fixed Place of Profession (FPP) in India?

Yes

Royalty & FTS would be computed as per sec 44DA under the head “PGBP” as per the provisions of the Income-tax Act, 1961; and normal rates of tax would apply

Accounts & Audit

Books of account to be maintained as per section 44AA

Deduction of expenditure

Books of account to be audited & Audit Report to be furnished along with return of income

No deduction in respect of expenses not incurred wholly & exclusively in relation to PE/ Fixed place of profession in India

No deduction in respect of amount paid (other than reimbursement of actual expenses) by PE/Fixed place of profession to HO & other offices

Deduction under Chap VI-A permissible

Concessional rate of tax@10% u/s 115A on gross royalty/FTS would apply

No deduction of any expenditure or allowance is allowable u/s 28 to 44C or u/s 57

No deduction in respect of amount paid (other than reimbursement of actual expenses) by PE/Fixed place of profession to HO & other offices

No exemption from filing return of income u/s 139(1)

(2) Special provision for computing tax on income from units purchased in foreign currency or capital gains arising from their transfer in case of offshore fund [Section 115AB]

Where the total income of an overseas financial organisation (Offshore Fund) includes the following incomes namely-

(i) Income received in respect of units purchased in foreign currency or
(ii) by way of long term capital gains arising from the transfer of units of a mutual fund specified under section 10(23D) or units of UTI purchased in foreign currency,

Then, the income tax payable shall be the aggregate of the following:

(a) 10% on income referred to above

(b) the amount of income-tax with which the Offshore Fund would have been chargeable had its total income been reduced by the amount of Long term Capital Gains and income received referred to above.

**Important Points:**

(i) The benefit of indexation shall **not** be available in the computation of long term capital gains.

(ii) No deduction shall be allowed to the assessee under sections 28 to 44C or section 57(i)/(iii) or under Chapter VI-A in computing the above income.

(iii) Where the gross total income of the Overseas Financial Organisation consists of other incomes, then, the deduction under Chapter VI-A will be available in respect of other incomes. The normal provisions of the Income-tax Act, 1961 will apply for computation of other income.

(iv) **“Overseas Financial Organisation”** means any fund, institution, association or body, whether incorporated or not, established under the laws of a country outside India, which has entered into an arrangement for investment in India with any public sector bank or public financial institution or a mutual fund specified under section 10(23D). Such arrangement should be approved by the Securities and Exchange Board of India.

(v) It may be noted that long term capital gains upto ₹ 1,00,000 on units of equity oriented fund would be exempt and long term capital gains exceeding ₹ 1,00,000 shall be taxable @10% under section 112A provided securities transaction tax has been paid on the sale of such units.

(vi) It may be noted that short term capital gains on units of equity oriented fund are taxable @15% under section 111A provided securities transaction tax has been paid on the sale of such units.

**Special provision for computing tax on income from bonds or Global Depository Receipts purchased in foreign currency or capital gains arising from their transfer [Section 115AC]**

(i) **Eligible assessee and special rate of tax:** According to section 115AC(1), where the total income of an assessee, being a non-resident includes:
(a) income by way of interest on bonds of an Indian company issued in accordance with such scheme as the Central Government may notify or on bonds of a public sector company sold by the Government, and purchased by him in foreign currency; or

(b) income by way of dividends, other than dividends referred to in section 115-O, on Global Depository Receipts:

1. issued in accordance with such scheme as the Central Government may specify against the initial issue of shares of an Indian company and purchased by him in foreign currency through an approved intermediary; or
2. issued against the shares of a public sector company sold by the Government and purchased by him in foreign currency through an approved intermediary; or
3. issued or re-issued in accordance with such scheme as the Central Government may specify against the existing shares of an Indian company purchased by him in foreign currency through an approved intermediary; or

(c) income by way of long-term capital gains arising from the transfer of above bonds or GDRs,

then, income-tax will be charged at the rate of 10% on the above income.

(ii) **Deductions not allowable [Section 115AC(2)]:** Where the gross total income of the non-resident consists only the aforesaid interest or dividend income referred to in (a) and (b) of (i) above, no deduction shall be allowed to him under section 28 to 44C or section 57(i) or 57(iii) or under Chapter VIA.

Deduction under Chapter VI-A is also not allowable against long term capital gains arising from transfer of bonds or GDRs.

Where the gross total income of the non-resident consists of incomes other than interest, dividend and long term capital gains referred to in (a), (b) and (c) of (i) above, then, the deduction under Chapter VI-A will be available in respect of other incomes.

(iii) **Non-availability of indexation benefit and computation of capital gains in foreign currency [Section 115AC(3)]:** The indexation benefit and benefit of computation of capital gains in foreign currency, shall not be available for the computation of long-term capital gains arising out of the transfer of long term asset, being bonds or GDRs.

(iv) **Filing of Return of Income not required [Section 115AC(4)]:** It shall not be necessary for a non-resident to furnish under section 139(1), a return of income if his total income in respect of which he is assessable under the Act during the previous year consisted only of aforesaid interest or dividend income, and the tax deductible at source under the provisions of Chapter XVII-B has been deducted from such income.
(v) **Concessional tax treatment for GDR/Bonds acquired in course of Amalgamation [Section 115AC(5)]:** Where the assessee acquired GDR or bonds in an amalgamated or resulting company by virtue of his holding GDR or bonds in the amalgamating or demerged company, in accordance with the provisions of 115AC(1) the concessional tax treatment would apply to such GDR or bonds.

(vi) **Meaning of Global Depository Receipts:** "Global Depository Receipts" means any instrument in the form of a depository receipt or certificate (by whatever name called) created by the Overseas Depository Bank outside India and issued to investors against the issue of —

(a) ordinary shares of issuing company, being a company listed on a recognised stock exchange in India; or

(b) foreign currency convertible bonds of issuing company;

(4) **Special provisions for computing tax on income of Foreign Institutional Investors from securities or capital gains arising from their transfer [Section 115AD]**

(i) **Special rate of tax:** Where the total income of a Foreign Institutional Investor includes the income referred to in column (2), the same would be subject to tax at the rate mentioned in column (3):

<table>
<thead>
<tr>
<th>(1)</th>
<th>(2)</th>
<th>(3)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>S. No.</strong></td>
<td><strong>Income</strong></td>
<td><strong>Rate of Tax</strong></td>
</tr>
</tbody>
</table>
| (a) | Income received in respect of securities *other than* **(i)**
| | • income by way of dividends ref u/s 115-O
| | • income on units ref u/s 115AB i.e., units of Mutual Fund specified u/s 10(23D) or UTI
| | • Interest referred u/s 194LD | 20% |
| (b) | Interest referred u/s 194LD | 5% |
| (c) | Income by way of Short term capital gains arising from the transfer of securities (other than Short term capital gains u/s 111A) | 30% |
| (d) | Income by way of Short term capital gains u/s 111A | 15% |
| (e) | Income by way of Long term capital gains arising from the transfer of securities (other than Long term capital gains u/s 112A) | 10% |
| (f) | Income by way of Long term capital gains u/s 112A exceeding ₹ 1 lakh | 10% |
| (g) | Other income of FII | At normal rates of tax |
Note - The Finance (No. 2) Act, 2019 has levied an enhanced surcharge of 25% and 37%, where the total income of an individual/HUF/AOP/BOI exceeds ₹ 2 crores and ₹ 5 crores, respectively. However, the enhanced surcharge of 25% and 37% has been withdrawn on tax payable at special rate under section 115AD by the FPI on the capital gains arising from the transfer of derivatives (Future & Options).

In case of assessee other than FPI, derivatives are not treated as capital asset and the income arising from the transfer of the derivatives is treated as business income. Further, it has been clarified that the business income arising from the transfer of derivatives to a person other than FPI would be liable to enhanced surcharge [Press Release dated 24-8-2019]

(ii) No deduction is allowed [Section 115AD(2)]: Where the gross total income of the Foreign Institutional Investor comprises only of the aforesaid interest or dividend income from securities, no deduction shall be allowed to it under sections 28 to 44C or section 57(i) or 57(iii) or under Chapter VI-A.

Deduction under Chapter VI-A is also not allowable in case of short term capital gain or long term capital gain arising from transfer of securities.

Where the gross total income of the Foreign Institutional Investor consists of incomes other than income referred to in (a), (b) and (c) of table in (i) above, then, the deduction under Chapter VI-A will be available in respect of other incomes.

(iii) First and second provisos to section 48 shall not apply [Section 115AD(3)]: The benefit of computation of capital gains in foreign currency and the benefit of indexation would not be available for the computation of capital gains arising on transfer of securities.

(5) Special provision for computing tax on non-resident sportsmen or sports associations [Section 115BBA]

(i) Eligible assessee and special rate of tax: Where the total income of an assessee, referred to in column (2) includes income referred to in column (3) of the table below, such income would be chargeable to tax@20%.

<table>
<thead>
<tr>
<th>Assessee</th>
<th>Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1)</td>
<td>(2)</td>
</tr>
<tr>
<td>(a)</td>
<td></td>
</tr>
<tr>
<td>A sportsman (including an athlete), who is not a citizen of India and is a non-resident</td>
<td>Any income received or receivable by way of—</td>
</tr>
<tr>
<td></td>
<td>(i)</td>
</tr>
<tr>
<td></td>
<td>(ii)</td>
</tr>
</tbody>
</table>
### Non-Resident Taxation

#### (iii) Contribution of Articles Relating to Any Game or Sport in India in Newspapers, Magazines or Journals

- **(b)** A non-resident sports association or institution
  - Any amount guaranteed to be paid or payable to such association or institution in relation to any game (other than a game the winnings wherefrom are taxable under section 115BB) or sport played in India.

- **(c)** An entertainer who is not a citizen of India and is a non-resident
  - Any income received or receivable from his performance in India.

#### Deduction of Expenditure Not Permissible

No deduction in respect of any expenditure or allowance shall be allowed under any provision of this Act in computing the income referred to in (a) or (b) or (c) in the table given above.

#### Filing of Return of Income Not Required

The assessee is not required to furnish under section 139(1) a return of his income if—

- **(a)** his total income in respect of which he is assessable under this Act during the previous year consisted only of income referred to in (a) or (b) or (c) above; and
- **(b)** the tax deductible at source under the provisions of Chapter XVII-B has been deducted from such income.

**Note:** The issue as to whether the non-resident match referees and umpires in the games played in India fall within the meaning of “sportsmen” to attract taxability under the provisions of section 115BBA, and consequently attract the TDS provisions under section 194E in the hands of the payer was taken up by the Calcutta High Court in *Indcom v. CIT (TDS)* (2011) 335 ITR 485.

In order to attract the provisions of the section 194E, the person should be a non-resident sportsperson or non-resident sports association or institution whose income is taxable as per the provisions of section 115BBA.

Umpires and match referees can be described as professionals or technical persons who render professional or technical services, but they cannot be said to be either non-resident sportsmen (including an athlete) or non-resident sports association or institution so as to attract the provisions of section 115BBA and consequently, the provisions of tax deduction at source under section 194E are not attracted.

The Calcutta High Court held that although the payments made to non-resident umpires and the match referees are “income” which has accrued and arisen in India, the same are not taxable under the provisions of section 115BBA and thus, the assessee is not liable to deduct tax under section 194E.

*It may be noted that since income has accrued and arisen in India to the non-resident umpires and match referees, the TDS provisions under section 195 would be attracted and tax would be deductible at the rates in force.*
ILLUSTRATION 7

During the financial year 2019-20, Nadal, a tennis professional and a non-Indian citizen participated in India in a Tennis Tournament and won prize money of ₹ 15 lakhs. He contributed articles on the tournament in a local newspaper for which he was paid ₹ 1 lakh. He was also paid ₹ 5 lakhs by a Soft Drink company for appearance in a T.V. advertisement. Although his expenses in India were met by the sponsors, he had to incur ₹ 3 lakhs towards his travel costs to India. He was a non-resident for tax purposes in India.

What would be his tax liability in India for A.Y. 2020-21? Is he required to file his return of income?

SOLUTION

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

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

(a) his total income during the previous year consists only of income arising under section 115BBA; and
(b) the tax deductible at source under the provisions of Chapter XVII-B have been deducted from such incomes.

ILLUSTRATION 8

Smith, a foreign national and a cricketer came to India as a member of Australian cricket team in the year ended 31st March, 2020. He received ₹ 5 lakhs for participation in matches in India. He also received ₹ 1 lakh for an advertisement of a product on TV. He contributed articles in a newspaper for which he received ₹ 10,000. When he stayed in India, he also won a prize of ₹ 20,000 from horse racing in Mumbai. He has no other income in India during the year.

(i) Compute tax liability of Smith for Assessment Year 2020-21.

(ii) Are the income specified above subject to deduction of tax at source?

(iii) Is he liable to file his return of income for Assessment Year 2020-21?

(iv) What would have been his tax liability, had he been a match referee instead of a cricketer?
SOLUTION

(i) Computation of tax liability of Smith for the A.Y.2020-21

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income taxable under section 115BBA</td>
<td></td>
</tr>
<tr>
<td>Income from participation in matches in India</td>
<td>5,00,000</td>
</tr>
<tr>
<td>Advertisement of product on TV</td>
<td>1,00,000</td>
</tr>
<tr>
<td>Contribution of articles in newspaper</td>
<td>10,000</td>
</tr>
<tr>
<td><strong>Total income</strong></td>
<td>6,30,000</td>
</tr>
<tr>
<td>Tax@ 20% under section 115BBA on ₹ 6,10,000</td>
<td>1,22,000</td>
</tr>
<tr>
<td>Tax@ 30% under section 115BB on income of ₹ 20,000 from horse races</td>
<td>6,000</td>
</tr>
<tr>
<td><strong>Add: Health and Education cess@4%</strong></td>
<td>5,120</td>
</tr>
<tr>
<td><strong>Total tax liability of Smith for the A.Y.2020-21</strong></td>
<td>1,33,120</td>
</tr>
</tbody>
</table>

(ii) Yes, the above income is subject to tax deduction at source.

Income referred to in section 115BBA (i.e., ₹ 6,10,000, in this case) is subject to tax deduction at source@ 20% under section 194E.

Income referred to in section 115BB (i.e., ₹ 20,000, in this case) is subject to tax deduction at source@30% under section 194BB.

Since Smith is a non-resident, the amount of tax to be deducted calculated at the prescribed rates mentioned above, would be increased by health and education cess@4%.

(iii) Section 115BBA provides that if the total income of the non-resident sportsman comprises of only income referred to in that section and tax deductible at source has been fully deducted, it shall not be necessary for him to file his return of income. However, in this case, Mr. Smith has income from horse races as well. Therefore, he cannot avail the benefit of exemption from filing of return of income as contained in section 115BBA. Hence, he would be liable to file his return of income for A.Y.2020-21.

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

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

2.10 APPlicability of MAT on Foreign Companies

[SECTION 115JB]

As per section 115JB(1), in case of company (domestic or foreign), if the income-tax payable on the total income computed under the Income-tax Act, 1961 is less than 18.5% of its book profit, such book profit shall be deemed to be the total income of the assessee and the tax payable by the assessee on such total income shall be the amount of income-tax at the rate of 18.5% (add surcharge, if applicable, i.e., 7% for domestic companies and 2% for foreign companies, where the total income exceeds ₹ 1 crore but does not exceed ₹ 10 crore, and 12% for domestic companies and 5% for foreign companies where the total income exceeds ₹ 10 crore). Further, health and education cess @4% shall be added on the aggregate of income-tax and surcharge.

In order to address the issue relating to the applicability of section 115JB(1) to Foreign Institutional Investors (FIIs) who do not have a permanent establishment (PE) in India, it has been provided that in case of a foreign company, any income by way of capital gains on transactions in securities or interest, royalty or fees for technical services chargeable to tax at the rates specified in Chapter XII, is credited to statement of profit and loss and income-tax payable thereon is at a rate lower than the rate specified in section 115JB, the same shall be reduced from the book profits; and the corresponding expenditure will be added back, if the same is debited to statement of profit and loss.

However, the above amendment by the Finance Act, 2015 was prospective w.e.f. A.Y.2016-17. Therefore, the issue related to applicability for assessment year prior to A.Y.2016-17 remained to be addressed.

6 Reduced to 15%. Refer press note at the end of this study material.
The Committee on Direct Tax matters headed by Justice A.P. Shah, set up by the Government to look into the matter, suggested that section 115JB be amended to clarify the applicability of Minimum Alternate Tax (MAT) provisions to Foreign Institutional Investors/ Foreign Portfolio Investors (FIIs/FPIs) in view of the fact that FIIs and FPIs normally do not have a place of business in India.

Keeping in mind the suggestions of the Committee and in order to ensure certainty in taxation of foreign companies, Explanation 4 was inserted in section 115JB by the Finance Act, 2016 with retrospective effect from 01.04.2001 to provide for non-applicability of levy of MAT under section 115JB in the following cases:

<table>
<thead>
<tr>
<th>Existence of DTAA with the country of residence of the foreign company</th>
<th>Additional condition to be satisfied for non-applicability of MAT</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) The foreign company is a resident of a country or a specified territory with which India has a DTAA under section 90(1) or the Central Government has adopted any agreement between specified associations for double taxation relief under section 90A(1)</td>
<td>It should not have a permanent establishment in India in accordance with the provisions of such Agreement</td>
</tr>
<tr>
<td>(ii) The foreign company is a resident of a country with which India does not have an agreement of the nature referred to in clause (i) above</td>
<td>It is not required to seek registration under any law for the time being in force relating to companies.</td>
</tr>
</tbody>
</table>

Explanation 4A to section 115JB has been inserted with retrospective effect from 01.04.2001 to clarify that MAT provisions shall not be applicable to a foreign company, whose total income comprises solely of profits and gains from business referred to in section 44B or section 44BB or section 44BBA and such income has been offered to tax at the presumptive rates specified thereunder.

Note: For detailed understanding of the provisions of Minimum Alternate Tax, students may refer to Chapter 12: Assessment of Various Entities in Module 2 of Paper 7: Direct Tax Laws and International Taxation
2.11 SPECIAL PROVISIONS RELATING TO CONVERSION OF INDIAN BRANCH OF A FOREIGN BANK INTO A SUBSIDIARY COMPANY [CHAPTER XII-BB]

(1) Conversion of an Indian branch of foreign company into subsidiary Indian company [Section 115JG(1)]

(i) The provisions of this section apply to a foreign company engaged in banking business in India through its branch situated in India, which is converted into an Indian subsidiary company in accordance with the scheme framed by RBI.

(ii) If the conditions notified by the Central Government in this behalf are satisfied, then capital gains arising from such conversion would not be chargeable to tax in the assessment year relevant to the previous year in which such conversion takes place.

(iii) Also, the provisions of the Act relating to computation of income of foreign company and Indian subsidiary company would apply with such exceptions, modifications and adaptations as specified in the notification.

(iv) Further, the benefit of set-off of unabsorbed depreciation, set-off or carry forward and set-off of losses, tax credit in respect of tax paid on deemed income relating to certain companies available under the Act shall apply with such exceptions, modifications and adaptations as specified in the notification.

Accordingly, the Central Government has, vide notification no. 85/2018, specified the conditions to be fulfilled –

(1) For Capital Gains exemption:

Where a foreign company is engaged in the business of banking through its Indian branch and converts such Indian branch into its Indian subsidiary company in accordance with the scheme framed by RBI, the capital gains arising from such conversion would not be chargeable to tax, if -

(a) the Indian branch amalgamates with the Indian subsidiary company in accordance with the scheme of amalgamation approved by the shareholders of the foreign company and the Indian subsidiary company and sanctioned by the RBI7

(b) all the assets and liabilities of the Indian branch immediately before conversion would become the assets and liabilities of the Indian subsidiary company;

7 under paragraph 20(h) of the Framework for setting up of wholly owned subsidiaries by foreign banks in India issued by the Reserve Bank of India vide Press release number 2013-2014/936 dated 6th day of November, 2013

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(c) the asset and liabilities of the Indian branch are transferred to the Indian subsidiary company at values appearing in the books of account of the Indian branch immediately before its conversion.

Note - Any change in the value of assets consequent to their revaluation would not be considered while determining the value of the assets.

(d) the foreign bank or its nominee shall hold the whole of the share capital of the Indian subsidiary company during the period beginning from the date of conversion and ending on the last day of the previous year in which the conversion took place and continue to hold the shares of Indian subsidiary company carrying not less than 51% of the voting power for a period of five years immediately succeeding the said previous year;

(e) the foreign company does not receive any consideration or benefit, directly or indirectly, in any form or manner, other than by way of allotment of shares in the Indian subsidiary company.

(2) Application of the provisions of the Income-tax Act, 1961 with modifications/exceptions

The provisions of the Income-tax Act, 1961 relating to unabsorbed depreciation, set off or carry forward and set off of losses, tax credit in respect of tax paid on deemed income relating to certain companies and the computation of income in case of foreign company and Indian subsidiary company shall apply with following modifications, exceptions and adaptation –

<table>
<thead>
<tr>
<th>Purpose</th>
<th>Modification/exception/adaptation</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) Allowance of depreciation under section 32</td>
<td>The aggregate deduction, in respect of depreciation on buildings, machinery, plant or furniture, being tangible assets, or know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature, being intangible assets, allowable to the Indian branch and the Indian subsidiary company shall not exceed in any previous year the deduction calculated at the prescribed rates as if the conversion had not taken place. Such deduction would be apportioned between the Indian branch and the Indian subsidiary company in the ratio of the number of days for which the assets were used by them;</td>
</tr>
<tr>
<td>(b) Set-off and c/f of loss and depreciation</td>
<td>The accumulated loss and the unabsorbed depreciation of the Indian branch would be deemed to be the loss or allowance for depreciation of the Indian subsidiary company for the previous year in which conversion was effected; and provisions of the Income-tax Act, 1961, relating to set off and carry forward of loss and allowance for depreciation shall apply accordingly.</td>
</tr>
<tr>
<td>(c) Determination of actual cost u/s 43(1)</td>
<td>The actual cost of the block of assets in the case of the Indian subsidiary company shall be the written down value of the block of assets as in the case of the Indian branch on the date of its</td>
</tr>
</tbody>
</table>
**conversion** into the Indian subsidiary company

The actual cost of any capital asset on which deduction has been allowed or is allowable under section 35AD, shall be treated as 'nil' in the case of the Indian subsidiary company if the capital asset became the property of the Indian subsidiary company as a result of conversion of the Indian branch.

(d) **Cost of acquisition of other capital assets**

Where the capital asset other than those referred to in (c) above became the property of the Indian subsidiary company as a result of conversion of the Indian branch, the cost of acquisition of the asset for the purposes of computation of capital gains shall be deemed to be the cost for which the Indian branch acquired it or, as the case may be, the cost for which previous owner has acquired it.

(e) **Tax credit**

The tax credit of the Indian branch shall be deemed to be the tax credit of the Indian subsidiary company for the purpose of the previous year in which conversion was effected; and the provisions of section 115JAA of the Income-tax Act, 1961 shall apply accordingly.

(f) **Amortisation of VRS Expenditure**

The provisions of 35DDA of the Act shall be, as far as may be, apply to the Indian subsidiary company, as they would have applied to the Indian branch, if the conversion had not taken place.

(g) **Deemed credit balance in provision for bad and doubtful debts**

The credit balance in the provision for bad and doubtful debts account made under section 36(1)(viia) of the Indian branch on the date of conversion shall be deemed to be the credit balance of the Indian subsidiary company and the provisions of section 36 of the Income-tax Act, 1961, shall apply accordingly.

(h) **Non-applicability of section 56(2)(x)**

The provisions of section 56(2)(x) shall not apply to the transaction of receipt of shares in the Indian subsidiary company by the foreign company or its nominee in consequence of the conversion of the Indian branch into the Indian subsidiary company.

**Meaning of certain terms (given in bold in the above table):**

<table>
<thead>
<tr>
<th>Term</th>
<th>Meaning</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accumulated loss</td>
<td>So much of the loss of the Indian branch before its conversion into Indian subsidiary company under the head “Profits and gains of business or profession” (not being a loss sustained in a speculation business) which such Indian branch would have been entitled to carry forward and set off under the provisions of section 72, if the conversion had not taken place.</td>
</tr>
<tr>
<td>Unabsorbed depreciation</td>
<td>So much of the allowance for depreciation of the Indian branch before its conversion into Indian subsidiary company, which remains to be allowed and which would have been allowed to the Indian branch under the provisions of the Act, if the conversion had not taken place.</td>
</tr>
<tr>
<td>Previous owner</td>
<td>In relation to any capital asset owned by the Indian subsidiary company means the last previous owner of the capital asset who acquired it by a mode of</td>
</tr>
</tbody>
</table>
acquisition other than those referred in section 49(1)(i)/(ii)/(iii)/(iv) or section 115JG(1).

Tax credit
So much of the tax credit of the Indian branch before conversion into Indian subsidiary company which such Indian branch would have been entitled to carry forward and set off under the provisions of section 115JAA of the Act, if the conversion had not taken place.

Date of conversion
The date, which the Reserve Bank of India appoints for the vesting of undertaking of the Indian branch in Indian subsidiary company

(2) Consequences of failure to comply with the specified conditions [Section 115JG(2)]
If the conditions specified in the scheme of RBI or notification issued by the Central Government are not complied with, then, all the provisions of the Act would apply to the foreign company and Indian subsidiary company without any benefit, exemption or relief under this section.

(3) Consequences of subsequent failure to comply with the conditions [Section 115JG(3)]

(i) If the benefit, exemption or relief has been granted to the foreign company or Indian subsidiary company in any previous year and thereafter, there is a failure to comply with any of the conditions specified in the scheme or notification, then, such benefit, exemption or relief shall be deemed to have been wrongly allowed.

(ii) In such a case, the Assessing Officer is empowered to re-compute the total income of the assessee for the said previous year and make the necessary amendment. This power is notwithstanding anything contained in the Income-tax Act, 1961.

(iii) The provisions of rectification under section 154, would, accordingly, apply and the four year period within which such rectification should be made has to be reckoned from the end of the previous year in which the failure to comply with such conditions has taken place.

(iv) Every notification under issued under this section shall be laid before each House of Parliament.

2.12 WITHHOLDING TAX PROVISIONS FOR NON-RESIDENTS

(1) Salary payable in foreign currency [Section 192]
By virtue of section 9(1)(ii), salary is deemed to accrue or arise in India, if services are rendered in India. Therefore, if a non-resident renders services in India, the salary income would be

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8 under paragraph 20(i) of the Framework for setting up of wholly owned subsidiaries by foreign banks in India issued by the Reserve Bank of India vide press release number 2013-2014/936 dated 6th day of November, 2013.

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chargeable to tax in India and the person responsible for paying the salary income i.e., the employer, has to deduct withholding tax in accordance with the provisions of Section 192.

Such income-tax has to be calculated at the average rate of income-tax computed on the basis of the rates in force for the relevant financial year in which the payment is made, on the estimated total income of the assessee.

Average rate of income-tax means the rate arrived at by dividing the amount of income-tax calculated on the total income, by such total income.

Section 192(6) deals with the provisions of withholding tax in case of salary payable in foreign currency. In case, where salary is payable in foreign currency, the amount of tax deducted is to be calculated after converting the salary payable into Indian currency at the telegraphic transfer buying rate as adopted by State Bank of India on the last day of the month immediately preceding the month in which the salary is due, or is paid in advance or in arrears [Rule 26 read with Rule 115].

Students may note that the Rule 26 and Rule 115 have been given as Annexure – 2 at the end of this material.

(2) Premature withdrawal from employees provident fund [Section 192A]

(i) Applicability and Rate of TDS: Section 192A provides for deduction of tax @10% on premature taxable withdrawal from employees provident fund scheme. Accordingly, in a case where the accumulated balance due to an employee participating in a recognized provident fund is includible in his total income owing to the provisions of Rule 8 of Part A of the Fourth Schedule not being applicable, the trustees of the Employees Provident Fund Scheme, 1952 or any person authorised under the scheme to make payment of accumulated balance due to employees are required to deduct income-tax @ 10%.

(ii) Time of tax deduction at source: Tax should be deducted at the time of payment of accumulated balance due to the employee.

(iii) Non-applicability of TDS under section 192A: No tax deduction is to be made under this section, if the amount of such payment or aggregate amount of such payment to the payee is less than ₹50,000.

(iv) Deduction at maximum marginal rate in case of non-submission of PAN: Any person entitled to receive any amount on which tax is deductible under this section has to furnish his PAN to the person responsible for deducting such tax. In case he fails to do so, tax would be deductible at the maximum marginal rate.

(3) Winnings from lotteries, crossword puzzles and horse races [Section 194B and 194BB]

(i) Rate of tax on casual income: Any income of a casual and non-recurring nature of the type of winnings from lotteries, crossword puzzles, card game and other game of any
sort, races including horse races, etc. will be charged to income-tax at a flat rate of 30% [Section 115BB].

(ii) **TDS on winning from lotteries, crossword puzzles etc.**: According to the provisions of section 194B, every person responsible for paying to any person, whether resident or non-resident, any income by way of winnings from lottery or crossword puzzle or card game and other game of any sort, is required to deduct income-tax therefrom at the rate of 30% if the amount of payment exceeds ₹10,000.

If payment is to a non-resident, surcharge, wherever applicable, and health and education cess @4% have to be added to the above rate for deduction of tax at source.

(iii) **Cases where winnings are partly in kind and partly in cash**: In a case where the winnings are wholly in kind or partly in cash and partly in kind but the part in cash is not sufficient to meet the liability of deduction of tax in respect of whole of the winnings, the person responsible for paying shall, before releasing the winnings, ensure that tax has been paid in respect of the winnings.

(iv) **Person responsible for deduction of tax under section 194BB**: Section 194BB casts responsibility on the following persons to deduct tax at source -

(a) a bookmaker; or

(b) a person to whom a license has been granted by the Government under any law for the time being in force -
   - for horse racing in any race course; or
   - for arranging for wagering or betting in any race course.

(v) **Threshold limit and rate of TDS under section 194BB**: The obligation to deduct tax at source under section 194BB arises when the above-mentioned persons make payment to any person of any income by way of winnings from any horse race in excess of ₹10,000. The rate applicable for deduction of tax at source is 30%.

Surcharge, wherever applicable, and health and education cess @4% have to be added to the above rate for deduction of tax at source in case of payment to a non-resident.

Tax will have to be deducted at source from winnings from horse races even though the winnings may be paid to the person concerned in instalments of less than ₹10,000. Similarly, in cases where the book-maker or other person responsible for paying the winnings, credits such winnings and debits the losses to the individual account of the punter, tax has to be deducted @30% on winnings before set-off of losses. Thereafter, the net amount, after deduction of tax and losses, has to be paid to the winner.

(vi) **Meaning of the expression “horse race”**: In the context of the provisions of section 194BB, the expression ‘any horse race’ used therein must be taken to include, wherever
the circumstances so necessitate, more than one horse race. Therefore, winnings by way of jack pot would also fall within the scope of section 194BB.

(4) Payments to non-resident sportsmen or sports association [Section 194E]

(i) **Applicability:** This section provides for deduction of tax at source in respect of any income referred to in section 115BBA payable to a non-resident sportsman (including an athlete) or an entertainer who is not a citizen of India or a non-resident sports association or institution.

(ii) **Rate of TDS:** Deduction of tax at source @20% plus surcharge, if applicable, plus health and education cess @4% should be made by the person responsible for making the payment.

(iii) **Time of deduction of tax:** Such tax deduction should be at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by issue of a cheque or draft or by any other mode, whichever is earlier.

(iv) **Income referred to in section 115BBA**

(a) income received or receivable by a non-resident sportsman (including an athlete) by way of-

   (1) participation in any game or sport in India (However, games like crossword puzzles, horse races etc. taxable under section 115BB are not included herein); or

   (2) advertisement; or

   (3) contribution of articles relating to any game or sport in India in newspapers, magazines or journals.

(b) Guarantee amount paid or payable to a non-resident sports association or institution in relation to any game or sport played in India. However, games like crossword puzzles, horse races etc. taxable under section 115BB are not included herein.

(c) income received or receivable by a non-resident entertainer (who is not a citizen of India) from his performance in India.

(5) Commission etc. on the sale of lottery tickets [Section 194G]

(i) **Applicability and Rate of TDS:** Under section 194G, the person responsible for paying to any person, who is or has been stocking, distributing, purchasing or selling lottery tickets, any income by way of commission, remuneration or prize (by whatever name called) on lottery tickets in an amount exceeding ₹ 15,000 shall deduct income-tax thereon at the rate of 5%.
Surcharge, wherever applicable, and health and education cess @4% have to be added to the above rate for deduction of tax at source in case of payment to a non-resident.

(ii) **Time of deduction of tax:** Such deduction should be made at the time of credit of such income to the account of the payee or at the time of payment of such income by cash, cheque, draft or any other mode, whichever is earlier.

Where any such income is credited to any account, whether called “Suspense Account” or by any other name, in the books of account of the person liable to pay such income, such crediting shall be deemed to be credit of such income to the account of the payee and the provisions of this section shall apply accordingly.

### (6) Income by way of interest from Infrastructure Debt Fund [Section 194LB]

(i) **Special rate of tax on interest received by non-residents from notified infrastructure debt funds:** Interest income received by a non-corporate non-resident or a foreign company from notified infrastructure debt funds set up in accordance with the prescribed guidelines would be subject to tax at a concessional rate of 5% under section 115A on the gross amount of such interest income as compared to tax @20% on other interest income of non-resident. The concessional rate of tax is expected to give a fillip to infrastructure and encourage inflow of long-term foreign funds to the infrastructure sector.

(ii) **Rate of TDS:** Accordingly, tax would be deductible @5% plus surcharge, if applicable, plus health and education cess @4% on interest paid/credited by such fund to a non-resident/foreign company.

(iii) **Time of deduction:** The person responsible for making the payment shall, at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by issue of a cheque or draft or by any other mode, whichever is earlier, deduct tax at source.

### (7) Income from units of a business trust to non-resident [Section 194LBA]

(i) **Applicability and rate of tax:** A business trust shall be liable to deduct the tax at source where any distributed income referred to in section 115UA, being in the nature referred to in section 10(23FC)(a) or section 10(23FCA) is payable by the business trust to its unit holder, being non-resident non-corporate and foreign company [Section 194LBA(2) & (3)].

<table>
<thead>
<tr>
<th>Nature of distributed income to its non-resident non-corporate and foreign company unit holders</th>
<th>Rate of tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) Interest income received by business trust from a SPV referred to in section 10(23FC)(a)</td>
<td>5%</td>
</tr>
<tr>
<td>(b) Rental income arising to business trust, being real estate investment trust from real estate referred to in section 10(23FCA)</td>
<td>At the rates in force</td>
</tr>
</tbody>
</table>
Surcharge, wherever applicable, and health and education cess @4% have to be added to the above rates for deduction of tax at source.

(ii) **Time of deduction:** Tax shall be deducted at the time of credit of such payment to the account of the payee or at the time of payment thereof in cash or by the issue of a cheque or draft or any other mode, whichever is earlier.

(iii) **Meaning of Business Trust:** “Business trust” means a trust registered as an Infrastructure Investment Trust (Invit) under SEBI (Infrastructure Investment Trusts) Regulations, 2014 or a Real Estate Investment Trust (REIT) under SEBI (Real Estate Investment Trusts) Regulations, 2014 and the units of which are required to be listed on a recognized stock exchange in accordance with the aforesaid regulations.

<table>
<thead>
<tr>
<th>(8) Income of units of investment fund to non-resident unit holders [Section 194LBB]</th>
</tr>
</thead>
</table>
| (i) **Applicability and rate of tax:** Investment fund to deduct tax at source on any income (other than the proportion of income which is of the same nature as income chargeable under the head “Profits and gains of business or profession” which is taxable at investment fund level) payable by the investment fund to a unit holder at rates in force in case of payable to a non-resident non corporate or non-corporate unit holder. Any such income credited to any account, whether called “suspense account” or by any other name, in the books of account of the person liable to pay such income, such crediting shall be deemed to be the credit of such income to the account of the payee, and the provisions of section 194LBB shall apply accordingly.

(ii) **No TDS if income is not chargeable under the Act:** In case of income payable to a non-resident non corporate or non-corporate unit holder, no deduction is to be made in respect of any income that is not chargeable to tax under the Act.

(iii) **Time of deduction:** Such tax has to be deducted at the time of credit of such income to the account of the payee or at the time of payment, whichever is earlier.

(iv) **Meaning of Investment Fund:** Any fund established or incorporated in India in the form of a trust or a company or a limited liability partnership or a body corporate which has been granted a certificate of registration as a Category I or a Category II Alternative Investment Fund and is regulated under the Securities and Exchange Board of India (Alternative Investment Fund) Regulations, 2012, made under the Securities and Exchange Board of India Act, 1992;

<table>
<thead>
<tr>
<th>(9) Income in respect of investment made in a securitisation trust [Section 194LBC]</th>
</tr>
</thead>
</table>
| (i) **Applicability and rate of tax:** Tax deduction at source under section 194LBC shall be effected by the securitisation at the rates in force trust where income is payable to an investor, being a non-resident non-corporate or a foreign company, in respect of investment in it.
Any such income credited to any account, whether called “suspense account” or by any other name, in the books of account of the person liable to pay such income, such crediting shall be deemed to be the credit of such income to the account of the payee, and the provisions of section 194LBC shall apply accordingly.

(ii) **Time of deduction:** TDS shall be deducted at the time of credit of such payment to the account of the payee or at the time of payment thereof in cash or by the issue of a cheque or draft or any other mode, whichever is earlier.

(iii) **Meaning of certain terms:**

<table>
<thead>
<tr>
<th>Term</th>
<th>Meaning</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) Investor</td>
<td>Means a person who is holder of any securitised debt instrument or securities or security receipt issued by the securitisation trust</td>
</tr>
<tr>
<td>(b) Securities</td>
<td>Means debt securities issued by a Special Purpose Vehicle as referred to in the guidelines on securitisation of standard assets issued by RBI</td>
</tr>
</tbody>
</table>
| (c) Securitisation trust | A trust being a –  
  (i) Special purpose distinct entity as defined in and regulated under SEBI (Public Offer and Listing of Securitised Debt Instruments) Regulations, 2008  
  (ii) Special Purpose vehicle as defined in and regulated by the guidelines on securitization of standard assets issued by the Reserve Bank of India  
  (iii) Trust set-up by a securitization company or a reconstruction company formed for the purpose of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 or any guidelines or directions issued by the RBI for the same. |

(10) **Income by way of interest from an Indian company [Section 194LC]**

(i) **Concessional rate of tax on interest on foreign currency borrowings by an Indian company or business trust:** Interest paid by an Indian company or business trust to a foreign company or a non-corporate non-resident in respect of borrowing made in foreign currency from sources outside India between 1.7.2012 and 30.6.2020 would be subject to tax at a concessional rate of 5% on gross interest (as against the rate of 20% of gross interest applicable in respect of other interest received by a non-corporate non-resident or foreign company from Government or an Indian concern on money borrowed or debt incurred by it in foreign currency).

To avail this concessional rate, the borrowing should be from a source outside India under a loan agreement at any time between 1.7.2012 and 30.6.2020 or by way of issue
of long-term infrastructure bonds during the period between 1.7.2012 and 30.9.2014 or by way of issue of any long-term bond, including long-term infrastructure bonds during the period between 1.10.2014 and 30.6.2020 and approved by the Central Government in this behalf.

The interest to the extent the same does not exceed the interest calculated at the rate approved by the Central Government, taking into consideration the terms of the loan or the bond and its repayment, will be subject to tax at a concessional rate of 5% plus surcharge, wherever applicable, plus health and education cess@4%.

**Note** - Interest payable by an Indian company or a business trust to a non-resident, including a foreign company, in respect of rupee denominated bond issued outside India during the period from 17.9.2018 to 31.3.2019 shall be exempt from tax, and consequently, no tax shall be deducted on the payment of interest in respect of the said bond under section 194LC [Press Release, dated 17-09-2018]

(ii) **Rate of TDS:** Such interest paid by an Indian company or business trust to a non-corporate non-resident or a foreign company would be subject to TDS@5% plus surcharge, wherever applicable, plus health and education cess@4% under section 194LC.

(iii) **Non-applicability of higher rate of TDS under section 206AA for non-furnishing of PAN:** Levy of higher rate of TDS@20% under section 206AA in the absence of PAN would not be attracted in respect of payment of interest on long-term bonds, as referred to in section 194LC, to a non-corporate non-resident or to a foreign company.

(11) **Interest on Government securities or rupee-denominated bonds of an Indian company payable to a Foreign Institutional Investor (FII) or a Qualified Foreign Investor (QFI) [Section 194LD]**

(i) **Applicability and Rate of TDS:** Section 194LD provides that any income by way of interest payable during the period between 1.6.2013 and 30.6.2020 in respect of investment made by an FII or QFI in a rupee denominated bond of an Indian company or a Government security, shall be subject to tax deduction at source at a concessional rate of 5% (as against the rate of 20% of interest applicable in respect of other interest received by a QFI or FII).

The interest to the extent the same does not exceed the interest calculated at the rate notified by the Central Government in this behalf will be subject to tax deduction at a concessional rate of 5% plus surcharge, wherever applicable, plus health and education cess@4%.

(ii) **Time of deduction:** Any person who is responsible for paying to a person being a FII or a QFI, any such interest shall, at the time of credit of such income to the account of the payee or at the time of payment of such income in cash or by the issue of a cheque or draft or by any other mode, whichever is earlier, deduct income-tax thereon@5% plus surcharge, wherever applicable, plus health and education cess@4%.
Meaning of FII and QFI:

<table>
<thead>
<tr>
<th>Term</th>
<th>Meaning</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) FII</td>
<td>Foreign Institutional Investors specified by the Central Government by notification in the Official Gazette.</td>
</tr>
<tr>
<td>(ii) QFI</td>
<td>Qualified Foreign Investors i.e., Foreign Investors, being non-residents, who meet certain KYC requirements under SEBI laws and are hence permitted to invest in equity and debt schemes of Mutual Funds, thereby enabling Indian Mutual Funds to have direct access to foreign investors and widen the class of foreign investors in Indian equity and debt market. QFI does not include FII.</td>
</tr>
</tbody>
</table>

TDS on withdrawal of cash [Section 194N]

(i) **Applicability and rate of TDS:** Section 194N, inserted with effect from 1.9.2019, provides that every person, being

- a banking company to which the Banking Regulation Act, 1949 applies (including any bank or banking institution referred under section 51 of that Act)
- a co-operative society engaged in carrying on the business of banking or
- a post office

who is responsible for paying, in cash, any sum or aggregate of sums exceeding ₹ 1 crore during the previous year to any person from one or more accounts maintained by such recipient-person with it, shall deduct tax at source @2% of sum exceeding ₹ 1 crore.

If payment is to a non-resident, surcharge, wherever applicable, and health and education cess @4% have to be added to the above rate for deduction of tax at source.

(ii) **Time of deduction:** This deduction is to be made at the time of payment of such sum.

(iii) **Non-applicability of TDS under section 194N:** Liability to deduct tax at source under section 194N shall not be applicable to any payment made to –

- the Government
- any banking company or co-operative society engaged in carrying on the business of banking or a post-office
- any business correspondent of a banking company or co-operative society engaged in carrying on the business of banking, in accordance with the RBI guidelines
- any white label ATM operator of a banking company or co-operative society engaged in carrying on the business of banking, in accordance with the
authorisation issued by the RBI under the Payment and Settlement Systems Act, 2007

- such other person or class of persons notified by the Central Government in consultation with the RBI.

### (13) Payment of any other sum to non-resident [Section 195]

#### (i) Applicability:
Any person responsible for paying interest (other than interest referred to in section 194LB or section 194LC or section 194LD) or any other sum chargeable to tax (other than salaries) to a non-corporate non-resident or to a foreign company is liable to deduct tax at source at the rates prescribed by the relevant Finance Act.

**Payee to be a non-resident** - In order to subject an item of income to deduction of tax under this section the payee must be a non-corporate non-resident or a foreign company.

**Payer may be a resident or non-resident** - 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”.

The words “any person” used in section 195(1) is intended to include both residents and non-residents. Therefore, a non-resident person is also required to deduct tax at source before making payment to another non-resident, if the payment represents income of the payee non-resident, chargeable to tax in India. Therefore, if the income of the payee non-resident is chargeable to tax, then tax has to be deducted at source, whether the payment is made by a resident or a non-resident.

**Explanation 2** 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 residence or place of business or business connection in India; or
- any other presence in any manner whatsoever in India.

#### (ii) Time of deduction:
The tax is to be deducted at source at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by the issue of a cheque or draft or by any other mode, whichever is earlier.

Where any interest or other sum as aforesaid is credited to any account, whether called “Interest payable account” or “Suspense account” or by any other name, in the books of account of the person liable to pay such income, such crediting shall be deemed to be credit of such income to the account of the payee.

However, in the case of interest payable by the Government or a public sector bank within the meaning of section 10(23D) or a public financial institution within the meaning of section 10(23D), deduction of tax shall be made only at the time of payment thereof in cash or by the issue of a cheque or draft or by any other mode.
(iii) **Payments subject to tax deduction:** The statutory obligation imposed under this section would apply for the purpose of deduction of tax at source from any sum being income assessable to tax (other than salary income) in the hands of the non-resident/foreign company. However, no deduction shall be made in respect of any dividends declared/distributed/paid by a domestic company, on which dividend distribution tax has been paid under section 115-O.

Payment to a non-resident by way of royalties and payments for technical services rendered in India are common examples of sums chargeable under the provisions of the Act to which the liability for deduction of tax at source would apply.

(iv) **Certificate of non-deduction of tax at source:**

(a) Any person entitled to receive any interest or other sum on which income-tax has to be deducted under section 195(1) may make an application in the prescribed form to the Assessing Officer for grant of certificate authorizing him to receive such interest or other sum without deduction of tax thereunder.

(b) Where any such certificate is granted, every person responsible for paying such interest or other sum to the person to whom certificate is granted make payment of such interest or other sum without deduction of tax at source under section 195(1), so long as the certificate in force.

(c) Such certificate shall remain in force till the expiry of the period specified therein. However, if it is cancelled by the Assessing Officer before the expiry of such period, the certificate shall remain in force till such cancellation.

(d) The CBDT is empowered to make rules specifying the cases in which, and the circumstances under which, an application may be made for the grant of certificate. While doing so, it should take into account the convenience of the assessees and the interests of the revenue.

(e) Such Rules would provide for the conditions subject to which such certificate may be granted and any other matter connected therewith.

(v) **Person responsible for paying any sum to non-resident to furnish prescribed information:** Section 195(6) provides that the person responsible for paying any sum, whether or not chargeable to tax under the provisions of the Act, 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 prescribed manner. Such form and manner is prescribed in Rule 37BB.

*Students may note that the Rule 37BB has been given as Annexure – 3 at the end of this material.*
(vi) Specified class or classes of persons, making payment to the non-resident, to mandatorily make application to Assessing Officer to determine the appropriate proportion of sum chargeable to tax

(a) Under section 195(1), any person responsible for paying to a non-corporate non-resident or to a foreign company, any interest or any other sum chargeable under the provisions of the Act (other than salary), has to deduct tax at source at the rates in force.

(b) Under section 195(2), where the person responsible for paying any such sum chargeable to tax under the Act (other than salary) to a non-resident, considers that the whole of such sum would not be income chargeable in the hands of the recipient, he may make an application in the prescribed form and manner to the Assessing Officer, to determine in the prescribed manner, the appropriate proportion of such sum so chargeable. When the Assessing Officer so determines, the appropriate proportion, tax shall be deducted under section 195(1) only on that proportion of the sum which is so chargeable.

(c) Consequent to the retrospective amendments in section 2(47), section 2(14) and section 9(1) by the Finance Act, 2012, section 195(7) provides that, notwithstanding anything contained in sections 195(1) and 195(2), the CBDT may, by notification in the Official Gazette, specify a class of persons or cases, where the person responsible for paying to a non-corporate non-resident or to a foreign company, any sum, whether or not chargeable under the provisions of this Act, shall make an application in the prescribed form and manner to the Assessing Officer, to determine in the prescribed manner, the appropriate proportion of sum chargeable to tax. Where the Assessing Officer determines the appropriate proportion of the sum chargeable, tax shall be deducted under sub-section (1) on that proportion of the sum which is so chargeable.

(d) Consequently, where the CBDT specifies a class of persons or cases, the person responsible for making payment to a non-corporate non-resident or a foreign company in such cases has to mandatorily make an application in the prescribed form and manner to the Assessing Officer, whether or not such payment is chargeable under the provisions of the Act.

(vii) Procedure for refund of TDS under section 195 to the person deducting tax in cases where tax is deducted at a higher rate prescribed in the DTAA

(a) The CBDT has, through Circular No.7/2011 dated 27.9.2011, modified Circular No.07/2007, dated 23.10.2007 which 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 in the
circumstances indicated therein as the income does not accrue to the non-resident or if the income is accruing, no tax is due or tax is due at a lesser rate. The amount paid to the Government in such cases to that extent does not constitute tax.

(b) The said Circular, however, did not cover a situation where tax is deducted at a rate prescribed in the relevant DTAA which is higher than the rate prescribed in the Income-tax Act, 1961. Since the law requires deduction of tax at a rate prescribed in the relevant DTAA or under the Income-tax Act, 1961, whichever is lower, there is a possibility that in such cases excess tax is deducted relying on the provisions of relevant DTAA.

(c) Accordingly, in order to remove the genuine hardship faced by the resident deductor, the CBDT has modified Circular No. 07/2007, dated 23-10-2007 to the effect that the beneficial provisions under the said Circular allowing refund of tax deducted at source under section 195 to the person deducting tax at source shall also apply to those cases where deduction of tax at a higher rate under the relevant DTAA has been made while a lower rate is prescribed under the domestic law.

(14) **Income payable net of tax [Section 195A]**

(i) Where, under an agreement or other arrangement, the tax chargeable on any income referred to in the foregoing provisions of this Chapter is to be borne by the person by whom the income is payable, then, for the purposes of deduction of tax under those provisions such income shall be increased to such amount as would, after deduction of tax thereon, be equal to the net amount payable under such agreement or arrangement.

(ii) However, no grossing up is required in the case of tax paid [under section 192(1A)] by an employer on the non-monetary perquisites provided to the employee.

(15) **Income from units [Section 196B]**

The person responsible for making the following payment to an Offshore Fund shall deduct tax @ 10% plus surcharge, wherever applicable, plus health and education cess@4% at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by the issue of a cheque or draft or by any other mode, whichever is earlier.

- income in respect of units referred to in section 115AB or

- income by way of long-term capital gains arising from the transfer of such units

(16) **Income from foreign currency bonds or shares of Indian company [Section 196C]**

The person responsible for making the following payment to a non-resident has to deduct tax @ 10% plus surcharge, wherever applicable, plus health and education cess@4% at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by the issue of a cheque or draft or by any other mode, whichever is earlier.
- income by way of interest or dividends in respect of bonds or Global Depository Receipts referred to in section 115AC or
- income by way of long-term capital gains arising from the transfer of such bonds or Global Depository Receipts.

However, no deduction shall be made in respect of any dividends referred to in section 115-O.

### (17) Income of foreign institutional investors from securities [Section 196D]

(i) The person responsible for making the payment in respect of securities referred to in section 115AD(1)(a) to a Foreign Institutional Investor has to deduct tax @20% plus surcharge, wherever applicable, plus health and education cess@4% at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by the issue of a cheque or draft or by any other mode, whichever is earlier.

(ii) However, no deduction shall be made in respect of the following
- any dividends referred to in section 115-O
- income, by way of capital gains arising from the transfer of securities referred to in section 115AD, payable to a Foreign Institutional Investor.

### (18) Certificate for deduction of tax at a lower rate [Section 197]

(i) This section applies where, in the case of any income of any person or sum payable to any person, income-tax is required to be deducted at the time of credit or payment, as the case may be at the rates in force as per the provisions of sections 192, 194G, 194LBB, 194LBC and 195.

(ii) In such cases, the assessee can make an application to the Assessing Officer for deduction of tax at a lower rate or for non-deduction of tax.

(iii) If the Assessing Officer is satisfied that the total income of the recipient justifies the deduction of income-tax at lower rates or no deduction of income-tax, as the case may be, he may give to the assessee such certificate, as may be appropriate.

(iv) Where the Assessing Officer issues such a certificate, then the person responsible for paying the income shall deduct income-tax at such lower rates specified in the certificate or deduct no tax, as the case may be, until such certificate is cancelled by the Assessing Officer.

(v) Enabling powers have been conferred upon the CBDT to make rules for prescribing the procedure in this regard.

### (19) Tax deducted is income received [Section 198]

(i) All sums deducted in accordance with the foregoing provisions shall, for the purpose of computing the income of an assessee, be deemed to be income received.
(ii) However, the following tax paid or deducted would not be deemed to be income received by the assessee for the purpose of computing the total income—

(a) the tax paid by an employer under section 192(1A) on non-monetary perquisites provided to the employees

(b) sum deducted under section 194N

(20) Credit for tax deducted at source [Section 199]

(i) Tax deducted at source in accordance with the above provisions and paid to the credit of the Central Government shall be treated as payment of tax on behalf of the-

(a) person from whose income the deduction was made; or

(b) owner of the security; or

(c) depositor; or

(d) owner of property; or

(e) unit-holder; or

(f) shareholder.

(ii) Any sum referred to in section 192(1A) and paid to the Central Government, shall be treated as the tax paid on behalf of the person in respect of whose income, such payment of tax has been made.

(iii) The CBDT is empowered to frame rules for the purpose of giving credit in respect of tax deducted or tax paid under Chapter XVII. The CBDT also has the power to make rules for giving credit to a person other than the persons mentioned in (i) and (ii) above. Further, the CBDT can specify the assessment year for which such credit may be given.

(iv) Rule 37BA – Credit for tax deducted at source for the purposes of section 199

Rule 37BA(1) provides that credit for tax deducted at source and paid to the Central Government shall be given to the person to whom the payment has been made or credit has been given (i.e., the deductee) on the basis of information relating to deduction of tax furnished by the deductor to the income-tax authority or the person authorized by such authority.

Rule 37BA(2)(i) provides that where under any provisions of the Act, the whole or any part of the income on which tax has been deducted at source is assessable in the hands of a person other than the deductee, credit for the whole or any part of the tax deducted at source, as the case may be, shall be given to the other person and not to the deductee.

However, the deductee should file a declaration with the deductor and the deductor should report the tax deduction in the name of the other person in the information relating to deduction of tax referred to in Rule 37BA(1).
(i) With a view to strengthening the PAN mechanism, section 206AA provides that any person whose receipts are subject to deduction of tax at source i.e. the deductee, shall mandatorily furnish his PAN to the deductor failing which the deductor shall deduct tax at source at higher of the following rates –
   (a) the rate prescribed in the Act;
   (b) at the rate in force i.e., the rate mentioned in the Finance Act; or
   (c) at the rate of 20%.

(ii) No certificate under section 197 will be granted by the Assessing Officer unless the application contains the PAN of the applicant.

(iii) If the PAN provided to the deductor is invalid or it does not belong to the deductee, it shall be deemed that the deductee has not furnished his PAN to the deductor. Accordingly, tax would be deductible at the rate specified in (i) above.

(iv) The provisions of section 206AA shall not apply in respect of payment of interest on long-term bonds, as referred to in section 194LC, to a non-corporate non-resident or to a foreign company.

(v) **Non-applicability of section 206AA to non-residents subject to fulfilment of certain conditions:** For the purpose of reducing the compliance burden, section 206AA provides for non-applicability of the requirements contained in section 206AA to a non-corporate non-resident or a foreign company not having PAN in respect of payment in the nature of interest, royalty, fees for technical services and payments on transfer of any capital asset, subject to the deductee furnishing the following details and documents to the deductor, namely:-
   a. name, e-mail id, contact number;
   b. address in the country or specified territory outside India of which the deductee is a resident;
   c. a certificate of his being resident in any country or specified territory outside India from the Government of that country or specified territory if the law of that country or specified territory provides for issuance of such certificate;
   d. Tax Identification Number of the deductee in the country or specified territory of his residence and in case no such number is available, then a unique number on the basis of which the deductee is identified by the Government of that country or the specified territory of which he claims to be a resident *[Notification No. 53/2016 dated 24th June, 2016]*.

(vi) Both the deductor and the deductee have to compulsorily quote the PAN of the deductee in all correspondence, bills, vouchers and other documents exchanged between them.
## Withholding tax provisions for Non-resident: A Summary

<table>
<thead>
<tr>
<th>Section</th>
<th>Nature of payment</th>
<th>Rate of TDS</th>
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</thead>
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<tr>
<td>192</td>
<td>Salary</td>
<td>Normal Slab rates</td>
</tr>
<tr>
<td>192A</td>
<td>Premature withdrawal from EPF, aggregating to ₹ 50,000 or more</td>
<td>10%</td>
</tr>
<tr>
<td>194B</td>
<td>Income by way of winnings from lotteries, crossword puzzles, card games and other games of any sort, where payment to a person &gt; ₹ 10,000</td>
<td>30%</td>
</tr>
<tr>
<td>194BB</td>
<td>Income by way of winnings from horse races, where payment to a person &gt; ₹ 10,000</td>
<td>30%</td>
</tr>
<tr>
<td>194E</td>
<td>Specified payments referred under section 115BBA to non-resident sportsmen/sports association or an entertainer</td>
<td>20%</td>
</tr>
<tr>
<td>194G</td>
<td>Commission etc. on the sale of lottery tickets, where payment to a person &gt; ₹ 15,000</td>
<td>5%</td>
</tr>
<tr>
<td>194LB</td>
<td>Payment of interest on infrastructure debt fund</td>
<td>5%</td>
</tr>
<tr>
<td>194LBA(2)</td>
<td>Distribution any interest income, received or receivable by a business trust from a SPV, to its unit holders.</td>
<td>5%</td>
</tr>
<tr>
<td>194LBA(3)</td>
<td>Distribution of any income received from renting or leasing or letting out any real estate asset directly owned by the business trust, to its unit holders.</td>
<td>At the rates in force</td>
</tr>
<tr>
<td>194LBB</td>
<td>Investment fund paying income to a unit holder [other than income which is exempt under section 10(23FBB)].</td>
<td></td>
</tr>
<tr>
<td>194LBC(2)</td>
<td>Income in respect of investment made in a securitisation trust (specified in Explanation to section 115TCA)</td>
<td></td>
</tr>
<tr>
<td>194LC</td>
<td>Payment of interest by an Indian Company or a business trust to a non-corporate non-resident or foreign company - in respect of money borrowed in foreign currency from a source outside India - under a loan agreement between 1.7.2012 and 30.6.2020 or - by way of issue of long term bonds (including long term infrastructure bond) between 1.10.2004 and 30.6.2020 as approved by Central Government or - in respect of money borrowed from source outside India by way of rupee denominated bond before 1.7.2020</td>
<td>5%</td>
</tr>
<tr>
<td></td>
<td>Interest payable by an Indian company or a business trust to a non-resident, including a foreign company, in respect of rupee denominated bond issued outside India during the Nil (Since such interest is exempt)</td>
<td></td>
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</tbody>
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<table>
<thead>
<tr>
<th>Section</th>
<th>Description</th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>194LD</td>
<td>Payment of interest between 1.6.2013 and 30.6.2020 on rupee denominated bond of an Indian Company or Government securities to a Foreign Institutional Investor or a Qualified Foreign Investor</td>
<td>5%</td>
</tr>
<tr>
<td>194N</td>
<td>On withdrawal of cash in excess of ₹ 1 crore</td>
<td>2%</td>
</tr>
<tr>
<td>195</td>
<td>Payment of any other sum to a non-resident</td>
<td>At the rates in force</td>
</tr>
<tr>
<td>196B</td>
<td>Income from units of a mutual fund or UTI purchased in foreign currency (including long term capital gain on transfer of such units) payable to an Offshore Fund</td>
<td>10%</td>
</tr>
<tr>
<td>196C</td>
<td>Income by way of interest on bonds of an Indian company or public sector company sold by the Government and purchased by a non-resident in foreign currency or GDRs referred to in section 115AC (including long term capital gain on transfer of such bonds or GDRs payable to a non-resident)</td>
<td>10%</td>
</tr>
<tr>
<td>196D</td>
<td>Income of foreign Institutional Investors from securities (not being income by way of interest referred to in section 194LD, dividend referred under section 115-O or capital gain arising from such securities)</td>
<td>20%</td>
</tr>
</tbody>
</table>

**Note:** In all the above cases, the rate of tax would be increased by surcharge, wherever applicable, and health and education cess @4%.

### 2.13 MISCELLANEOUS PROVISIONS

#### (1) Furnishing of Return of Income [Section 139(1)]

Filing an income-tax return in India is mandatory for non-residents except in the cases specified in “Chapter XII: Determination of tax in certain special cases” of the Income-tax Act, 1961 [Refer to para 2.9].

Section 139(1) of the Income-tax Act, 1961 requires every person,—

(a) being a company or a firm; or
(b) being a person other than a company or a firm, if his total income or the total income of any other person in respect of which he is assessable under this Act during the previous year exceeded the basic exemption limit,

to furnish a return of his income or the income of such other person during the previous year, in the prescribed form and verified in the prescribed manner and setting forth such other particulars as may be prescribed on or before the due date specified thereunder.

'Due date' means -

<table>
<thead>
<tr>
<th>Assessee</th>
<th>Due Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) Where the assessee, other than an assessee referred to in clause (ii), is -</td>
<td></td>
</tr>
<tr>
<td>(a) a company,</td>
<td>30th September of the assessment year</td>
</tr>
<tr>
<td>(b) a person (other than a company) whose accounts are required to be audited under the Income-tax Act, 1961 or any other law in force; or</td>
<td></td>
</tr>
<tr>
<td>(c) a working partner of a firm whose accounts are required to be audited under the Income-tax Act, 1961 or any other law for the time being in force.</td>
<td></td>
</tr>
<tr>
<td>(ii) in the case of an assessee who is required to furnish a report referred to in section 92E.</td>
<td>30th November of the assessment year</td>
</tr>
<tr>
<td>(iii) in the case of any other assessee.</td>
<td>31st July of the assessment year</td>
</tr>
</tbody>
</table>

Section 139(1C) empowers the Central Government to exempt any class or classes of persons from the requirement of furnishing a return of income subject to such conditions as may be specified therein.

Accordingly, the Central Government has, vide Notification No. S.O.2672(E) dated 26.7.2019, specified the class of persons who are exempts from the requirement of furnishing a return of income under section 139(1) from A.Y.2019-20 onwards.

(i) **Notified classes of person:** Non-corporate non-residents and foreign companies, having any income chargeable under the Income-tax Act, 1961 during a previous year from any investment fund sent up in an International Financial Services Centre (IFSC) located in India,

(ii) **Conditions:** The above mentioned class of persons are exempted from the requirement of furnishing a return of income under section 139(1), if

- any income-tax due on income of the abovementioned class of persons has been deducted at source and remitted to the Central Government by the investment fund at the tax rate in force as per section 194LBB and
- there is no other income during the previous year for which the above mentioned class of persons, is otherwise liable to file the return of income.

However, the exemption from the requirement of furnishing a return of income would not be available to the abovementioned class of persons where a notice under section 142(1)/148/153A or 153C has been issued for filing return of income for the assessment year specified therein

(iii) **Meaning of “investment fund”:** Investment fund means any fund established or incorporated in India in the form of a trust or a company or a limited liability partnership or a body corporate which has been granted a certificate of registration as a Category I or Category II Alternative Investment Fund (AIF) and is regulated under the SEBI (AIF) Regulations, 2012 made under the SEBI Act, 1992.

### (2) Who may be regarded as Representative Assessee? [Section 160]

As per section 160(1)(i), in respect of the income deemed to accrue or arise in India to a non-resident under section 9(1), the agent of the non-resident including a person who is treated as an agent under section 163 would be treated as a representative assessee.

### (3) Who may be regarded as agent? [Section 163]

An agent is considered a representative assessee but only if he is the agent of non-resident person. According to section 163, an agent, in relation to a non-resident person, includes any person in India:

(i) who is employed by or on behalf of the non-resident;

(ii) who is having any business connection with the non-resident;

(iii) from or through whom the non-resident is in receipt of any income, whether directly or indirectly;

(iv) who is trustee of the non-resident.

An agent also includes any other person who (whether resident or non-resident) has acquired a capital asset in India by means of a transfer.

**A Broker: Can he be treated as an agent?**

Where transactions are carried on in the ordinary course of business through a broker in India and the broker does not deal directly with or on behalf of a non-resident principal but deals with or through a non-resident broker, the broker in India cannot be treated as an agent in respect of the income arising to the non-resident from such transactions. Further, the non-resident broker should also carry on such transactions in the ordinary course of his business as a principal. Accordingly, where *bona fide* hedging transactions take place through a broker in India and a foreign broker acting for an undisclosed principal, the Indian broker cannot be deemed to be agent of the foreign

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principal. Thus, generally a broker is not deemed to be the agent of a non-resident person so long as he functions exclusively in his capacity as a broker.

**Opportunity of being heard to be given before treating a person as an agent of a non-resident**

Before a person can be treated as an agent of a non-resident he must be given a reasonable opportunity of being heard by the Assessing Officer as to his liability to be so treated.

**4 Liability of Representative Assessee [Section 161]**

Every representative assessee has the same responsibilities, duties and liabilities as if the income were being received by or accruing to or in favour of him beneficially. He is liable to be assessed in his own name in respect of such income but the assessment is deemed to have been made upon him in his representative capacity. The tax is levied on and is recovered from such an assessee, in like manner and to the same extent as it would have been levied upon and recovered from the person represented by him.

If certain income is assessed in the hands of any person in the capacity of representative assessee, the same income shall not be assessed in his hands under any other provision of the Act.

**5 Rights of representative assessee to recover tax paid [Section 162]**

Every representative assessee who pays any amount under the Act, is entitled to recover the sum so paid from the person on whose behalf he had paid it or to adjust it against any moneys in his possession, but belonging to the other persons. The representative assessee has the right to retain out of the moneys in his representative capacity, an amount equal to any sum paid by him under the Act in addition to the right to recover the same from the beneficial owner of the income.

Any representative assessee or any person who apprehends that he may be assessed in respect of any other person (principal) as a representative assessee, has the right to retain out of the money payable by him to such other person, amount to the extent of his estimated liability.

In case of disagreement between the principal and representative assessee, such representative assessee, may secure from the Assessing Officer a certificate stating the amount to be so retained pending final settlement of the liability. The certificate so obtained shall be treated as warrant authorising retention of the amount.

The amount recoverable from such representative assessee at the time of final settlement should not exceed the amount specified in such certificate. However, where a representative assessee holds, in his hands, any additional assets of the principal at the time of final settlement, then the Assessing Officer may initiate the recovery of the balance tax liability of the principal from such representative to the extent of assets held by him.
(6) Direct assessment or recovery not barred [Section 166]

Direct assessment of the person on whose behalf or for whose benefit income is receivable, or the recovery from such person of the tax payable in respect of such income is not barred by any provision in Chapter XV of the Income-tax Act, 1961.

(7) Remedies against property in cases of representative assesseees [Section 167]

The Assessing Officer has the same remedies against all property of any kind vested in or under the control or management of any representative assessee as he would have against the property of any person liable to pay any tax, and in as full and ample a manner, irrespective of whether the demand is raised against the representative assessee or directly against the beneficiary.

(8) Recovery of tax in respect of non-resident from his assets [Section 173]

In a case where the person entitled to the income arising from any business connection in India or from any property in India or through or from any asset or source of income in India or through the transfer of a capital asset situated in India is a non-resident, the tax chargeable thereon, whether in his name or in the name of his agent who is liable as a representative assessee, may be recovered by deduction under any of the provisions of Chapter XVII-B. Further, any arrears of tax may be recovered also in accordance with the provisions of this Act from any assets of the non-resident which are, or may at any time come, within India. These provisions are without prejudice to the provisions of section 161(1) or of section 167.

(9) Recovery against the assessee’s property in foreign countries [Section 228A]

Where an assessee is in default or is deemed to be in default in making a payment of tax, the Tax Recovery Officer may, if the assessee is a resident of a country (being a country with which the Central Government has entered into an agreement for the recovery of income tax under this Act and the corresponding law in force in that country) or has any property in that country, forward to the CBDT a certificate drawn up by him under section 222. Thereafter, the CBDT may take such action thereon as it may deem appropriate having regard to the terms of the agreement with such country.

Similarly, the Government of the other country or any authority under that Government may send to the CBDT a certificate of recovery of any tax due under such corresponding law from a person having property in India and the CBDT may forward such certificate to Tax Recovery Officer having jurisdiction over the resident or within whose jurisdiction such property is situated, for recovery of such tax. Tax Recovery Officer can proceed to recover the amount specified in the Certificate by –

(a) attachment and sale of assessee’s movable or immovable property
(b) arrest of the assessee and his detention in prison.
(c) appointing a receiver for the management of assessee’s movable and immovable property.

He shall thereafter remit the sum so recovered to the CBDT.
(10) Submission of statement by a non-resident having liaison office [Section 285]

(i) A non-resident can operate in India through a branch or a liaison office set up after getting the approval of the Reserve Bank of India. Since the branch constitutes a permanent establishment of the non-resident, it has to file its return of income. However, prior to 1.6.2011, there was no such requirement as regards a liaison office since no business activity is allowed to be carried out in India via a liaison office of a non-resident.

(ii) With effect from 1.6.2011, such a non-resident is required to file a statement in the prescribed form [Form No.49C] to the Assessing Officer having jurisdiction, within 60 days from the end of the financial year, providing the details in respect of activities carried out by the liaison office in India during the financial year.

(iii) This requirement has to be complied with by every person, being a non-resident having a liaison office in India set up in accordance with the guidelines issued by the RBI under the Foreign Exchange Management Act, 1999.

(iv) The statement of a particular financial year should be filed on or before 30th May, of the succeeding financial year in electronic form along with digital signature. For example, the statement for F.Y. 2019-20 should be filed on or before 30th May, 2020. Further, the statement is to be verified by a Chartered Accountant or by the Authorized Signatory i.e., the person authorized by the non-resident in this behalf.

(11) Furnishing of information or documents by an Indian Concern [Section 285A]

(i) There shall be a reporting obligation on the Indian concern through or in which the Indian assets are held by a foreign company or entity.

(ii) For the purposes of determination of any income accruing or arising in India under section 9(1)(i), an Indian concern has to furnish, within the prescribed period to the prescribed income-tax authority, the information or documents, in prescribed manner, if -

- any share of, or interest in, a company or an entity registered or incorporated outside India derives, directly or indirectly, its value substantially from the assets located in India, as referred to in Explanation 5 to section 9(1)(i), and

- such company or, entity, holds, directly or indirectly, such assets in India through, or in, the Indian concern.

(iii) The information has to be furnished in Form No.49D electronically within a period of 90 days from the end of the financial year in which the transfer of such share or interest referred to above takes place.

(iv) If any Indian concern fails to furnish the information or documents, the income-tax authority, as may be prescribed under the said section, may direct that such Indian concern shall pay, by way of penalty under section 271GA,—
(a) @2% of the value of the transaction in respect of which such failure has taken place, if such transaction had the effect of directly or indirectly transferring the right of management or control in relation to the Indian concern;

(b) ₹ 5,00,000 in any other case.

**Rule 114DB**, prescribing the time limit and information or documents to be furnished under section 285A, has been given as Annexure – 4 at the end of this material.

**Note** – In this Chapter, the provisions of income-tax law which specifically relate to non-residents have been dealt with in detail. Further, certain significant general provisions of income-tax law, which are also applicable to non-residents in the same or modified form are discussed in some length. In addition to these provisions, there may be other general provisions of income-tax law, which are also applicable to non-residents. For a detailed discussion of these provisions, students are advised to refer to the Study Material of Paper 7: Direct Tax Laws and International Taxation, wherein the entire income-tax law is discussed in detail. Students are expected to be aware of such provisions and apply the same while solving problems and addressing issues related to non-residents in this Elective Paper.
After studying this chapter, you would be able to -

- **appreciate** the need for double taxation relief;
- **identify** the types of double taxation relief available;
- **Integrate, analyse and apply** the provisions relating to double taxation relief contained in the Income-tax Act, 1961 and Income-tax Rules, 1962 in problem solving and addressing related issues;
- **appreciate** the procedure for claiming deduction where there is no double taxation avoidance agreement between India and the other country where the income has been taxed and **compute** the amount of deduction;
- **appreciate** the concept of Permanent Establishment under double taxation avoidance agreements and its relevance.
3.1 CONCEPT OF DOUBLE TAXATION RELIEF

In the present era of cross-border transactions across the globe, the effect of taxation is one of the important considerations for any trade and investment decision in other countries. One of the most significant results of globalisation is the visible impact of one country’s domestic tax policies on the economy of another country. This has led to the need for continuously assessing the tax regimes of various countries and bringing about necessary reforms.

Where a taxpayer is resident in one country but has a source of income situated in another country it gives rise to possible double taxation. This arises from the two basic rules that enables the country of residence as well as the country where the source of income exists to impose tax namely, (i) the source rule and (ii) the residence rule. The source rule holds that income is to be taxed in the country in which it originates irrespective of whether the income accrues to a resident or a non-resident whereas the residence rule stipulates that the power to tax should rest with the country in which the taxpayer resides. If both rules apply simultaneously to a business entity and it were to suffer tax at both ends, the cost of operating on an international scale would become prohibitive and would deter the process of globalisation. It is from this point of view that Double Taxation Avoidance Agreements (DTAA) become very significant.

DTAAs lay down the rules for taxation of the income by the source country and the residence country. Such rules are laid for various categories of income, for example, interest, dividend, royalties, capital gains, business income etc. Each such category is dealt with by separate article in the DTAA.

Double taxation means taxing the same income twice in the hands of an assessee. A particular income may be taxed in India in the hands of a person based on his/its residence. However, the same income may be taxed in his/its hands in the Source Country also, as per the domestic laws of that country. This gives rise to double taxation. It is a universally accepted principle that the same income should not be subjected to tax twice. In order to take care of such situations, the Income-tax Act, 1961 has provided for double taxation relief.

3.2 TYPES OF RELIEF

Relief from double taxation can be provided in mainly two ways:

(1) **Bilateral Relief**: Under this method, the Governments of two countries can enter into an agreement to provide relief against double taxation by mutually working out the basis on which the relief is to be granted. India has entered into agreements for relief against or
Double taxation relief can be obtained in more than 100 countries including Sri Lanka, Switzerland, Sweden, Denmark, Japan, Federal Republic of Germany, Greece, etc.

Bilateral Relief may be granted in the following ways:

- **Exemption Method**
  - A particular income is taxed in only one of the two countries.

- **Tax Credit Method**
  - Income is taxable in both countries in accordance with their respective tax laws read with double taxation avoidance agreement.
  - The country of resident of the tax payer, however, allows him credit for the tax charged thereon in the country of source.

In India, double taxation relief is provided by a combination of the two methods.

2. **Unilateral Relief**: This method provides for relief of some kind by the home country even where no mutual agreement has been entered into by the two countries.

### 3.3 DOUBLE TAXATION RELIEF PROVISIONS UNDER THE INCOME TAX ACT, 1961

Sections 90 and 91 of the Income-tax Act, 1961 provide for double taxation relief in India.

1. **Agreement with foreign countries or specified territories - Bilateral relief [Section 90]**
   - Section 90(1) provides that the Central Government may enter into an agreement with the Government of any country outside India or specified territory outside India,—
     - (a) for the granting of relief in respect of—
       - (i) income on which income-tax has been paid both in India and in that country or specified territory; or
       - (ii) income-tax chargeable under this Act and under the corresponding law in force in that country or specified territory to promote mutual economic relations, trade and investment; or
(b) for the avoidance of double taxation of income under this Act and under the corresponding law in force in that country or specified territory; or

Accordingly, the Central Government has notified that where such an agreement provides that any income of a resident of India may be taxed in the other country then, such income shall be included in his total income chargeable to tax in India in accordance with the provisions of the Income-tax Act, 1961, and relief shall be granted in accordance with the method for elimination or avoidance of double taxation provided in such agreement [Notification No. 91/2008, dated 28.8.2008].

(c) for exchange of information for the prevention of evasion or avoidance of income-tax chargeable under this Act or under the corresponding law in force in that country or specified territory or investigation of cases of such evasion or avoidance; or

(d) for recovery of income-tax under this Act and under the corresponding law in force in that country or specified territory.

The Central Government may, by notification in the Official Gazette, make such provisions as may be necessary for implementing the agreement.

(ii) Where the Central Government has entered into such an agreement with the Government of any country outside India or specified territory outside India 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 this Act shall apply to the extent they are more beneficial to that assessee.

(iii) However, the provisions of Chapter X-A, General Anti-Avoidance Rule, shall apply to the assessee even if such provisions are not beneficial to him.

(iv) **Meaning of terms used in any DTAA with a foreign country or specified territory**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Meaning of the term</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) Term used in any DTAA with a foreign country or specified territory, and not defined in the agreement or the Act but assigned a meaning in the notification issued by the Central Government in the Official Gazette, which is still in force.</td>
<td>The term shall have the meaning assigned in the said notification and the meaning shall be deemed to have effect from the date on which the DTAA came into force.</td>
</tr>
<tr>
<td>(2) Term used in any DTAA with a foreign country or specified territory, which is defined in the DTAA itself.</td>
<td>The term shall have the same meaning assigned to it in the DTAA.</td>
</tr>
<tr>
<td>(3) Term used in any DTAA with a foreign country or specified territory, which is not defined in the said DTAA, but defined in the Income-tax Act, 1961.</td>
<td>The term shall have the meaning assigned to it in the Income-tax Act, 1961 and explanation, if any, given to it by the Central Government.</td>
</tr>
</tbody>
</table>
(v) The DTAAs under section 90 are intended to provide relief to the taxpayer, who is resident of one of the contracting country to the agreement. Such taxpayer can claim relief by applying the beneficial provisions of either the treaty or the domestic law. However, in many cases, taxpayers who were not residents of a contracting country also resorted to claiming the benefits under the agreement entered into by the Indian Government with the Government of the other country. In effect, third party residents claimed the unintended treaty benefits.

Therefore, section 90(4) provides that the non-resident to whom the agreement referred to in section 90(1) applies, shall be allowed to claim the relief under such agreement if a Tax Residence Certificate (TRC) obtained by him from the Government of that country or specified territory, is furnished declaring his residence of the country outside India or the specified territory outside India, as the case may be.

(vi) Therefore, a certificate issued by the Government of a foreign country would constitute proof of tax residency, without any further conditions regarding furnishing of “prescribed particulars” therein. In addition to such certificate issued by the foreign Government, the assessee would be required to provide such other documents and information, as may be prescribed, for claiming the treaty benefits.

(vii) The charge of tax in respect of a foreign company at a rate higher than the rate at which a domestic company is chargeable, shall not be regarded as less favourable charge or levy of tax in respect of such foreign company.

(viii) Circular No. 333 dated 2.4.1982, issued by CBDT provides that a specific provision of the DTAA will prevail over the general provisions of the Income-tax Act, 1961. Therefore, where a DTAA provides for a particular mode of computation of income, this mode will take precedence over the Income-tax Act, 1961. However, where there is no specific provision in the treaty, then the Income-tax Act will apply.

(ix) Notification No. 91/2008 dated 28.8.2008 issued by CBDT states that any income of a resident of India which "may be taxed" in the other country (Source Country) as per the DTAA shall be included in his total income chargeable to tax in India in accordance with the provisions of the Income-tax Act, 1961. Thereafter, relief shall be granted in accordance with the method for elimination or avoidance of double taxation provided in such agreement.

Tax treaties are generally based on certain models. The most common ones are:

Model Tax Conventions

- OECD Model Tax Convention
- U.N. Model Tax Convention

These model tax conventions will be discussed in detail in Chapter 9 “Overview of Model Tax Conventions”.
ILLUSTRATION 1

Examine the correctness or otherwise of the following statement with reference to the provisions of Income-tax Act, 1961.

The double taxation avoidance treaties entered into by the Government of India override the domestic law.

SOLUTION

The statement is correct.

Section 90(2) provides that where a double taxation avoidance treaty is entered into by the Government, the provisions of the Income-tax Act, 1961 would apply to the extent they are more beneficial to the assessee.

In case of any conflict between the provisions of the double taxation avoidance agreement and the Income-tax Act, 1961, the provisions of the DTAA would prevail over the Act in view of the provisions of section 90(2), to the extent they are more beneficial to the assessee [CIT v. P.V.A.L. Kulandagan Chettiar (2004) 267 ITR 654 (SC)].

ILLUSTRATION 2

Cosmos Limited, a company incorporated in Mauritius, has a branch office in Hyderabad opened in April, 2019. The Indian branch has filed return of income for assessment year 2020-21 disclosing income of ₹50 lacs. It paid tax at the rate applicable to domestic company i.e. 30% plus higher education cess @4% on the basis of paragraph 2 of Article 24 (Non-Discrimination) of the Double Taxation Avoidance Agreement between India and Mauritius, which reads as follows:

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

However, the Assessing Officer computed tax on the Indian branch at the rate applicable to a foreign company i.e. 40% plus higher education cess @4%.

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

SOLUTION

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

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

ILLUSTRATION 3

Arif is a resident of both India and another foreign country in the previous year 2019-20. He owns immovable properties (including residential house) in both the countries. He earned income of ₹50 lacs from rubber estates in the foreign country during the financial year 2019-20. He also sold some house property situated in foreign country resulting in short-term capital gain of ₹10 lacs during the year. Arif has no permanent establishment of business in India. However, he has derived rental income of ₹6 lacs from property let out in India and he has a house in Lucknow where he stays during his visit to India.

Article 4 of the Double Taxation Avoidance Agreement between India and the foreign country where Arif is a resident, provides that “where an individual is a resident of both the Contracting States, then, he shall be deemed to be resident of the Contracting State in which he has permanent home available to him. If he has permanent home in both the Contracting States, he shall be deemed to be a resident of the Contracting State with which his personal and economic relations are closer (centre of vital interests)”.

You are required to examine with reasons whether the business income of Arif arising in foreign country and the capital gains in respect of sale of the property situated in foreign country can be taxed in India.

SOLUTION

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

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

Arif owns rubber estates in a foreign country from which he derives business income. However, Arif has no permanent establishment of his business in India. Therefore his personal and economic relations with foreign country are closer, since foreign country is the place where –

(a) the property is located and
(b) the permanent establishment (PE) has been set-up

Therefore, he shall be deemed to be resident of the foreign country for A.Y. 2020-21.

The fact of the case and issues arising therefrom 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 would become irrelevant, since the DTAA prevails over sections 4 and 5.

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

Therefore, in this case, Arif is not liable to income tax in India for assessment year 2020-21 in respect of business income and capital gains arising in the foreign country provided he furnishes the Tax Residency Certificate and provides such other documents and information as may be prescribed.

(2) Double taxation relief to be extended to agreements between specified associations adopted by the Central Government [Section 90A]

(i) Section 90A provides that any specified association in India may enter into an agreement with any specified association in the specified territory outside India and the Central Government may, by notification in the Official Gazette, make the necessary provisions for adopting and implementing such agreement for -

(a) grant of double taxation relief,
(b) avoidance of double taxation of income,
(c) exchange of information for the prevention of evasion or avoidance of income-tax, or
(d) recovery of income-tax.

Section 90A(1) provides that an agreement may be entered into by any specified association in India with any specified association in the specified territory outside India which may be adopted by the Central Government by way of notification in the Official Gazette, for granting
relief of tax or, as the case may be, for avoidance of double taxation.

The Central Government has, vide Notification No.90/2008 dated 28.8.2008, notified that where such an agreement provides that any income of a resident of India may be taxed in the other country then, such income shall be included in his total income chargeable to tax in India in accordance with the provisions of the Income-tax Act, 1961, and relief shall be granted in accordance with the method for elimination or avoidance of double taxation provided in such agreement.

(ii) In relation to any assessee to whom the said agreement applies, the provisions of the Income-tax Act, 1961 shall apply to the extent they are more beneficial to that assessee.

(iii) However, the provisions of Chapter X-A, General Anti-avoidance rule, shall apply to the assessee even if such provisions are not beneficial to him.

(iv) **Meaning of terms used in any agreement which any specified association in India may enter into with any specified association in the specified territory outside India for double taxation relief**

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<td>The term shall have the meaning assigned in the said notification and the meaning shall be deemed to have effect from the date on which the agreement came into force.</td>
</tr>
<tr>
<td>(2) Term used in any such agreement, which is defined in the agreement itself</td>
<td>The term shall have the same meaning assigned to it in the said agreement</td>
</tr>
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<td>(3) Term used in any such agreement, which is not defined in the said agreement, but defined in the Income-tax Act, 1961</td>
<td>The term shall have the meaning assigned to it in the Income-tax Act, 1961 and explanation, if any, given to it by the Central Government</td>
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</table>

(v) The DTAAs under section 90A are intended to provide relief to the taxpayer, who is resident of one of the contracting country to the agreement. Such tax payer can claim relief by applying the beneficial provisions of either the treaty or the domestic law. However, in many cases, taxpayers who were not residents of a contracting country also resorted to claiming the benefits under the agreement entered into by the Indian Government with the Government of the other country. In effect, third party residents claimed the unintended treaty benefits.

Therefore, section 90A(4) provides that the non-resident to whom the agreement referred to in section 90A(1) applies, shall be allowed to claim the relief under such agreement if a Tax Residence Certificate (TRC) obtained by him from the Government of that country or specified territory is furnished, declaring his residence of the country outside India or the specified
(vi) Therefore, a certificate issued by the Government of a foreign country would constitute proof of tax residency, without any further conditions regarding furnishing of “prescribed particulars” therein. In addition to such certificate issued by the foreign Government, section 90A(5) requires the assessee to provide such other documents and information, as may be prescribed, for claiming the treaty benefits.

### Documents and information, to be furnished by the assessee for claiming treaty benefits, prescribed by CBDT vide Notification No. 57/2013 dated 01.08.2013:

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

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

The assessee shall keep and maintain such documents as are necessary to substantiate the information provided. An income-tax authority may require the assessee to provide the said documents in relation to a claim by the said assessee of any relief under an agreement referred to in section 90(1) or section 90A(1), as the case may be.

(vii) The charge of tax at a higher rate for a company incorporated in the specified territory outside India as compared to a domestic company would not be considered as less favourable charge or levy of tax in respect of such company.

(viii) For the purpose of this section, the ‘specified association’ means any institution, association or body, whether incorporated or not, functioning under any law for the time being in force in India or the laws of the specified territory outside India and which may be notified as such by the Central Government and ‘specified territory’ means any area outside India which may be notified by the Central Government.

### ILLUSTRATION 4

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

SOLUTION

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

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

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

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

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

(3) Countries with which no agreement exists – Unilateral Agreements [Section 91] In the case of income arising to an assessee in countries with which India does not have any double taxation agreement, relief would be granted under Section 91 provided all the following
conditions are fulfilled:

(a) The assessee is a resident in India during the previous year in respect of which the income is taxable.

(b) The income accrues or arises to him outside India.

(c) The income is not deemed to accrue or arise in India during the previous year.

(d) The income in question has been subjected to income-tax in the foreign country in the hands of the assessee.

(e) The assessee has paid tax on the income in the foreign country.

(f) There is no agreement for relief from double taxation between India and the other country where the income has accrued or arisen.

In such a case, the assessee shall be entitled to a deduction from the Indian income-tax payable by him. The deduction would be a sum calculated on such doubly taxed income at the Indian rate of tax or the rate of tax in the said country, whichever is lower, or at the Indian rate of tax if both the rates are equal.

**Meaning of important terms**:

(i) “Indian rate of tax” means the rate determined by dividing the amount of Indian income-tax after deduction of any relief due under the provisions of the Act but before deduction of any double taxation relief due to the assessee.

(ii) “Rate of tax of the said country” means income-tax and super-tax actually paid in that country in accordance with the corresponding laws in force in the said country after deduction of all relief due, but before deduction on account of double taxation relief due in the said country, divided by the whole amount of income assessed in the said country.

(iii) The expression “income-tax” in relation to any country includes any excess profits tax or business profits tax charged on the profits by the Government of any part of that country or a local authority in that country.

**ILLUSTRATION 5**

Nandita, an individual resident retired employee of the Prasar Bharati aged 60 years, is a well-known dramatist deriving income of ₹1,10,000 from theatrical works played abroad. Tax of ₹11,000 was deducted in the country where the plays were performed. India does not have any Double Tax Avoidance Agreement under section 90 of the Income-tax Act, 1961, with that country. Her income in India amounted to ₹6,10,000. In view of tax planning, she has deposited ₹1,50,000 in Public Provident Fund and paid contribution to approved Pension Fund of LIC ₹32,000. She also contributed ₹28,000 to Central Government Health Scheme during the previous year and gave payment of medical insurance premium of ₹26,000 to insure the health of her father, a non-resident aged 84 years, who is not dependent on her. Compute the tax liability of Nandita for the Assessment year 2020-21.
**SOLUTION**

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

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Indian Income</td>
<td>6,10,000</td>
</tr>
<tr>
<td>Foreign Income</td>
<td>1,10,000</td>
</tr>
<tr>
<td><strong>Gross Total Income</strong></td>
<td>7,20,000</td>
</tr>
<tr>
<td><em>Less: Deduction under section 80C</em></td>
<td></td>
</tr>
<tr>
<td>Deposit in PPF</td>
<td>1,50,000</td>
</tr>
<tr>
<td>Under section 80CCC</td>
<td></td>
</tr>
<tr>
<td>Contribution to approved Pension Fund of LIC</td>
<td>32,000</td>
</tr>
<tr>
<td><strong>Under section 80CCE</strong></td>
<td>1,82,000</td>
</tr>
<tr>
<td>The aggregate deduction under section 80C, 80CCC and 80CCD(1) has to be restricted to ₹ 1,50,000</td>
<td>1,50,000</td>
</tr>
<tr>
<td>Under section 80D</td>
<td></td>
</tr>
<tr>
<td>Contribution to Central Government Health Scheme ₹ 28,000 is also allowable as deduction under section 80D.</td>
<td>28,000</td>
</tr>
<tr>
<td>Since she is a resident senior citizen, the deduction is allowable to a maximum of ₹ 50,000 (See Note 1)</td>
<td>25,000</td>
</tr>
<tr>
<td>Medical insurance premium of ₹ 26,000 paid for father aged 84 years. Since the father is a non-resident in India, he will not be entitled for the higher deduction of ₹ 50,000 eligible for a senior citizen, who is resident in India. Hence, the deduction will be restricted to maximum of ₹ 25,000.</td>
<td>2,03,000</td>
</tr>
<tr>
<td><strong>Total Income</strong></td>
<td>5,17,000</td>
</tr>
<tr>
<td><strong>Tax on Total Income</strong></td>
<td></td>
</tr>
<tr>
<td>Income-tax (See Note below)</td>
<td>13,400</td>
</tr>
<tr>
<td>Add: Health and Education Cess @4%</td>
<td>536</td>
</tr>
<tr>
<td><strong>Average rate of tax in India</strong></td>
<td>13,936</td>
</tr>
<tr>
<td>(i.e. ₹ 13,936/ ₹ 5,17,000 × 100)</td>
<td>2.696%</td>
</tr>
<tr>
<td><strong>Average rate of tax in foreign country</strong></td>
<td></td>
</tr>
<tr>
<td>(i.e. ₹ 11,000/ ₹ 1,10,000 ×100)</td>
<td>10%</td>
</tr>
<tr>
<td>Deduction under section 91 on ₹ 1,10,000 @ 2.696% (lower of average Indian-tax rate or average foreign tax rate)</td>
<td>2,966</td>
</tr>
<tr>
<td><strong>Tax payable in India (₹ 13,936 – ₹ 2,966)</strong></td>
<td>10,970</td>
</tr>
</tbody>
</table>
Notes:

1. Section 80D allows a higher deduction of up to ₹ 50,000 in respect of the medical premium paid to insure the health of a senior citizen. Therefore, Nandita will be allowed deduction of ₹ 28,000 under section 80D, since she is a resident Indian of the age of 60 years.

2. The basic exemption limit for senior citizens is ₹ 3,00,000 and the age criterion for qualifying as a “senior citizen” for availing the higher basic exemption limit is 60 years. Accordingly, Nandita is eligible for the higher basic exemption limit of ₹ 3,00,000, since she is 60 years old.

3. An assessee shall be allowed deduction under section 91 provided all the following conditions are fulfilled:
   
   (a) The assessee is a resident in India during the relevant previous year.
   (b) The income accrues or arises to him outside India during that previous year.
   (c) Such income is not deemed to accrue or arise in India during the previous year.
   (d) The income in question has been subjected to income-tax in the foreign country in the hands of the assessee and the assessee has paid tax on such income in the foreign country.
   (e) There is no agreement under section 90 for the relief or avoidance of double taxation between India and the other country where the income has accrued or arisen.

In this case, since all the above conditions are satisfied, Nandita is eligible for deduction u/s 91.

ILLUSTRATION 6

Mr. Kamesh, an individual resident in India aged 52 years, furnishes you the following particulars of income earned in India, Country "X" and Country "Y" for the previous year 2019-20. India has not entered into double taxation avoidance agreement with these two countries.

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

Note: Business loss in Country "Y" not eligible for set off against other incomes as per law of that country.

The rates of tax in Country "X" and Country "Y" are 10% and 20%, respectively.

Compute total income and tax payable by Mr. Kamesh in India for Assessment Year 2020-21.
### SOLUTION

#### Computation of total income of Mr. Kamesh for A.Y.2020-21

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

#### Computation of tax liability of Mr. Kamesh for A.Y.2020-21

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax on total income [30% of ₹ 2,96,000 + ₹ 1,12,500]</td>
<td>2,01,300</td>
</tr>
<tr>
<td>Add: Health and Education cess@4%</td>
<td>8,052</td>
</tr>
<tr>
<td></td>
<td><strong>2,09,352</strong></td>
</tr>
</tbody>
</table>

\(^1\) Rental Income has been taken as GAV in the absence of other information relating to fair rent, municipal value etc.

\(^2\) As per section 70(1), inter-source set-off of income is permitted.

\(^3\) It is assumed that the royalty earned outside India has been brought into India in convertible foreign exchange within a period of six months from the end of the previous year.
Less: Deduction under section 91 (See Working Note below) 69,739
Tax Payable 1,39,613
Tax payable (rounded off) 1,39,610

Working Note: Calculation of Rebate under section 91

<table>
<thead>
<tr>
<th>₹</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Average rate of tax in India [i.e., ₹ 2,09,352 / ₹ 12,96,000 x 100]</td>
<td>16.154%</td>
</tr>
<tr>
<td>Average rate of tax in country X</td>
<td>10%</td>
</tr>
<tr>
<td>Doubly taxed income pertaining to country X</td>
<td></td>
</tr>
<tr>
<td>Agricultural Income</td>
<td>50,000</td>
</tr>
<tr>
<td>Royalty Income [₹ 6,00,000 – ₹ 50,000 (Expenses) – ₹ 3,00,000 (deduction under section 80QQB)]⁴</td>
<td>2,50,000</td>
</tr>
<tr>
<td></td>
<td>3,00,000</td>
</tr>
<tr>
<td>Deduction under section 91 on ₹ 3,00,000 @10% [being the lower of average Indian tax rate (16.154%) and foreign tax rate (10%)]</td>
<td>30,000</td>
</tr>
<tr>
<td>Average rate of tax in country Y</td>
<td>20%</td>
</tr>
<tr>
<td>Doubly taxed income pertaining to country Y</td>
<td></td>
</tr>
<tr>
<td>Income from house property</td>
<td>1,61,000</td>
</tr>
<tr>
<td>Dividend</td>
<td>1,50,000</td>
</tr>
<tr>
<td></td>
<td>3,11,000</td>
</tr>
<tr>
<td>Less: Business loss set-off</td>
<td>65,000</td>
</tr>
<tr>
<td></td>
<td>2,46,000</td>
</tr>
<tr>
<td>Deduction u/s 91 on ₹ 2,46,000 @16.154% (being the lower of average Indian tax rate (16.154%) and foreign tax rate (20%))</td>
<td>39,739</td>
</tr>
<tr>
<td>Total rebate under section 91 (Country X + Country Y)</td>
<td>69,739</td>
</tr>
</tbody>
</table>

Note: Mr. Kamesh shall be allowed deduction u/s 91, since the following conditions are fulfilled:-

(a) He is a resident in India during the relevant previous year (i.e., P.Y.2019-20).
(b) The income in question accrues or arises to him outside India in foreign countries X and Y during that previous year and such income is not deemed to accrue or arise in India during the previous year.

⁴ Doubly taxed income includes only that part of income which is included in the assessee's total income. The amount deducted under Chapter VIA is not doubly taxed and hence, no relief is allowable in respect of such amount – CIT v. Dr. R.N. Jhanji (1990) 185 ITR 586 (Raj.).
(c) The income in question has been subjected to income-tax in the foreign countries X and Y in his hands and it is presumed that he has paid tax on such income in those countries.

(d) There is no agreement u/s 90 for the relief or avoidance of double taxation between India and Countries X and Y where the income has accrued or arisen.

(4) Foreign Tax Credit [Rule 128 of Income-tax Rules, 1962]

(i) Year of availability of credit for foreign tax paid

An assessee, being a resident shall be allowed a credit for the amount of any foreign tax paid by him in a country or specified territory outside India, by way of deduction or otherwise, in the year in which the income corresponding to such tax has been offered to tax or assessed to tax in India, in the manner and to the extent as specified in this rule.

However, in a case where income on which foreign tax has been paid or deducted, is offered to tax in more than one year, credit of foreign tax shall be allowed across those years in the same proportion in which the income is offered to tax or assessed to tax in India.

(ii) Meaning of “Foreign tax”:

<table>
<thead>
<tr>
<th>Country/Specified Territory</th>
<th>Foreign Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) in respect of a country or specified territory outside India with which India has entered into an agreement for the relief or avoidance of double taxation of income in terms of section 90 or section 90A</td>
<td>the tax covered under the said agreement</td>
</tr>
</tbody>
</table>

| (ii) in respect of any other country or specified territory outside India | the tax payable under the law in force in that country or specified territory in the nature of income-tax referred to in section 91. For this purpose, income-tax in relation to any country includes any excess profits tax or business profits tax charged on the profits by the Government of any part of that country or a local authority in that country. |

(iii) Components of income-tax in respect of which FTC is available

Foreign Tax Credit (FTC) is available against the amount of tax, surcharge and cess payable under the Income-tax Act, 1961. However, it is not available in respect of any sum payable by way of interest, fee or penalty.

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(iv) Manner of computing FTC

The credit of foreign tax would be the aggregate of the amounts of credit computed separately for each source of income arising from a particular country or specified territory outside India and shall be given effect to in the following manner:-

(a) the credit would be the lower of the tax payable under the Income-tax Act, 1961 on such income and the foreign tax paid on such income. However, where the foreign tax paid exceeds the amount of tax payable in accordance with the provisions of the agreement for relief or avoidance of double taxation, such excess has to be ignored.

(b) the credit would be determined by conversion of the currency of payment of foreign tax at the telegraphic transfer buying rate on the last day of the month immediately preceding the month in which such tax has been paid or deducted.

Note – Students are advised to refer to Rule 128 of Income-tax Rules, 1961 given as Annexure 5 at the end of the Study Material.

ILLUSTRATION 7

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

SOLUTION

The assessee is a resident in India and accordingly, the income accruing or arising to him globally is chargeable to tax in India. However, section 91 specifies that if a person resident in India has paid tax in any country with which no agreement under section 90 exists, then, for the purpose of relief or avoidance of double taxation, a deduction is allowed from the Indian income-tax payable by him, of a sum calculated on such doubly taxed income at Indian rate of tax or the rate of tax of such foreign country, whichever is lower, or at the Indian rate of tax, if both the rates are equal. Accordingly, the assessee shall not be given any credit of the tax paid on the income in other country, but shall be allowed a deduction from the Indian income-tax payable by him as per the scheme of section 91 read with Rule 128 on Foreign Tax Credit.
Summary

DT Relief under the Income-tax Act, 1961

Bilateral Relief [Section 90/90A]

Agreement with foreign countries or specified territories

- The Central Government may enter into an agreement with the Government of any country outside India or specified territory or specified assn outside India,—
  - for the granting of relief in respect of doubly taxed income
  - for the avoidance of double taxation of income
  - for exchange of information for the prevention of evasion or avoidance of income-tax
  - for recovery of income-tax

Unilateral Relief [Section 91]

Countries with which no agreement exists

Applicability

- Assessee, who is a resident in India during the PY

Objective

- Taxability of income would be detd based on DTAA or the Income-tax Act, 1961, whichever is more beneficial.

Taxability

- The charge of tax in respect of a foreign company at a rate higher than the rate at which a domestic company is chargeable, shall not be regarded as less favourable charge or levy of tax in respect of such foreign company.

Charge of tax on foreign Company

- In order to claim DT relief, the non-resident to whom such DTAA applies, has to obtain a TRC from the Government of that country or specified territory.
  - The non-resident to also provide such other documents and information, as may be prescribed, for claiming treaty benefits.

Tax Residency Certificate (TRC)

Computation of Relief

- Doubly taxed income \times \text{Indian rate of tax or Rate of tax in the said country, whichever is lower}

Conditions

- The income accrues or arises to him outside India.
- The income is not deemed to accrue or arise in India during the PY.
- The income in question has been subjected to income-tax in the foreign country in the hands of the assessee.
- The assessee has paid tax on the income in the foreign country.
- There is no agrmt for relief from DT between India and the other country where the income has accrued or arisen.
3.4 CONCEPT OF PERMANENT ESTABLISHMENT

In order to determine the taxability of business income of foreign enterprises operating in India, it is important to determine the existence of a Permanent Establishment (‘PE’). Article 5(1) of the DTAA provides that for the purpose 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. The term ‘Enterprise’ has been defined in section 92F(iii) [See discussion under section 92A in Chapter 1].

According to Article 5(2), the term PE includes:

1. A place of management
2. A branch
3. An office
4. A factory
5. A warehouse
6. A mine, an oil or gas well, a quarry, or any other place of extraction of natural resources (not exploration)
7. A sales outlet
8. A workshop

(1) Permanent establishment means a fixed place of business through which the business of an enterprises is wholly or partly carried on.

(2) Every DTAA has a specific clause, which will deal with an explanation of permanent establishment for the purpose of such DTAA.

(3) Business Income of a non-resident will not be taxed in India, unless such non-resident has a permanent establishment in India.

(4) Taxability of income under business connection and permanent establishment is explained here below:
ILLUSTRATION 8

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

SOLUTION

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

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

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

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

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

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

3.5 TAXATION OF BUSINESS PROCESS OUTSOURCING UNITS IN INDIA

The provisions containing taxation of IT-enabled business process outsourcing units are not contained in the Income-tax Act, 1961 but are given in Circular No.5/2004 dated 28.9.2004 issued by CBDT. The provisions are briefed hereunder -
(a) A non-resident entity may outsource certain services to a resident Indian entity. If there is no business connection between the two, the resident entity may not be a Permanent Establishment of the non-resident entity, and the resident entity would have to be assessed to income-tax as a separate entity. In such a case, the non-resident entity will not be liable under the Income-tax Act, 1961.

(b) However, it is possible that the non-resident entity may have a business connection with the resident Indian entity. In such a case, the resident Indian entity could be treated as the Permanent Establishment of the non-resident entity.

(c) The non-resident entity or the foreign company will be liable to tax in India only if the IT enabled BPO unit in India constitutes its Permanent Establishment.

(d) A non-resident or a foreign company is treated as having a Permanent Establishment in India if the said non-resident or foreign company carries on business in India through a branch, sales office etc. or through an agent (other than an independent agent) who habitually exercises an authority to conclude contracts or regularly delivers goods or merchandise or habitually secures orders on behalf of the non-resident principal. In such a case, the profits of the non-resident or foreign company attributable to the business activities carried out in India by the Permanent Establishment becomes taxable in India.

(e) If a foreign enterprise carries on business in another country through a Permanent Establishment situated therein, the profits of the enterprise may be taxed in the other country but only so much of them as is attributable to the Permanent Establishment.

(f) Profits are to be attributed to the Permanent Establishment as if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a Permanent Establishment.

(g) In determining the profits of a Permanent Establishment there shall be allowed as deduction, expenses which are incurred for the purposes of the Permanent Establishment including executive and general administrative expenses so incurred, whether in the State in which the Permanent Establishment is situated or elsewhere.

(h) The expenses that are deductible would have to be determined in accordance with the accepted principles of accountancy and the provisions of the Income-tax Act, 1961.

(i) The profits to be attributed to a Permanent Establishment are those which that Permanent Establishment would have made if, instead of dealing with its Head Office, it had been dealing with an entirely separate enterprise under conditions and at prices prevailing in the ordinary market. This corresponds to the “arm’s length principle”.

(j) Hence, in determining the profits attributable to an IT-enabled BPO unit constituting a Permanent Establishment, it will be necessary to determine the price of the services rendered by the Permanent Establishment to the Head office or by the Head office to the Permanent Establishment on the basis of “arm’s length principle”.

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After studying this Chapter, you will be able to–

- appreciate the meaning and scope of the term “advance ruling”, the need for obtaining advance ruling and the restricted binding nature of an advance ruling;

- appreciate the constitution of Authority for Advance Rulings;

- examine the procedure for making an application to the Authority for Advance Rulings and the procedure to be followed by the Authority on receipt of application;

- pinpoint the circumstances when an advance ruling can be declared void;

- integrate, analyse and apply the advance ruling provisions for addressing relevant issues.
4.1 INTRODUCTION

Chapter XIX-B, consisting of sections 245N to 245V provides a scheme for giving advance rulings in respect of transactions involving non-residents and specified residents with a view to avoiding needless litigation and promoting better tax-payer relations.

4.2 DEFINITIONS

(1) **Advance Ruling [Section 245N(a)]:** The meaning of Advance Ruling is detailed hereunder:

<table>
<thead>
<tr>
<th>Section</th>
<th>Determination by the Authority</th>
</tr>
</thead>
<tbody>
<tr>
<td>245N(a)(i)</td>
<td>in relation to a transaction which has been undertaken or is proposed to be undertaken by a non-resident applicant.</td>
</tr>
<tr>
<td>245N(a)(ii)</td>
<td>in relation to the tax liability of a non-resident arising out of a transaction which has been undertaken or is proposed to be undertaken by a resident applicant with such non-resident and such determination shall include the determination of any question of law or of fact specified in the application.</td>
</tr>
<tr>
<td>245N(a)(iii)</td>
<td>in relation to the tax liability of a resident applicant, arising out of a transaction which has been undertaken or is proposed to be undertaken by such applicant and such determination shall include the determination of any question of law or of fact specified in the application.</td>
</tr>
<tr>
<td>245N(a)(iv)</td>
<td>in respect of an issue relating to computation of total income which is pending before any Income-tax Authority or the Appellate Tribunal and such determination or decision shall include the determination or decision of any question of law or fact in relation to such computation of total income specified in the application.</td>
</tr>
<tr>
<td>245N(a)(v)</td>
<td>or decision whether an arrangement, which is proposed to be undertaken by any person being a resident or a non-resident, is an impermissible avoidance arrangement as referred to in Chapter X-A or not.</td>
</tr>
</tbody>
</table>

(2) **Applicant [Section 245N(b)(A)]:** ‘Applicant’ means any person who –

(i) is a non-resident referred to in section 245N(a)(i) above; or

(ii) is a resident referred to in section 245N(a)(ii) above; or

(iii) is a resident referred to in section 245N(a)(iii) above falling within any such class or category of persons as the Central Government may, by notification in the Official Gazette, specify.

[A resident in relation to his tax liability arising out of one or more transactions valuing ₹ 100 crore or more in total which has been undertaken or is proposed to be undertaken by a resident applicant, arising out of a transaction which has been undertaken or is proposed to be undertaken by such applicant and such determination shall include the determination of any question of law or of fact specified in the application.]

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undertaken would be an applicant – Notification No.73/2014 dated 28.11.2014; or

(iv) is a resident falling within such class or category of persons as the Central Government may, by notification in the Official Gazette, specify in this behalf [Public sector company as defined under section 2(36A) of the Income-tax Act, 1961 – Notification No. 725(E) dated 3.8.2000]; or

(v) is referred to in section 245N(a)(iv) above; and

who makes an application for advance ruling under section 245Q(1).

On account of the merger of Authority for Advance Rulings for income-tax, central excise, customs duty and service tax, the definition of applicant would now also include an applicant defined under the Central Excise Act, 1944, Customs Act, 1962 and the Finance Act, 1994¹.

Who can be an applicant in relation to different clauses of section 245N(a) defining advance ruling?

<table>
<thead>
<tr>
<th>S. No.</th>
<th>Applicant u/s 245N(b)</th>
<th>Advance Ruling u/s 245N(a) means determination by the AAR in relation to</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i)</td>
<td>Non-resident (NR)</td>
<td>A transaction which has been undertaken or is proposed to be undertaken by him.</td>
</tr>
<tr>
<td>(ii)</td>
<td>Resident</td>
<td>The tax liability of a NR arising out of a transaction which has been undertaken or is proposed to be undertaken by a resident applicant with such NR and such determination shall include the determination of any question of law or of fact specified in the application.</td>
</tr>
<tr>
<td>(iii)</td>
<td>Resident of class or category of persons notified by Central Government</td>
<td>The tax liability of a resident applicant, arising out of a transaction which has been undertaken or is proposed to be undertaken by such applicant and such determination shall include the determination of any question of law or of fact specified in the application.</td>
</tr>
</tbody>
</table>

**Note:** The Central Government notified a resident, in relation to his tax liability arising out of one or more transactions valuing ₹100 crore or more in total.

| (iv)   | Resident of class or category of persons notified by Central Government | an issue relating to computation of total income which is pending before any Income-tax Authority or the Appellate Tribunal and such determination or decision shall include the determination or decision of any question of law or fact in relation to such computation of total income specified in the application. |

**Note:** A public sector undertaking has been notified by the Central Government.

¹ No amendment has been made in pursuance of GST being effective from 01.07.2017
Resident or NR whether an arrangement, which is proposed to be undertaken by any person being a resident or a NR, is an impermissible avoidance arrangement as referred to in Chapter X-A or not.

Restrictions on Appellate Authority: Section 245RR provides that where a resident applicant has made an application to AAR in respect of an issue for decision of AAR, then, any Income-tax Authority or Tribunal shall not take any decision in respect of such issues. In other words, a resident assessee cannot pursue both the remedies, i.e. an appeal or revision before Income-tax Authority/Appellate Authority as well as an application for Advance Ruling to AAR, in respect of an issue.

4.3 AUTHORITY FOR ADVANCE RULINGS [SECTION 245-O]

The Authority for Advance Rulings shall be constituted by the Central Government.

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Provisions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Composition of AAR</td>
<td>AAR to consist of a Chairman and such number of Vice Chairmen, revenue Members and law Members as the Central Government may, by notification, appoint.</td>
</tr>
<tr>
<td></td>
<td><strong>Qualifications for appointment:</strong></td>
</tr>
<tr>
<td></td>
<td>(a) <strong>Chairman</strong> – a person who has been a judge of the Supreme Court or the Chief Justice of a High Court or for at least seven years a judge of a High Court;</td>
</tr>
<tr>
<td></td>
<td>(b) <strong>Vice Chairman</strong> – a person who has been a Judge of a High Court;</td>
</tr>
<tr>
<td></td>
<td>(c) <strong>A Revenue Member from the Indian Revenue Service</strong> – a person who is, or is qualified to be, a Member of the Board on the date of occurrence of vacancy;</td>
</tr>
<tr>
<td></td>
<td>(d) <strong>A Revenue Member from the Indian Customs and Central Excise Service</strong> – a person who is, or is qualified to be a Member of the Central Board of Excise and Customs on the date of occurrence of vacancy.</td>
</tr>
<tr>
<td></td>
<td>(e) <strong>A law Member from the Indian legal service</strong> – a person who is, or is qualified to be, an Additional Secretary to the Government of India (‘GOI’) on the date of occurrence of vacancy.</td>
</tr>
<tr>
<td></td>
<td><strong>Note</strong> – The above qualifications are relevant for appointments made before 26.5.2017. Appointments made on or after 26.5.2017 shall be governed by section 184 of the Finance Act, 2017 [Refer para 4.4 below]</td>
</tr>
<tr>
<td>Terms &amp; Conditions</td>
<td>The terms and conditions of service and the salaries and allowances payable to the Members shall be such as may be prescribed.</td>
</tr>
</tbody>
</table>
Note – The terms and conditions in respect of appointments made on or after 26.5.2017 shall be governed by section 184 of the Finance Act, 2017 [Refer para 4.4 below]

| Officers & Employees | The Central Government shall provide to the Authority with such officers and employees, as may be necessary, for the efficient discharge of the functions of the Authority under the Act. |
| Location of AAR and benches | The Authority shall be located in the National Capital Territory of Delhi and its benches shall be located at places as notified by the Central Government. |
| Constitution of Benches | The powers and functions of the AAR may be discharged by its Benches as may be constituted by the Chairman from amongst its Members thereof. |
| Composition of Benches | A Bench shall consist of the Chairman or the Vice-Chairman and one revenue and one law Member. However, where the Authority is dealing with an application seeking advance ruling in any matter relating to the Income-tax Act, the revenue member of the Bench shall be such Member from the Indian Revenue Service, who is, or is qualified to be, a member of the Board. |
| Any vacancy in the office of the Chairman by reason of his death, resignation or otherwise | The senior-most Vice Chairman shall act as the Chairman until the date on which a new Chairman, appointed in accordance with the provisions of the Act to fill such vacancy, enters upon his office |
| In case the Chairman is unable to discharge his functions owing to absence, illness or other cause | The senior-most Vice Chairman shall discharge the functions of the Chairman until the date on which the Chairman resumes his duties. |

4.4 QUALIFICATIONS, TERMS AND CONDITIONS OF SERVICE OF CHAIRMAN, VICE CHAIRMAN AND MEMBERS [SECTION 245-OA]

The qualifications, appointment, term of office, salaries and allowances, resignation, removal and the other terms and conditions of service of the Chairman, Vice-Chairman and other Members of the Authority appointed on or after 26.05.2017, being the date on which the provisions of Part XIV of Chapter VI of the Finance Act, 2017 came into force, shall be governed by the provisions of section 184 of Finance Act 2017.
However, the Chairman, Vice-Chairman and Member appointed before 26.05.2017 shall continue to be governed by the provisions of the Act and the rules made thereunder as if the provisions of section 184 of the Finance Act, 2017 had not come into force.

**Section 184 of Finance Act, 2017**

1. **Power to Central Government to make rules:** The Central Government may, by notification, make rules to provide for qualifications, appointment, term of office, salaries and allowances, resignation, removal and the other terms and conditions of service of the Chairman, Vice-Chairman or Member of the Authority.

2. **Term of Chairman, Vice-Chairman or Member of the Authority:** The Chairman, Vice-Chairman or Member of the Authority shall hold office for such term as specified in the rules made by the Central Government but not exceeding 5 years from the date on which he enters upon his office and shall be eligible for reappointment.

3. **Age Criteria of Chairman, Vice-Chairman or Member of the Authority:** No Chairman, Vice-Chairman or Member of the Authority shall hold office as such after he has attained such age as specified in the rules made by the Central Government which shall not exceed:

<table>
<thead>
<tr>
<th>In case of</th>
<th>Age</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chairman</td>
<td>seventy years</td>
</tr>
<tr>
<td>Vice-Chairman or any other Member</td>
<td>sixty-seven years</td>
</tr>
</tbody>
</table>

Accordingly, the Central Government had notified “Tribunal, Appellate Tribunal and other Authorities (Qualifications, Experience and other Conditions of Service of Members) Rules, 2017”, to specify the qualifications, appointment, term of office, salaries and allowances, resignation, removal and the other terms and conditions of service of the Chairman, Vice-Chairman and other Members of the Authority. Qualifications and term of office of the Chairman, Vice-Chairman and other Members of the Authority is as follows:

<table>
<thead>
<tr>
<th>Particulars for appointment</th>
<th>Provisions</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) Chairman – a person who</td>
<td>- is or has been or is qualified to be a judge of the Supreme Court or</td>
</tr>
<tr>
<td></td>
<td>- is or has been a Chief Justice of a High Court or</td>
</tr>
<tr>
<td></td>
<td>- has, for at least 7 years, been a Judge of a High Court or</td>
</tr>
<tr>
<td></td>
<td>- has, for at least 3 years, been a Vice-Chairman, Revenue Member or Law Member of the Authority for Advance Ruling or</td>
</tr>
<tr>
<td></td>
<td>- is a person of ability, integrity and standing, and having special knowledge of, and professional experience of not less than 25 years in economics, business, commerce,</td>
</tr>
</tbody>
</table>
4.4 (b) **Vice Chairman** – a person who is, or has been, or is qualified to be, a Judge of a High Court;

(c) **Revenue Member**
- from the Indian Revenue Service is qualified to be a Member of the Central Board of Direct Taxes Board and
- an officer of the Indian Customs and Central Excise Service, who is qualified to be a Member of the Central Board of Excise and Customs.

(d) **A law Member from the Indian legal service** – a person who is an Additional Secretary to the Government of India (‘GOI’).

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**Term of Chairman, Vice-Chairman or Member of the Authority**

<table>
<thead>
<tr>
<th>Age Criteria of Chairman, Vice-Chairman or Member of the Authority</th>
<th>In case of</th>
<th>Age</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chairman</td>
<td>70 years</td>
<td></td>
</tr>
<tr>
<td>Vice-Chairman</td>
<td>65 years</td>
<td></td>
</tr>
<tr>
<td>Member</td>
<td>62 years</td>
<td></td>
</tr>
</tbody>
</table>

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4.5 **VACANCIES, ETC., NOT TO INVALIDATE PROCEEDINGS [SECTION 245P]**

No proceeding before, or pronouncement of advance ruling by, the Authority shall be questioned or shall be invalid on the ground merely of the existence of any vacancy or defect in the constitution of the Authority.

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4.6 **APPLICATION FOR ADVANCE RULING [SECTION 245Q]**

Section 245Q(1) provides that an applicant desirous of obtaining an advance ruling may make an application stating the question on which the advance ruling is sought in the prescribed form and in the prescribed manner.

As per section 245Q(2), the application shall be made in quadruplicate and be accompanied by a fee of ₹ 10,000 or such fee as may be prescribed, whichever is higher.

Rule 44E prescribes the fees mentioned in column (3) to be paid by the applicant mentioned in column (1) in the cases of column (2).
Rule 44E prescribes the form of application for obtaining an advance ruling. Every application under Rule 44E shall be accompanied by the proof of payment of fees.

Section 245Q(3) provides that an applicant may withdraw an application within 30 days from the date of the application.

**ILLUSTRATION 1**

Q, a non-resident, made an application to the Authority for Advance Rulings on 2.7.2019 in relation to a transaction proposed to be undertaken by him. On 31.8.2019, he decides to withdraw the said application. Can he withdraw the application on 31.8.2019?

**SOLUTION**

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

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

The Authority on receipt of an application will send a copy to the Principal Commissioner or Commissioner concerned and wherever considered necessary, also call upon the Principal Commissioner or Commissioner to furnish relevant records. Such records will be returned to the Principal Commissioner or Commissioner as soon as possible.

The Authority may either allow or reject an application. However, the Authority shall not allow an application where the question raised in the application is:

| Pending with income-tax authorities/tribunal/court | is already pending before any income-tax authority, or Appellate Tribunal or any court. However, a resident falling within any class or category of persons as notified by the Central Government i.e., a public sector undertaking can seek for advance ruling even if question raised is pending before any income-tax authority or Appellate. |
| Determination of Fair Market Value | involves the determination of the fair market value of any property; |
| Transaction designed for avoidance of income-tax | relates to a transaction or issue which is designed prima facie for avoidance of income-tax (except in case of a resident applicant falling within any class or category of persons as notified by the Central Government i.e., a public sector undertaking or in the case of resident or a non-resident for determination of whether an arrangement, which is proposed to be undertaken is an impermissible avoidance arrangement). |

However, no application shall be rejected unless an opportunity has been given to the applicant of being heard. Further, where an application is rejected, the reason for rejection shall be given in the order. A copy of every order shall be sent to the applicant and to the PCIT/CIT.

Where an application is allowed, the Authority would pronounce its advance ruling on that question specified in the application, after examining such further material as may be placed before it by the applicant or obtained by the Authority.

An applicant on request can appear either in person or can be represented through a duly authorised representative. The authority will pronounce the advance ruling within 6 months from the receipt of application by the authority and the copy of advance ruling pronounced, duly signed by the Members and certified, shall be sent to the applicant and to the PCIT/CIT.

ILLUSTRATION 2

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

**SOLUTION**

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 Phi plc. before the AAR on the ground that similar issue is pending before the Assessing Officer in respect of the same transaction i.e., provision of technical know to Beta Ltd.

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

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

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

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

4.8 APPLICABILITY OF ADVANCE RULING [SECTION 245S]

The advance ruling shall be binding only on the Principal Commissioner or Commissioner and the income-tax authorities subordinate to the Principal Commissioner or Commissioner in respect of the applicant and the said transaction.

The advance ruling will continue to remain in force unless there is a change either in law or in fact on the basis of which the advance ruling was pronounced.

ILLUSTRATION 3

Mr. Balram is a non-resident. The appeal pertaining to the assessment year 2018-19 is pending before the Income-tax Appellate Tribunal, the issue involved being computation of export profit and tax thereon. The same issue persists for the assessment year 2019-20 as well. Mr. Balram’s brother Mr. Krishna has obtained an advance ruling under Chapter XIX - B of Income-tax Act, 1961 from the Authority for Advance Rulings on an identical issue. Mr. Balram proposes to use
the said ruling for his assessment pertaining to the assessment year 2019-20. Can he do so?

**SOLUTION**

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

In view of the above provision, Mr. Balram cannot use the advance ruling, obtained on an identical issue by his brother, for his assessment pertaining to the assessment year 2019-20.

*Note – Though the ruling of the Authority for Advance Rulings is not binding on others but there is no bar on the Tribunal taking a view or forming an opinion in consonance with the reasoning of the Authority for Advance Rulings dehors the binding nature [CIT v. P. Sekar Trust (2010) 321 ITR 305 (Mad.)].*

**4.9 ADVANCE RULING TO BE VOID IN CERTAIN CIRCUMSTANCES [SECTION 245T]**

Where the Authority finds, on a representation made to it by the PCIT/CIT or otherwise, that an advance ruling has been obtained by the applicant by fraud or misrepresentation of facts, the Authority may, by order, declare such ruling to be *void ab initio*. The provisions of the Act shall apply (excluding the period beginning with the date of such advance ruling and ending with the date of order under this section) to the applicant as if such advance ruling had never been made. A copy of this order shall be sent to the applicant and the Principal Commissioner or Commissioner.

**ILLUSTRATION 4**

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

**SOLUTION**

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

The Authority shall have all the powers of the Civil Court in respect of discovery and inspection, enforcing the attendance of any person, including any officer of a banking company and examining on oath, issuing commissions and compelling the production of books of accounts and other documents. The Authority shall be deemed to be a Civil Court for the purposes of section 195 of the Code of Criminal Procedure, 1973 which provides for prosecution for contempt of lawful authority of public servants, for offences against public justice. Every proceeding before the Authority shall be deemed to be a judicial proceeding under the Indian Penal Code.

However, the Authority shall not be deemed to a Civil Court for the purpose of Chapter XXVI of the Code of Criminal Procedure, 1973 containing the provisions as to offences affecting the administration of justice.

ILLUSTRATION 5

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

SOLUTION

The statement is correct.

Under section 245U, the Authority for Advance Rulings shall have all the powers vested in the Civil Court under the Code of Civil Procedure, 1908 as are referred to in section 131.

Accordingly, the Authority for Advance Rulings shall have the same powers as are vested in a court under the Code of Civil Procedure, 1908, when trying a suit in respect of the following matters, namely -

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

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

4.11 PROCEDURE OF AUTHORITY [SECTION 245V]

The Authority shall, subject to the provisions of this Chapter, have power to regulate its own procedure in all matters arising out of the exercise of its powers under the Act.

For ease of reference, the process of application for Advance Ruling is explained below in a summarized form:
Overview of Advance Ruling Procedure

Cannot make an application for advance ruling

Is the applicant an eligible applicant falling u/s 245N(b)?

Entitled to make an application for advance ruling

Is the application withdrawn by the applicant within 30 days?

No further processing

AAR shall not allow the application

Opportunity of being heard to be given to the applicant

Reasons for rejection to be given in the order.

Whether the question raised in the application is already pending before income-tax authorities/ITAT/Court (except in case of public sector company, being a notified class of resident applicant)?

Whether the question raised in the application involves determination of FMV of any property?

Whether the question raised in the application relates to a transaction designed prima facie for avoidance of income-tax?

Whether application accepted?

Copy of application forward to PC or Commissioner requiring him to furnish records, if required

AAR to pronounce with ruling within 6 months of receipt of application

Advance Ruling pronounced is binding only on -

• The applicant who has sought it
• In respect of the specific transaction for which the ruling has been sought
• On PC/Commissioner and the IT Authority subordinate to him, in respect of the applicant and the transaction

Advance Ruling is void ab initio

Is the advance ruling obtained by

Advance Ruling is valid