‘A’ Ltd., an Indian company, was incorporated in the year 2009. It is a wholly owned subsidiary of A Inc, USA. A Ltd. is engaged in the business of manufacturing and selling virtual reality cameras. During the previous year 2018-19, A Ltd. entered into various transactions with the following enterprises for purchase of raw materials, use of technology and sale of finished goods. The earnings before interest, dividend, tax and amortization of A Ltd for Financial year 2018-19 is ₹ 200 crores. The details of the transactions entered into by A Ltd. during F.Y.2018-19 are given hereunder:

<table>
<thead>
<tr>
<th>S. No</th>
<th>Transaction</th>
<th>Enterprise</th>
<th>Amount (₹ in crores)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Purchase of raw-materials</td>
<td>AA Ltd, China</td>
<td>150</td>
</tr>
<tr>
<td>2</td>
<td>Payment of royalty</td>
<td>A Inc, USA</td>
<td>5</td>
</tr>
<tr>
<td>3</td>
<td>Sale of finished goods</td>
<td>AAA Ltd, Taiwan</td>
<td>50</td>
</tr>
</tbody>
</table>

Prior to F.Y.2018-19, A Ltd. had obtained loan of ₹ 1000 crores @8% from A LLC, Cyprus in April, 2017.

The following additional information pertaining to loans obtained by A Ltd. is provided for the previous year 2018-19:

- Interest of ₹ 80 crores paid to A LLC, Cyprus on the loan of ₹ 1000 crores. The book value of the total assets of A Ltd is ₹ 1800 crores.

- A Ltd. obtained loan of ₹ 100 crores from Bank of Chennai, India based on a guarantee provided by A Inc., USA. Interest of ₹ 8 crores paid on such loan and guarantee fee of ₹ 50 lacs paid to A Inc., USA.

- A Ltd. obtained loan of ₹ 50 crores from TN Mercantile Bank, India based on a letter of comfort provided by Mr. Balaji, who is an Indian resident and director of A Ltd. Interest of ₹ 4 crores is paid towards such loan.

- A Ltd. obtained an independent loan of ₹ 300 crores from Union City Bank, India for which interest of ₹ 3 crores has been paid to the bank.

- A Ltd. obtained loan of ₹ 50 crores from Bank of Taiwan, India Branch. Guarantee was provided by AAA Ltd., Taiwan. Interest paid for the concerned year is ₹ 3 crores.
Guarantee fees paid to AAA Ltd. is ₹ 25 lakhs. A Ltd. holds shares carrying 25% voting power in AAA Ltd., Taiwan.

- A Ltd. obtained interest-free loan of ₹ 50 crores from A Pty, Singapore. Out of the 25 directors of A Pty., Singapore, 10 are appointed by A Ltd.
- A Ltd. obtained foreign currency loan of $ 10 million from Wells Cargo Bank of USA, in USA, based on a back to back deposit made by A Inc. USA to the tune of $ 5 million in the bank. Interest of ₹ 6 crores is paid on such loan.
- A Ltd. obtained foreign currency loan of $ 20 million from Bank of USA, in USA, based on a back to back deposit made by A Inc., USA to the tune of $ 20 million in the bank. Interest works out to ₹ 12 crores.
- A Ltd. had to incur a sum of ₹ 1 crore as an interest towards the delayed payment to AA Ltd. China, being its creditor for supply of raw material. 90% of raw materials required by A Ltd. is supplied by AA Ltd., China. The price and other conditions for supply of raw material are influenced by AA Ltd., China.

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

I. OBJECTIVE TYPE QUESTIONS

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

(5 x 2 = 10 Marks)

1. Which of the following enterprises are associated enterprises/deemed associated enterprises of A Ltd.?

   (a) A Inc., USA; A LLC, Cyprus; and AAA Ltd., Taiwan.
   (b) A Inc., USA; A LLC, Cyprus; and A Pty, Singapore.
   (c) A Inc., USA; A LLC, Cyprus; and AA Ltd., China.
   (d) A Inc., USA; AA Ltd., China; and A Pty, Singapore.

2. A Ltd. has a wholly owned subsidiary in Sri Lanka, and it extends corporate guarantee to the said non-resident subsidiary. If the amount guaranteed is ₹ 95 crore, the Assessing
Officer has to accept the guarantee fee declared by A Ltd. for F.Y.2018-19, if the guarantee fee declared is -

(a) ₹ 47.50 lakhs
(b) ₹ 90 lakhs
(c) ₹ 95 lakhs
(d) Either (a) or (b)

3. If A Ltd. does not furnish transfer pricing report for F.Y.2018-19, what would be the quantum of penalty imposable under the Income-tax Act, 1961 for such a failure?

(a) 1% of the value of international transaction
(b) 2% of the value of international transaction
(c) ₹ 1 crore – fixed penalty
(d) ₹ 1 lakh – fixed penalty

4. In a case where primary adjustment to transfer price is made *suo motu* by A Ltd., the time limit for repatriation of “excess money” is -

(a) 60 days from 30th September of the Assessment Year
(b) 90 days from 30th September of the Assessment Year
(c) 60 days from 30th November of the Assessment Year
(d) 90 days from 30th November of the Assessment Year

5. The excess money which is available with the AE, if not repatriated to India within the prescribed time, shall be deemed to be an advance made by A Ltd. to such AE, if the primary adjustment to transfer price, made by it *suo motu* in its return of income, is in respect of -

(a) A.Y.2016-17 and the amount of primary adjustment is ₹ 2 crores.
(b) A.Y.2018-19 and the amount of primary adjustment is ₹ 1 crore
(c) A.Y.2018-19 and the amount of primary adjustment is ₹ 1.05 crore

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II. DESCRIPTIVE QUESTIONS

1. Based on the details provided in respect of interest paid by A Ltd., determine the amount of interest to be disallowed for A.Y.2019-20 under the relevant provisions of the Income-tax Act, 1961 relating to limitation of interest deduction, giving reasons for treatment of each item of interest. Consequently, determine the permissible interest deduction while computing income under the head “Profits and gains of business or profession”.  


   (2 Marks)

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

   (2 Marks)

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

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

Mr. Vallish, the non-resident partner, is a resident of Country L. Mr. Vallish has also invested in India Infradebt Ltd., an infrastructure debt fund notified under section 10(47). He is due to receive interest of Rs.5 lakhs in March, 2019 from such fund. He incurred expenditure of Rs. 10,000 to earn such income. Mr. Vallish’s brother Harish is also resident of Country L. Both Mr. Vallish and Mr. Harish are citizens of India.

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

The details of the assignments are as follows -

Assignment 1 [Client – Mr. Harry Smith]

Mr. Harry Smith, a citizen and resident of Country Y, and a swimmer came to India for participation in international swimming competition held in New Delhi. He came to New Delhi on 5th February, 2019 and left on 30th March, 2019 for Country Y. He received Rs. 15 lakhs for participation in competitions in India. He also received Rs. 2 lakh from XYZ Ltd. for advertisement of a product, namely shaving cream, on television. He contributed articles related to swimming in a newspaper for which he received Rs. 20,000. He incurred Rs.1 lakh as his travel costs to India. All other expenses were met by his sponsors. When he stayed in India, he also won a prize of Rs. 25,000 from horse racing in Mumbai. He has no other income in India during the year ended 31.3.2019. He wants to know his tax liability in India. He also wants to know whether he has to file return of income in India.

Mr. Harry Smith has a sister Ms. Rita Smith and a brother Mr. Austin Smith, who are also citizens and residents of Country Y. Ms. Rita Smith is a pop singer who accompanied Mr. Harry Smith to India in February-March, 2019. She earned Rs. 2 lakhs from music performances given by her in India during that period. She has no other income in India during the year. Mr. Harry Smith wants to know Ms. Rita Smith’s tax liability in India and whether she has to file her return of income in India.
Assignment 2 [Client – MNO Ltd.]

MNO Ltd., a company having registered head office in Country X, for the first time, carried out operations during the year 2018-19 of purchase of goods in India on three occasions. Immediately after purchase, the company exported the same to China. The total value of such exports was Rs. 85 lakhs, on which it earned profits of Rs. 15 lakhs, before the expenses of Rs. 8 lakhs, which were directly paid by H.O. The company does not carry on any other operation in India. All its board meetings are held in Country X and key management and commercial decisions for the conduct of the company’s business as a whole are taken in such board meetings. The company wants to know its tax liability in India for A.Y.2019-20.

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

M/s. Pacific Airlines, incorporated as a company in Country Y, operated its flights to India and vice versa during the year 2018-19 and collected charges of Rs. 280 crores for carriage of passengers and cargo out of which Rs. 100 crores were received in Country Y Dollars for the passenger fare from Country Y to Delhi. Out of Rs. 100 crores, Country Y dollars equivalent to Rs. 40 crores is received in India. The total expenses for the year on operation of such flights were Rs. 11 crores. The company wants to know its income chargeable to tax in India for A.Y.2019-20 and the rate at which such income would be subject to tax.

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

Based on the above facts, answer the following questions –
Multiple Choice Questions

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

1. Assuming that the tax deductible at source, if any, has been fully deducted, does Mr. Harry Smith and Ms. Rita Smith have to file return of income in India for A.Y.2019-20?

(a) Yes, because they have earned income in India which is chargeable to tax as per the provisions of the Income-tax Act, 1961.

(b) No, because tax deductible at source has been fully deducted from income earned by them in India.

(c) Harry Smith has to file his return of income but Rita Smith need not file her return of income.

(d) Rita Smith has to file her return of income but Harry Smith need not file his return of income.

2. MNO Ltd. is a company -

(a) resident in India, since it has carried on the operation of purchase of goods in India.

(b) non-resident in India, since its registered head office is in Country ‘X’.

(c) non-resident in India, since key management decisions are taken in Country ‘X’.

(d) non-resident in India, due to reasons stated in (b) and (c) above.

3. The effective rate of income-tax applicable on total income of M/s. Pacific Airlines is –

(a) 42.432%

(b) 44.512%

(c) 43.68%

(d) 46.592%

4. Salary paid by M/s. Hari Om & Co. to its partners falls within the limits prescribed under section 40(b)(v). Does Hari Om & Co. have to deduct tax on salary paid to its partners?

(a) Yes; tax is deductible at source under section 192 on salary paid to its partners.

(b) No; salary paid to partners is not subject to tax deduction at source.

(c) Yes; tax is deductible at source under section 192 on salary paid to resident partners and under section 195 on salary paid to the non-resident partner.

(d) Salary paid to resident partners is not subject to tax deduction at source; but tax has to be deducted under section 195 on salary paid to the non-resident partner.
Mr. Harish and Mr. Austin Smith have been appointed as senior officials of Country L embassy and Country Y embassy, respectively, in India in October, 2018. Mr. Harish and Mr. Austin Smith are subjects of Country L and Country Y, respectively, and are not engaged in any other business or profession in India. The remuneration received by Indian officials working in Indian embassy in Country L is exempt but in Country Y is taxable. The tax treatment of remuneration received by Mr. Harish and Mr. Austin Smith from embassies of Country L and Country Y, respectively, in India for the P.Y.2018-19 is:

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

DESCRIPTIVE QUESTIONS

1. (a) Compute the income-tax liability of Mr. Harry Smith and Ms. Rita Smith for A.Y.2019-20. (6 Marks)

(b) Let us suppose that there has been a failure to deduct tax at source on the amount of Rs.2 lakh paid by XYZ Ltd. to Mr. Harry Smith for advertisement of shaving cream. The Assistant Commissioner of Income-tax imposed penalty on the company for failure to deduct tax at source. The company seeks your advice on whether penalty is imposable for such failure and if so, in this case, whether such levy is in order. Examine. (3 Marks)

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

(b) Determine the income of M/s. Pacific Airlines chargeable to tax in India (4 Marks)

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**CASE STUDY - 3**

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

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

Arvind visits Country “P” for 60 days every year. For the rest of the year, he stays in Delhi. He is engaged in the business of wholesale trade in foodgrains in Delhi. He has no source of income in Country “P” except rental income from house property purchased by him in the P.Y.2014-15 and interest on fixed deposits made by him with a bank in that country out of his Indian income.

Sudha and her team are engaged in a project with Cure House Inc., a company based in Country “R”, to provide consultancy services in field of medicine to various research institutes in India. The engagement began during May 2018 and continued throughout the year. Due to the nature of project, Sudha frequently travels across the country to various institutes. There is no fixed place for provision of consultancy services. The expected revenue from the project is INR 70 crores.

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

During the year 2018-19, the company initiated a Global Mobility Program and selected Shivam for secondment to Country “Q” on a three-year assignment. Once Shivam starts his assignment, no further salary shall be processed from India payroll and he shall receive salary for services rendered in Country “Q” in his Country “Q” bank account. As per the terms of global mobility program, Shivam would be entitled to a monthly basic salary of QGD 1400 and cost of living allowance of QGD 1000. Tax at the rate of 15% would be withheld on such salary as per Country “Q” tax laws. Shivam would be staying there in a rent-free accommodation provided by the company for the three year period.

Shivam left India on September 30, 2018 for his overseas assignment and reached Country “Q” next day. His parents and Sudha stayed in India in the same rented accommodation in Defence Colony, Delhi owing to Sudha’s work commitments. For F.Y.2018-19, Shivam paid rent of INR 25,000 per month in respect of the said accommodation.

On July 31, 2018, the company announced a bonus of INR 3,00,000 for the previous financial year (i.e. F.Y.2017-18). As a retention policy, such bonus was paid after the first half of the financial year i.e. in October 2018. Shivam received the bonus amount in his salary account with the bank in Country “Q”.

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Shivam had invested his overseas salary in purchase of securities of a Country “Q” company which yielded an interest income of QGD 5,000 due as on March 31, 2019. Such interest was taxed at 15% of the gross amount as per Country “Q” domestic tax laws. The rate of tax in respect of such income as per the India-Country “Q” DTAA is also 15% on the gross amount.

He has also purchased shares of Country “Q” Company and dividend of QGD 1,000 was credited to his bank account on March 31, 2019. Just like Indian tax laws, dividend paid by Country “Q” Company is exempt in the hands of shareholders.

On 31.03.2019, he had earned interest income of QGD 150 from his saving bank account in Country “Q”, which is also exempt as per the domestic tax laws of Country “Q”.

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

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

Other points:

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

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

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

I MULTIPLE CHOICE QUESTIONS

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

1. Delhi Tamil Sangam, as per its rules, pays a fixed honorarium per concert to each musician performing in the concerts organised by it. Shivam, however, refuses to accept this sum. If he requests Delhi Tamil Sangam to pay such sum directly to Help All, an unregistered institution providing relief to the poor and needy in rural India, what would be the tax consequence?

   (a) No amount would be chargeable to tax in the hands of Mr. Shivam, since this is a case of diversion of income at source by overriding title.

   (b) The amount payable to Help All would be chargeable to tax only in the hands of Mr. Shivam, since it is a case of application of income.

   (c) The amount payable to Help All would be chargeable to tax only in the hands of the institution which has received the amount.

   (d) The amount payable to Help All would be chargeable to tax both in the hands of Mr. Shivam and in the hands of the institution.

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2. Mr. Arvind opened a bank account in Country “P” on 1.7.2016. He has made deposits of foreign currency equivalent to INR 5 lakhs on 1.7.2016, INR 7 lakhs on 1.10.2016, INR 12 lakhs on 1.9.2018 and INR 25 lakhs on 1.3.2019, in that bank, out of Indian income which has not been assessed to tax in India. The deposit of INR 12 lakhs on 1.9.2018 is made out of the withdrawal of earlier deposits made on 1.7.2016 and 1.12.2016 with the said bank. Further, out of INR 25 lakhs deposited by him on 1.3.2019, Mr. Arvind withdrew INR 2 lakhs on 31.3.2019. The value of an undisclosed asset in form of bank account under the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 will be taken as:

(a) INR 49 lakhs
(b) INR 47 lakhs
(c) INR 37 lakhs
(d) INR 35 lakhs

3. If Cure House Inc. opts for advance ruling for the project of providing consultancy in field of medicine, such ruling shall be binding on:

(a) Cure House Inc., in relation to the abovementioned project
(b) Jurisdictional Assessing Officer of Cure House
(c) Both (a) and (b)
(d) Cure House Inc. and Jurisdictional Assessing Officer in relation to the abovementioned project and for any future transaction of similar nature in India

4. Which of the following would not be considered as a permanent home of Mr. Shivam in context of the relevant rule in the DTAA with Country “Q” for dual residency?

(i) House in Defence Colony, Delhi where his family lives
(ii) Own house in Mumbai which has been let out
(iii) Rent-free accommodation provided by his employer in Country “Q”

The correct answer is -

(a) Only (i) above
(b) Only (ii) above
(c) Only (iii) above
(d) Both (i) and (iii) above

5. Mr. Arvind acquired a flat in Country “P” in the P.Y.2014-15 for INR 50 lakhs out of his Indian income. Out of the said sum, INR 20 lakhs was assessed to tax in India during the P.Y.2014-15 and earlier years. This asset comes to the notice of the Assessing Officer in the year 2018-19. If the value of the flat on 1.4.2018 is INR 90 lakhs, the amount chargeable to tax in the year 2018-19 would be:

(a) INR 90 lakhs

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(b) INR 70 lakhs
(c) INR 54 lakhs
(d) INR 30 lakhs

II DESCRIPTIVE QUESTIONS

1. (i) With reference to the DTAA between India and Country “Q”, examine whether Shivam is a resident in India or Country “Q” in the year 2018-19. (5 Marks)

(ii) With reference to the DTAA between India and Country “R”, comment on whether provision of consultancy services through Sudha would lead to creation of PE in India for Cure House Inc., a Country “R” company. (2 Marks)

2. Determine the total income and tax liability of Shivam for the previous year 2018-19 as per the provisions of the Income-tax Act, 1961. Advance tax calculations may be ignored. Ignore the perquisite value of rent free accommodation provided to Shivam in Country “Q”. Indicate reasons for treatment of each item. Working Notes should form part of your answer. (8 Marks)

EXHIBIT I

Telegraphic Transfer Buying Rate

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

<table>
<thead>
<tr>
<th>Date</th>
<th>Exchange Rate (INR)</th>
<th>Date</th>
<th>Exchange Rate (INR)</th>
</tr>
</thead>
<tbody>
<tr>
<td>30.09.2018</td>
<td>45.95</td>
<td>31.01.2019</td>
<td>47.83</td>
</tr>
<tr>
<td>31.10.2018</td>
<td>46.85</td>
<td>28.02.2019</td>
<td>48.52</td>
</tr>
<tr>
<td>30.11.2018</td>
<td>45.10</td>
<td>31.03.2019</td>
<td>48.61</td>
</tr>
<tr>
<td>31.12.2018</td>
<td>46.95</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

EXHIBIT II

Rate of exchange for conversion into rupees of income expressed in foreign currency

[Rule 115 of the Income-tax Rules, 1962]

(1) The rate of exchange for the calculation of the value in rupees of any income accruing or arising or deemed to accrue or arise to the assessee in foreign currency or received or deemed to be received by him or on his behalf in foreign currency shall be the telegraphic transfer buying rate of such currency as on the specified date.

Explanation: For the purposes of this rule
"telegraphic transfer buying rate" shall have the same meaning as in the Explanation to rule 26;

As per Explanation to Rule 26 "telegraphic transfer buying rate", in relation to a foreign currency, means the rate or rates of exchange adopted by the State Bank of India, for buying such currency, having regard to the guidelines specified from time to time by the Reserve Bank of India for buying such currency, where such currency is made available to that bank through a telegraphic transfer.

"specified date" means—

(a) in respect of income chargeable under the head "Salaries", the last day of the month immediately preceding the month in which the salary is due, or is paid in advance or in arrears;

(b) in respect of income [by way of] "interest on securities", the last day of the month immediately preceding the month in which the income is due;

(c) in respect of income chargeable under the heads "Income from house property", "Profits and gains of business or profession" [not being income referred to in clause (d)] and "Income from other sources" (not being income by way of dividends [and "Interest on securities"]), the last day of the previous year of the assessee;

(d) in respect of income chargeable under the head "Profits and gains of business or profession" in the case of a non-resident engaged in the business of operation of ships, the last day of the month immediately preceding the month in which such income is deemed to accrue or arise in India;

(e) in respect of income by way of dividends, the last day of the month immediately preceding the month in which the dividend is declared, distributed or paid by the company;

(f) in respect of income chargeable under the head "Capital gains", the last day of the month immediately preceding the month in which the capital asset is transferred.

Provided that the specified date, in respect of income referred to in sub-clauses (a) to (f) payable in foreign currency and from which tax has been deducted at source under rule 26, shall be the date on which the tax was required to be deducted under the provisions of the Chapter XVII-B.

(2) Nothing contained in sub-rule (1) shall apply in respect of income referred to in clause (c) of the Explanation to sub-rule (1) where such income is received in, or brought into India by the assessee or on his behalf before the specified date in accordance with the provisions of the Foreign Exchange Regulation Act, 1973.

EXHIBIT III

Foreign Tax Credit [Rule 128 of the Income-tax Rules, 1962]

(1) 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:
Provided that 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.

(2) The foreign tax referred to in sub-rule (1) shall mean,—

(a) 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, the tax covered under the said agreement;

(b) 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 clause (iv) of the Explanation to section 91.

(3) The credit under sub-rule (1) shall be available against the amount of tax, surcharge and cess payable under the Act but not in respect of any sum payable by way of interest, fee or penalty.

(4) No credit under sub-rule (1) shall be available in respect of any amount of foreign tax or part thereof which is disputed in any manner by the assessee:

Provided that the credit of such disputed tax shall be allowed for the year in which such income is offered to tax or assessed to tax in India if the assessee within six months from the end of the month in which the dispute is finally settled, furnishes evidence of settlement of dispute and an evidence to the effect that the liability for payment of such foreign tax has been discharged by him and furnishes an undertaking that no refund in respect of such amount has directly or indirectly been claimed or shall be claimed.

(5) The credit of foreign tax shall 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:—

(i) the credit shall be the lower of the tax payable under the Act on such income and the foreign tax paid on such income:

Provided that 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 shall be ignored for the purposes of this clause;

(ii) the credit shall 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.

(6) In a case where any tax is payable under the provisions of section 115JB or section 115JC, the credit of foreign tax shall be allowed against such tax in the same manner as is allowable against any tax payable under the provisions of the Act other than the provisions of the said sections (hereafter referred to as the "normal provisions").

(7) Where the amount of foreign tax credit available against the tax payable under the provisions of section 115JB or section 115JC exceeds the amount of tax credit available against the normal provisions, then while computing the amount of credit under section 115JAA or section 115JD in respect of the taxes paid under section 115JB or section 115JC, as the case may be, such excess shall be ignored.

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(8) Credit of any foreign tax shall be allowed on furnishing the following documents by the assessee, namely:—

(i) a statement of income from the country or specified territory outside India offered for tax for the previous year and of foreign tax deducted or paid on such income in Form No.67 and verified in the manner specified therein;

(ii) certificate or statement specifying the nature of income and the amount of tax deducted therefrom or paid by the assessee,—

(a) from the tax authority of the country or the specified territory outside India; or

(b) from the person responsible for deduction of such tax; or

(c) signed by the assessee:

Provided that the statement furnished by the assessee in clause (c) shall be valid if it is accompanied by,—

(A) an acknowledgement of online payment or bank counter foil or challan for payment of tax where the payment has been made by the assessee;

(B) proof of deduction where the tax has been deducted.

(9) The statement in Form No.67 referred to in clause (i) of sub-rule (8) and the certificate or the statement referred to in clause (ii) of sub-rule (8) shall be furnished on or before the due date specified for furnishing the return of income under sub-section (1) of section 139, in the manner specified for furnishing such return of income.

(10) Form No.67 shall also be furnished in a case where the carry backward of loss of the current year results in refund of foreign tax for which credit has been claimed in any earlier previous year or years.

Explanation—For the purposes of this rule 'telegraphic transfer buying rate' shall have the same meaning as assigned to it in Explanation to Rule 26.

EXHIBIT IV

EXTRACTS OF DTAA BETWEEN INDIA AND COUNTRY "Q"

ARTICLE 4

FISCAL DOMICILE

1. For the purposes of this Agreement, the term "resident of a Contracting State" means any person who is a resident of a Contracting State in accordance with the taxation laws of that State.

2. "Where by reason of the provisions of paragraph 1, an individual is a resident of both Contracting States, then his status shall be determined as follows:

(a) he shall be deemed to be a resident of the State in which he has a permanent home available to him; if he has a permanent home available to him in both States, he shall be deemed to be a resident of the State with which his personal and economic relations are closer (centre of vital interests) ;

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(b) if the State in which he has his centre of vital interests cannot be determined, or if he has not a permanent home available to him in either State, he shall be deemed to be a resident of the State in which he has an habitual abode;

(c) if he has an habitual abode in both States or in neither of them, he shall be deemed to be a resident of the State of which he is a national;

(d) if he is a national of both States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement.

ARTICLE 23

AVOIDANCE OF DOUBLE TAXATION

1. The laws in force in either of the Contracting States shall continue to govern the taxation of income in the respective Contracting States except where express provision to the contrary is made in this Agreement.

2. Where a resident of India derives income which, in accordance with the provisions of this Agreement, may be taxed in Country “Q”, India shall allow as a deduction from the tax on the income of that resident an amount equal to the Country “Q” tax paid, whether directly or by deduction. Where the income is a dividend paid by a company which is a resident of Country “Q” to a company which is a resident of India and which owns directly or indirectly not less than 25 per cent of the share capital of the company paying the dividend, the deduction shall take into account the Country “Q” tax paid in respect of the profits out of which the dividend is paid. Such deduction in either case shall not, however, exceed that part of the tax (as computed before the deduction is given) which is attributable to the income which may be taxed in Country “Q”.

EXHIBIT V

EXTRACT OF DTAA BETWEEN INDIA AND COUNTRY “R”

ARTICLE 5

PERMANENT ESTABLISHMENT

1. For the purposes of this Agreement, the term “permanent establishment” means a fixed place of business through which the business of an enterprise is wholly or partly carried on.

2. The term “permanent establishment” includes especially:

   (a) a place of management;
   
   (b) a branch;
   
   (c) an office;
   
   (d) a factory;
   
   (e) a workshop;
(f) a sales outlet;

(g) a warehouse in relation to a person providing storage facilities for others;

(h) a farm, plantation or other place where agricultural, forestry, plantation or related activities are carried on; and

(i) a mine, an oil or gas well, a quarry or any other place of extraction of natural resources.

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

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

(b) the furnishing of services including consultancy services by an enterprise through employees or other personnel by the enterprise for such purpose, but only where activities of that nature continue (for the same or a connected project) within the Contracting State for a period or periods aggregating more than 180 days within any twelve-month period.
CASE STUDY - 4

Mr. Arjun Batra, a resident Indian, aged 58, has business interests in India and in some other foreign nations also. The Finance Manager has sent a mail, furnishing details of income earned in India and outside India during the P.Y. 2018-19.

Income earned in foreign nations

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

<table>
<thead>
<tr>
<th>Particulars of Income</th>
<th>(Rs. in lakhs)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>E</td>
</tr>
<tr>
<td>Gross rental receipts from commercial property</td>
<td>2</td>
</tr>
<tr>
<td>Share income from Partnership firm (loss)</td>
<td>-1</td>
</tr>
<tr>
<td>Business income</td>
<td>2.2</td>
</tr>
<tr>
<td>STCG from sale of vacant site on 1.11.2018</td>
<td>15</td>
</tr>
<tr>
<td>Agricultural Income</td>
<td>1.2</td>
</tr>
</tbody>
</table>

Income earned in India

<table>
<thead>
<tr>
<th>Particulars</th>
<th>(Rs. in lakhs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Business income</td>
<td>1.5</td>
</tr>
<tr>
<td>Long-term capital gains on sale of residential house in Mumbai on 1.3.2019</td>
<td>45</td>
</tr>
<tr>
<td>Agricultural income from lands in Bengaluru</td>
<td>3.2</td>
</tr>
</tbody>
</table>

The Manager (Finance) has informed that following investments were made in India during the year ended 31-3-2019:

<table>
<thead>
<tr>
<th>Particulars of Income</th>
<th>(Rs. In lakhs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Purchase of residential house at Jaipur on 22-3-2019 in wife’s name</td>
<td>37</td>
</tr>
<tr>
<td>Contribution to PPF</td>
<td>1.50</td>
</tr>
</tbody>
</table>

Income-tax rate structure:

Country E

<table>
<thead>
<tr>
<th>(Rs.)</th>
<th>Tax rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Upto Rs.3 lakhs</td>
<td>Nil</td>
</tr>
<tr>
<td>Rs.3 to Rs.6 lakhs</td>
<td>15%</td>
</tr>
<tr>
<td>Above Rs.6 lakhs</td>
<td>22%</td>
</tr>
</tbody>
</table>

Country F

Flat 27% without any basic exemption limit.

Tax treatment/ concessions in other nations

(i) No statutory allowance/deduction in respect of house property income in Country E as well as Country F.
(ii) Loss from firm can be set off against other business income in Country F only.
(iii) Agricultural income is exempt in Country E only.
A Search is conducted by the Income-tax department in India in the premises of Mr. Arjun Batra on 30.4.2019 and it has come to the notice of the department that Mr. Arjun Batra has earned income to the tune of Rs.5 lakhs in country E during the previous year 2017-18.

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

The jewellery had been purchased for Rs.4.2 lakhs. Its value as per report of Valuer recognized by the Government is Rs.5.2 lakhs as on 1-4-2019 and Rs.5.3 lakhs as on 30-4-2019.

I. MULTIPLE CHOICE QUESTIONS

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

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

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

3. Assume that Arjun had acquired a factory building in Country Z for Rs.24 lakhs on 21-3-2016, for which Rs.18 lakhs was invested from explained sources which had suffered tax in India. This asset comes to the knowledge of the Assessing Officer on 20-5-2018. The market value of the asset as on 1-4-2018 is Rs.40 lakhs. The value of undisclosed foreign asset as per Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 (BM Act) is
   (a) Rs.40 lakhs
   (b) Rs.22 lakhs
   (c) Rs.10 lakhs
   (d) Rs.6 lakhs

4. Continuing the facts of MCQ 3., assume that the Assessing Officer has issued the notice under BM Act on 30-5-2019. The time limit for completion of assessment under the BM Act is
   (a) 31-3-2022
   (b) 30-5-2021
   (c) 31-3-2023
5. In respect of the foreign income and foreign asset unearthed by the income-tax department during the search on 30-4-2019, which of the following statements are correct, with reference to the taxability of the impugned items in the hands of Mr. Arjun in India under the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 (BM Act)?

(i) Both undisclosed income and undisclosed asset would be taxable in the P.Y.2019-20
(ii) Both undisclosed income and undisclosed asset would be taxable in the P.Y.2017-18
(iii) Undisclosed income is taxable in the P.Y.2017-18 and undisclosed asset in the P.Y.2019-20
(iv) Undisclosed asset is taxable in the P.Y.2017-18 and undisclosed income in the P.Y.2019-20
(v) The value of undisclosed asset is Rs.4.2 lakhs
(vi) The value of undisclosed asset is Rs.5.2 lakhs
(vii) The value of disclosed asset is Rs.5.3 lakhs

The correct answer is –

(a) (i) and (vi)
(b) (ii) and (v)
(c) (iii) and (vi)
(d) (iv) and (vii)

II. DESCRIPTIVE QUESTIONS

1. Ascertain the income-tax liability of Mr. Arjun Batra for the assessment year 2019-20. (15 marks)
CASE STUDY - 5

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

I. MULTIPLE CHOICE QUESTIONS

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

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

(a) Non-resident and Resident and Ordinarily Resident, respectively
(b) Non-resident for both years
(c) Resident and Ordinarily Resident for both years
(d) Resident but Not Ordinarily Resident for both years

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

(a) No, as agricultural income is exempt u/s 10(1).
(b) No, as the income has accrued and arisen outside India and is also received outside India.
(c) Yes, since it is remitted to India in the same year.
(d) Yes, as agricultural income earned outside India is not exempted in India in the hands of a resident.
3. Mr. Bhandari only holds the shares in RB Pvt. Ltd. If he sells the shares held by him in RB Pvt. Ltd. for a gain during the Previous Year 2018-19, which of the following statements is true?

(a) The resultant gain is a short-term capital gain taxable under the normal provisions of the Act.
(b) The resultant gain is a short-term capital gain taxable@15% u/s 111A.
(c) The resultant gain is a long-term capital gain taxable@20% u/s 112.
(d) The resultant gain is a long-term capital gain taxable@10% u/s 112A.

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

(a) Mr. Bhandari is liable to pay tax on such dividend as it forms part of his total income
(b) RB Pvt. Ltd. will have to pay a dividend distribution tax u/s 115-O on such payments
(c) Mr. Bhandari is eligible for an exemption under section 10(34) in respect of such dividend.
(d) Both (b) and (c)

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

(a) One of the four directors of PB Pvt. Ltd. is Mr. Bhandari
(b) RB Pvt. Ltd. owns 20% of shares in PB Pvt. Ltd.
(c) RB Pvt. Ltd. extended a loan of Rs.20 lakhs to PB Pvt. Ltd. when the book value of the latter is Rs.42 lakhs
(d) Mr. Bhandari owns 26% of shares in PB Pvt. Ltd.

II. DESCRIPTIVE QUESTIONS

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

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

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

In your opinion, can the Indian tax authorities argue that RB Pvt. Ltd. is resident in India for tax purposes, despite the fact that the company has been incorporated in Mauritius? Would their reasoning be the same as cited by the tax lawyer? (8 Marks)

2. Assume that Mr. Bhandari has opened an office of RB Pvt. Ltd. in Pune from where he and Mr. Sharma execute the work of the company relating to Indian operations. RB Pvt. Ltd. is further considering advertising the product on internet using Facebook. RB Pvt. Ltd. enters into talks with Facebook for hosting the desired advertisements. It negotiated a sum of INR 10 lakhs, which is paid to Facebook for online advertisement services in March, 2019. Assume that Facebook does not have a permanent establishment in India.

(a) Is the fee paid for online advertisement services by RB Pvt. Ltd. to Facebook Inc. taxable in India? Discuss. (3 Marks)

(b) If the answer to (a) is in the affirmative, is there any requirement to deduct tax at source? If tax is not so deducted, what would be the consequence? (3 Marks)
(c) What is the provision incorporated in the Indian tax laws to avoid double taxation of such income? (1 Mark)
Ind Co is an unlisted, private limited, Indian company incorporated under the Companies Act, 1956 and is engaged in the business of the manufacturing of automobile components. Ind Co is held by 4 groups of shareholders (Groups A, B, C and D) in different proportions. Groups A, B, C and D are headquartered in US, Germany, Cyprus and UK respectively. However, these headquarter companies do not hold shares of Ind Co directly, but hold the shares through intermediary companies in Singapore, Mauritius, Australia, Spain respectively, as depicted in the shareholding pattern below:

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

<table>
<thead>
<tr>
<th>Date of acquisition</th>
<th>Group A</th>
<th>Group B</th>
<th>Group C</th>
<th>Group D</th>
</tr>
</thead>
<tbody>
<tr>
<td>Date of acquisition by US Co in Singapore Intermediary Co - 1 April 2013</td>
<td>Date of acquisition by Germany Co in Mauritius Intermediary Co - 1 April 2013</td>
<td>Date of acquisition by Cyprus Co in Australia Intermediary Co - 1 April 2013</td>
<td>Date of acquisition by UK Co in Spain Intermediary Co - 1 April 2013</td>
<td></td>
</tr>
<tr>
<td>Date of acquisition by Singapore Intermediary Co in Ind Co - 1 March 2018</td>
<td>Date of acquisition by Mauritius Intermediary Co in Ind Co - 1 April 2013</td>
<td>Date of acquisition by Australia Intermediary Co in Ind Co - 1 April 2013</td>
<td>Date of acquisition by Spain Intermediary Co in Ind Co - 1 April 2013</td>
<td></td>
</tr>
</tbody>
</table>

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

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

<table>
<thead>
<tr>
<th>Group A</th>
<th>Group B</th>
<th>Group C</th>
<th>Group D</th>
</tr>
</thead>
</table>
Ind Co follows 1 April - 31 March as the Financial Year and the book value of assets of Ind Co as on 31 March 2019 was INR 100 crores.

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

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

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

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

I. **MULTIPLE CHOICE QUESTIONS**

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

1. Based on the facts in the case, where US Co proposes to transfer shares of Singapore Intermediary Co, which of the following Double Taxation Avoidance Agreements (‘DTAA’), would be applicable for analysing the taxability in the hands of US Co in India -
   (a) US-Singapore DTAA
2. With respect to transfer of shares of Singapore Intermediary Co by US Co, which of the following would be the ‘specified date’ for the purpose of determining whether such shares derive its value substantially from assets located in India:

(a) 30th June 2018
(b) 31st December 2018
(c) 31st March 2019
(d) 31st May 2019

3. With respect to transfer of shares of Mauritius Intermediary Co by Germany Co, what would be the value of ‘assets located in India’ –

(a) INR 27.5 crores
(b) INR 32.5 crores
(c) INR 45 crores
(d) INR 50 crores

4. Ind Co is required to report details with respect to transfer of shares of Singapore Intermediary Co by US Co in which of the following forms-

(a) Form 3CEA
(b) Form 3CT
(c) Form 49D
(d) There is no reporting requirement on Ind Co and reporting requirement applies only on Singapore Intermediary Co

5. What is the timeline within which Ind Co is required to furnish information pertaining to transfer of shares of Mauritius Intermediary Co by Germany Co if the transaction has the effect of directly or indirectly transferring rights and management of Ind Co -

(a) Within the due date for filing return of income for the year in which the transfer has taken place
(b) Within 90 days from the date of the transaction
(c) Within 90 days from the end of the Financial Year in which such transfer has taken place
(d) There is no requirement on Ind Co to furnish information

II. DESCRIPTIVE QUESTIONS

1. Examine the tax consequences of the following transactions under section 9(1)(i) of the Income-tax Act, 1961 and the applicable Double Taxation Avoidance Agreements -

(a) Transfer of shares of Singapore Intermediary Co by US Co to an unrelated Buyer (4 Marks)
(b) Transfer of shares of Mauritius Intermediary Co by Germany Co to an unrelated Buyer (4 Marks)
(c) Transfer of shares of Australia Intermediary Co by Cyprus Co to an unrelated Buyer (3 Marks)
(d) Transfer of shares of Spain Intermediary Co by UK Co to an unrelated Buyer (4 Marks)

EXHIBIT I

EXTRACTS OF ARTICLE ON CAPITAL GAINS FROM DOUBLE TAXATION AVOIDANCE AGREEMENTS
India-US DTAA

“ARTICLE 13 - GAINS

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

India- Singapore DTAA

“ARTICLE 13 – CAPITAL GAINS

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

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

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

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

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

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

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

Germany-Mauritius DTAA

“ARTICLE 13 – CAPITAL GAINS

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

2. Gains from the alienation of movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State including such gains from the alienation of such a permanent establishment (alone or with the whole enterprise), may be taxed in that other State.

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

4. Gains derived by a resident of a Contracting State from the alienation of shares, participation, or other rights in the capital of a company or an interest in a partnership which is a resident of the other Contracting State may be taxed in that other Contracting State.

5. Gains from the alienation of any property other than that referred to in paragraphs 1 to 4, shall be taxable only in the Contracting State of which the alienator is a resident.
6. Where an individual who was a resident of a Contracting State for a period of 5 years or more has become a resident of the other Contracting State, paragraph 5 shall not prevent the first-mentioned State from taxing under its domestic law the capital appreciation of shares in a company resident in the first-mentioned State for the period of residency of that individual in the first-mentioned State. In such case, the appreciation of capital taxed in the first-mentioned State shall not be included in the determination of the subsequent appreciation of capital by the other State."

India-Germany DTAA

“ARTICLE 13 – CAPITAL GAINS

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

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

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

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

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

India-Mauritius DTAA

“ARTICLE 13 – CAPITAL GAINS

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

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

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

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

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

4. Gains from the alienation of any property other than that referred to in paragraphs 1, 2, 3 and 3A shall be taxable only in the Contracting State of which the alienator is a resident.
5. For the purposes of this article, the term "alienation" means the sale, exchange, transfer, or relinquishment of the property or the extinguishment of any rights therein or the compulsory acquisition thereof under any law in force in the respective Contracting States.

India-Cyprus DTAA

"ARTICLE 13 – CAPITAL GAINS"

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

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

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

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

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

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

India-Australia DTAA

"Article 13 – Alienation of Property"

1. Income or gains derived by a resident of one of the Contracting States from the alienation of real property referred to in Article 6 and, as provided in that Article, situated in the other Contracting State may be taxed in that other State.

2. Income or gains derived from the alienation of property, other than real property referred to in Article 6, that forms part of the business property of a permanent establishment which an enterprise of one of the Contracting States has in the other Contracting State or pertains to a fixed base available to a resident of the first-mentioned State in that other State for the purpose of performing independent personal services, including income or gains from the alienation of such a permanent establishment (alone or with the whole enterprise) or of such a fixed base, may be taxed in that other State.

3. Income or gains derived from the alienation of ships or aircraft operated in international traffic, or of property other than real property referred to in Article 6 pertaining to the operation of those ships or aircraft, shall be taxable only in the Contracting State of which the enterprise which operated those ships or aircraft is a resident.

4. Income or gains derived from the alienation of shares or comparable interests in a company, the assets of which consist wholly or principally of real property referred to in Article 6 and, as provided in that Article, situated in one of the Contracting States, may be taxed in that State.

5. Income or gains derived from the alienation of shares or comparable interests in a company, other than those referred to in paragraph (4), may be taxed in the Contracting State of which the company is a resident.
6. Nothing in this Agreement affects the application of a law of a Contracting State relating to the taxation of gains of a capital nature derived from the alienation of property other than that to which any of paragraphs (1), (2), (3), (4) and (5) apply."

**UK-Spain DTAA**

"Article 13 – Capital Gains

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

2. Gains from the alienation of movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State including such gains from the alienation of such a permanent establishment (alone or with the whole enterprise) may be taxed in that other Contracting State.

3. Gains derived by a resident of a Contracting State from the alienation of ships or aircraft operated in international traffic by an enterprise of that State or movable property pertaining to the operation of such ships or aircraft, shall be taxable only in that State.

4. Gains derived by a resident of a Contracting State from the alienation of shares, other than shares in which there is substantial and regular trading on a Stock Exchange, or comparable interests, deriving more than 50 per cent of their value directly or indirectly from immovable property situated in the other Contracting State may be taxed in that other State.

5. Gains from the alienation of shares or other rights, which directly or indirectly entitle the owner of such shares or rights to the enjoyment of immovable property situated in a Contracting State, may be taxed in that State.

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

**India-UK DTAA**

"Article 14- Capital Gains

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

**India-Spain DTAA**

"Article 14 – Capital Gains

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

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

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

4. Gains from the alienation of shares of the capital stock of a company the property of which consists, directly or indirectly, principally of immovable property situated in a Contracting State may be taxed in that State.
5. Gains for the alienation of shares of the capital stock of a company forming part of a participation of at least 10 per cent in a company which is a resident of a Contracting State may be taxed in that Contracting State.

6. Gains from the alienation of any property other than that mentioned in paragraphs 1, 2, 3, 4 and 5 shall be taxable only in the Contracting State of which the alienator is a resident.”
M/s. Vaish & Co., an Indian firm, is a leading Delhi-based international tax consultant, specializing in transfer pricing assignments. The following are the details pertaining to some of its assignments:

(1) Sigma Ltd., operating in India, is one of the dealers for the goods manufactured by Epsilon Ltd., Country B. During the course of assessment, the Assessing Officer, after verification of transactions between Sigma Ltd. and Epsilon Ltd., opined that transfer pricing provisions would become applicable in this case. The Assessing Officer adjusted the total income of Sigma Ltd. by making an addition of `2 crore to the declared income of `6 crore for A.Y.2019-20. It also issued show cause notice asking the company to explain why penalty should not be levied for failure to report such transactions and maintain the requisite records. Sigma Ltd is of the opinion that transfer pricing provisions would not be applicable in its case and hence, there is no question of levy of such penalty. Sigma Ltd. wants to know the lines in which reply needs to be given to the show cause notice.

(2) The following clients want to know whether the operating profit margin declared by them would be accepted by the Income-tax Authorities. They have all exercised a valid option for application of safe harbour rules,—

(a) Alpha Ltd., an Indian company, provides user documentation preparation services to Xylo Inc., which is a “specified foreign company” in relation to Alpha Ltd. The value of the transaction entered into in the P.Y.2018-19 is `87 crore. The operating expenses incurred are `68 crore. It has declared operating profit of `10 crore.

(b) Fulcrum Ltd. is an Indian company, solely engaged in the original manufacture and export of non-core auto components. It exports these parts to Gigo Inc., a foreign company. Fulcrum Ltd. appoints seven out of the twelve Directors of Gigo Inc. The aggregate value of transactions entered into in the P.Y.2018-19 is `25 crore. The operating expenses incurred are `18 crores. It has declared operating profit of `1 crore.

(c) Buttons and Bows Ltd., an Indian company, provides call centre services with the use of information technology to Yale Inc., its foreign subsidiary. The aggregate value of transactions entered into in the P.Y.2018-19 is `192 crore. The operating expenses incurred are `160 crores. It has declared operating profit of `32 crore.
Based on the facts given above and the exhibit given at the end, you are required to answer the following questions:

I. MULTIPLE CHOICE QUESTIONS

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

1. If Fulcrum Ltd. had entered into an agreement for sale of 1,000 units of non-core auto components to Mr. Rajiv, an unrelated party, on 13.7.2018, and Mr. Rajiv had entered into an agreement for sale of such components with Gigo Inc. on 8.7.2018, which of the following statements is correct?

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

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

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

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

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

(i) 2% of the value of transaction

(ii) 50% of tax payable on under-reported income

(iii) 200% of tax payable on under-reported income

(a) Only (i) above

(b) (i) and (ii) above

(c) (i) and (iii) above

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

3. Let us suppose Alpha Ltd. has entered into an advance pricing agreement (APA) in respect of its transactions with Xylo Inc. for the P.Y.2017-18. The company decides to make an application for roll back of the said APA. However, rollback provision shall not be available in respect of the said transaction for a rollback year, if –

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

(ii) determination of the arm’s length price of the said transactions for the said year has been the subject matter of appeal before Commissioner (Appeals) and the Commissioner

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Appeals) has passed an order disposing of such appeal at any time before signing of the agreement.

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

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

The most appropriate answer is -

(a) (i) and (ii) above.

(b) (i) and (iii) above.

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

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

4 Assuming that Fulcrum Ltd.’s business income of A.Y.2019-20 has increased by ₹ 2 crores due to application of arm’s length price by the Assessing Officer, and the same has been accepted by Fulcrum Ltd., then,-

(a) business loss of A.Y.2018-19 cannot be set-off against the enhanced income.

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

(c) unabsorbed depreciation of A.Y.2013-14 cannot be set-off against the enhanced income.

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

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

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

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

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

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

1. Examine whether transfer pricing provisions would be attracted in respect of transactions between Sigma Ltd. and Epsilon Ltd. If so, what is the penalty leviable for defaults, if any, by Sigma Ltd. in compliance of the requisite provisions under the Income-tax Act? (5 Marks)

2. With respect to the transactions listed in (a) to (c) under para (2) in the case study, you are required to analyze –

   (i) the basis on which the parties to the transactions can be deemed as associated enterprises for attracting transfer pricing provisions

   (ii) how the transactions qualify as eligible international transactions.

   (iii) whether the transfer price declared by the assessee in each case can be accepted by the Income-tax authorities, without making any adjustment thereto.

Would your answer change if Yale Inc. is located in a notified jurisdictional area? Examine. (10 Marks)

Exhibit A: Details relating to Sigma Ltd.

(1) Shareholding pattern of Sigma Ltd.

<table>
<thead>
<tr>
<th>Shareholder</th>
<th>Number of equity shares</th>
</tr>
</thead>
<tbody>
<tr>
<td>Himalaya Ltd., India</td>
<td>75,000</td>
</tr>
<tr>
<td>Satpura Ltd., India</td>
<td>90,000</td>
</tr>
<tr>
<td>Vindhyas Ltd., India</td>
<td>45,000</td>
</tr>
<tr>
<td>Epsilon Ltd., Country B</td>
<td>1,40,000</td>
</tr>
<tr>
<td>Aravalli Ltd., India</td>
<td>25,000</td>
</tr>
<tr>
<td>General public</td>
<td>1,50,000</td>
</tr>
</tbody>
</table>

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

(2) Particulars of turnover of Sigma Ltd.

<table>
<thead>
<tr>
<th>Previous Year</th>
<th>Turnover</th>
</tr>
</thead>
<tbody>
<tr>
<td>2015-16</td>
<td>₹ 35 crores</td>
</tr>
<tr>
<td>2016-17</td>
<td>₹ 55 crores</td>
</tr>
<tr>
<td>2017-18</td>
<td>₹ 82 crores</td>
</tr>
<tr>
<td>2018-19</td>
<td>₹ 117 crores</td>
</tr>
</tbody>
</table>
I. ANSWERS TO OBJECTIVE TYPE QUESTIONS

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

2. (c) ₹ 95 lakhs

3. (d) ₹ 1 lakh – fixed penalty

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

5. (c) A.Y.2018-19 and the amount of primary adjustment is ₹1.05 crore

II. ANSWERS TO DESCRIPTIVE QUESTIONS

1. Section 94B is applicable to an Indian company or a permanent establishment of a foreign company in India, being the borrower who pays interest in respect of any form of debt issued by
   
   • non-resident, being an associated enterprises (AE) of such borrower or
   
   • by a lender which is not an AE but where the AE provides either implicit or explicit guarantee to such lender or deposits a corresponding and matching amount of funds with the lender, then such debt would be deemed to have been issued by an AE.

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

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount (₹ in crores)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest paid to A LLC Cyprus [See Note (i)]</td>
<td>80.00</td>
</tr>
<tr>
<td>Transaction Description</td>
<td>Amount</td>
</tr>
<tr>
<td>----------------------------------------------------------------------------------------</td>
<td>---------</td>
</tr>
<tr>
<td>Interest paid to Bank of Chennai based on guarantee provided by A Inc, USA [See Note (ii)]</td>
<td>8.00</td>
</tr>
<tr>
<td>Guarantee Fee paid to A Inc, USA [See Note (iii)]</td>
<td>0.50</td>
</tr>
<tr>
<td>Interest paid to TN Mercantile bank based on letter of comfort by director of A Ltd. [See Note (iv)]</td>
<td>Nil</td>
</tr>
<tr>
<td>Interest paid to Union City Bank, India [See Note (v)]</td>
<td>Nil</td>
</tr>
<tr>
<td>Interest paid to Bank of Taiwan [See Note (vi)]</td>
<td>Nil</td>
</tr>
<tr>
<td>Guarantee fee paid to AAA Ltd., Taiwan [See Note (vi)]</td>
<td>Nil</td>
</tr>
<tr>
<td>Interest paid to Wells Cargo Bank based on deposits made by A Inc, USA [See Note (vii)]</td>
<td>Nil</td>
</tr>
<tr>
<td>Interest paid to Bank of USA based on deposits made by A Inc, USA [See Note (viii)]</td>
<td>12.00</td>
</tr>
<tr>
<td>Interest paid to AA Ltd, China, being interest on delayed payment to creditor [See Note (ix)]</td>
<td>1.00</td>
</tr>
<tr>
<td><strong>Interest paid or payable to non-resident AE</strong></td>
<td>101.50</td>
</tr>
<tr>
<td><strong>EBIDTA</strong></td>
<td>200.00</td>
</tr>
<tr>
<td><strong>Excess Interest: lower of the following would be disallowed</strong></td>
<td>41.50</td>
</tr>
<tr>
<td>- Interest paid or payable to non-resident AE in excess of 30% of EBIDTA [₹ 101.50 crores - ₹ 60.00 crores]</td>
<td>-</td>
</tr>
<tr>
<td>- Interest paid or payable to non-resident AE</td>
<td>₹ 101.50 crores</td>
</tr>
<tr>
<td>Therefore, interest paid or payable allowable as deduction under the head “Profits and gains of business or profession” would be ₹ 76.25 crores [₹ 60 crores (₹ 101.50 crores – ₹ 41.50 crores), being the amount paid or payable to non-resident AE <strong>plus</strong> ₹ 16.25 crores, being the amount paid to other entities]</td>
<td>76.25</td>
</tr>
</tbody>
</table>

**Notes:**

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

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

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

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

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

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

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

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

(vi) Since A Ltd.’s voting power in AAA Ltd., Taiwan is less than 26%, AAA Ltd., Taiwan is not an AE of A Ltd. Since loan was obtained by A Ltd from Bank of Taiwan, Indian branch, for which guarantee was given by an enterprise, not being an AE, this interest shall not be considered for the purposes of section 94B. Likewise, guarantee fee paid to AAA Ltd. shall also not be considered for the purposes of section 94B.
The proviso to section 94B(1) provides that “where the debt is issued by a lender which is not associated but an associated enterprise either provides an implicit or explicit guarantee to such lender or deposits a corresponding and matching amount of funds with the lender, such debt shall be deemed to have been issued by an associated enterprise.”

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

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

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

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

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

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

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1 CIT v. Vijay Ship Breaking Corporation decision of Supreme Court [2008] 175 Taxman 77 (SC)
interest paid towards delayed payment has to be considered for the purpose of limitation of interest deduction under section 94B.

**ALTERNATE ANSWER:**

Section 94B(1) of the Income-tax Act, 1961, provides that notwithstanding anything contained in this Act, where an Indian company, or a permanent establishment of a foreign company in India, being the borrower, incurs any expenditure by way of interest or of similar nature exceeding one crore rupees which is deductible in computing income chargeable under the head "Profits and gains of business or profession" in respect of any debt issued by a non-resident, being an associated enterprise of such borrower, the interest **shall not be deductible** in computation of income under the said head to the extent that it arises from excess interest, as specified in sub-section (2).

As per section 94B(2), the excess interest shall mean an amount of **total interest paid or payable** in excess of 30% of earnings before interest, taxes, depreciation and amortization (EBITDA) of the borrower in the previous year or interest paid or payable to associated enterprises for that previous year, whichever is less.

As per Explanatory Memorandum to the Finance Bill, 2017, the interest expenses claimed by an entity to its associated enterprises shall be restricted to 30% of its earnings before interest, taxes, depreciation and amortization (EBITDA) or interest paid or payable to associated enterprise, whichever is less. It implies that “excess interest” means the amount

- interest paid or payable by an entity to its non-resident associated enterprises in excess of 30% of earnings before interest, taxes, depreciation and amortization (EBITDA) of the borrower in the previous year or
- interest paid or payable to non-resident associated enterprises for that previous year,

whichever is less.

The intent behind insertion of this section also appears to restrict the interest paid to non-resident AE to 30% of EBITDA. In the above solution, the excess amount is computed in line with the intent expressed in section 94B(1) read with the Explanatory Memorandum.

However, an alternate view may also be possible on the basis of the interpretation as per the plain reading of section 94B(2).

On a plain reading of provisions of section 94B(2), it appears that the “excess amount” has to be computed by taking–
- **total interest paid or payable** by the borrower in excess of 30% of earnings before interest, taxes, depreciation and amortization (EBITDA) of the borrower in the previous year or

- interest paid or payable to associated enterprises for that previous year, whichever is less.

Accordingly, the interest disallowance and amount of interest paid or payable by A Ltd allowable as deduction under the head “Profits and gains of business or profession” would be –

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount (₹ in crores)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest paid to A LLC Cyprus</td>
<td>80.00</td>
</tr>
<tr>
<td>Interest paid to Bank of Chennai based on guarantee provided by A Inc, USA</td>
<td>8.00</td>
</tr>
<tr>
<td>Guarantee Fee paid to A Inc, USA</td>
<td>0.50</td>
</tr>
<tr>
<td>Interest paid to TN Mercantile bank based on letter of comfort by director of A Ltd.</td>
<td>4.00</td>
</tr>
<tr>
<td>Interest paid to Union City Bank, India</td>
<td>3.00</td>
</tr>
<tr>
<td>Interest paid to Bank of Taiwan</td>
<td>3.00</td>
</tr>
<tr>
<td>Guarantee fees paid to AAA Ltd., Taiwan</td>
<td>0.25</td>
</tr>
<tr>
<td>Interest paid to Wells Cargo Bank based on deposits made by A Inc, USA</td>
<td>6.00</td>
</tr>
<tr>
<td>Interest paid to Bank of USA based on deposits made by A Inc, USA</td>
<td>12.00</td>
</tr>
<tr>
<td>Interest paid to AA Ltd., China being interest on delayed payment to creditor</td>
<td>1.00</td>
</tr>
<tr>
<td><strong>Total interest paid or payable by A Ltd.</strong></td>
<td><strong>117.75</strong></td>
</tr>
<tr>
<td><strong>Interest paid or payable to non-resident AE (computed above)</strong></td>
<td><strong>101.50</strong></td>
</tr>
<tr>
<td><strong>EBIDTA</strong></td>
<td><strong>200.00</strong></td>
</tr>
</tbody>
</table>

**Excess Interest: lower of the following would be disallowed,**

- Total interest paid or payable in excess of 30% of ₹ 57.75 crores EBITDA [i.e., ₹ 117.75 crores – ₹ 60.00 crores]

- Interest paid or payable to non-resident AE ₹ 101.50 crores

Therefore, interest paid or payable allowable as deduction under the head “Profits and gains of business or profession” would be ₹ 60 crores (₹117.75 crores – ₹ 57.75 crores)
2. (i) Multinational groups are often able to structure their financing arrangements to maximize these benefits. To prevent tax erosion on account of such arrangements, country's tax administrations often introduce rules that place a limit on the amount of interest that can be deducted in computing a company's profit for tax purposes. Such rules are designed to counter cross-border shifting of profit through excessive interest payments, and thus aim to protect a country's tax base. Under the initiative of the G-20 countries, the Organization for Economic Co-operation and Development (OECD) in its Base Erosion and Profit Shifting (BEPS) project had taken up the issue of base erosion and profit shifting by way of excess interest deductions by the MNEs in its Action plan 4. The OECD has recommended several measures in its final report to address this issue. In view of the above, section 94B has been inserted in the Income-tax Act, 1961, in line with the recommendations of OECD BEPS Action Plan 4, to provide that interest paid or payable by an entity to its non-resident associated enterprises shall be restricted to 30% of its earnings before interest, taxes, depreciation and amortization (EBITDA) or interest paid or payable to non-resident associated enterprises, whichever is less.

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

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

1. (c)  
2. (d)  
3. (c)  
4. (d)  
5. (b)

II. ANSWERS TO DESCRIPTIVE QUESTIONS

1. (a) Mr. Harry Smith is a non-resident in India for A.Y.2019-20, since he has stayed in India only for 54 days in the P.Y.2018-19. Ms. Rita Smith would also be non-resident in India for A.Y.2019-20, since she has also stayed in India only for 54 days in the P.Y.2018-19. Since Mr. Harry Smith is a non-resident sports person, who is not a citizen of India, the special provisions under section 115BBA would apply to him for income from participation in swimming competition in India, advertisement of product on TV and contribution of articles in newspaper. Income from horse races would, however, be taxable@30% under section 115BB. Since Ms. Rita Smith is a non-resident entertainer, who is not a citizen of India, the special provisions under section 115BBA would apply to her for computation of income from music performances.

Computation of tax liability of Harry Smith for the A.Y.2019-20

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income taxable under section 115BBA</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income from participation in swimming competition in India</td>
<td>15,00,000</td>
<td></td>
</tr>
<tr>
<td>Advertisement of product on TV</td>
<td>2,00,000</td>
<td></td>
</tr>
<tr>
<td>Contribution of articles in newspaper</td>
<td>20,000</td>
<td></td>
</tr>
</tbody>
</table>
Income taxable under section 115BB

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income from horse races</td>
<td>25,000</td>
</tr>
<tr>
<td><strong>Total income</strong></td>
<td><strong>17,45,000</strong></td>
</tr>
</tbody>
</table>

Tax@ 20% under section 115BBA on ₹ 17,20,000  | 3,44,000 |
Tax@ 30% under section 115BB on income of ₹ 25,000 from horse races | 7,500 |

Add: Health & Education cess@4%          | 14,060  |

**Total tax liability of Harry Smith for the A.Y.2019-20** | **3,65,560** |

Computation of tax liability of Rita Smith for the A.Y.2019-20

<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 music performances given in India</td>
<td>2,00,000</td>
</tr>
<tr>
<td><strong>Total income</strong></td>
<td><strong>2,00,000</strong></td>
</tr>
</tbody>
</table>

Tax@ 20% under section 115BBA on ₹ 2,00,000 | 40,000 |
Add: Health & education cess@4%          | 1,600   |

**Total tax liability of Rita Smith for the A.Y.2019-20** | **41,600** |

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

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

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

2. (a) MNO Ltd. is a non-resident assessee during the previous year relevant to assessment year 2019-20. As per Explanation 1(b) of section 9(1)(i), no income shall be deemed to accrue or arise in India to a non-resident through or from operations which are confined to purchase of goods in India for the purpose of export. MNO Ltd. had purchased the goods in India and thereafter exported the same in total to China and accordingly no
income of MNO Ltd. shall be subject to tax for assessment year 2019-20.

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

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

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

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

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

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

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

The business income chargeable to tax in the hands of M/s. Pacific Airlines is ₹ 11 crores. No deduction is allowable in respect of any expenditure incurred to earn such income.
I. ANSWERS TO MCQs (Most appropriate answers)

1. (d)
2. (c)
3. (c)
4. (b)
5. (c)

II. ANSWERS TO DESCRIPTIVE QUESTIONS

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

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

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

a) He has been in India during the previous year for a total period of 182 days or more; or
b) He has been in India during the 4 years immediately preceding the previous year for total period of 365 days or more and has been in India for at least 60 days in the previous year.

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

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

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

(i) He is a resident in at least 2 out of 10 years preceding the relevant previous year, and
(ii) His total stay in India in last seven years preceding P.Y. 2018-19 is 730 days or more.

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

As per Country “Q” tax residency rules, Shivam qualifies to be resident for the year 2018-19 in Country “Q”, since he stays for 182 days (more than 180 days) in Country “Q” in the Financial Year 2018-19.
Thus, as per the domestic tax laws of India and Country “Q”, Shivam qualifies to be a resident both in India and Country “Q” during the year 2018-19. Hence, the tie-breaker rule provided in Article 4(2) of the India-Country “Q” DTAA will come into play.

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

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

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

(a) the residential property is located and
(b) social and cultural activities are closer

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

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

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

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

<table>
<thead>
<tr>
<th>Particulars</th>
<th>INR</th>
<th>INR</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Income from Salaries</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Salary from services rendered in India (April - September 2018)</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Basic Salary (INR 70,000 x 6)</td>
<td>4,20,000</td>
<td></td>
</tr>
<tr>
<td>Dearness Allowance (INR 30,000 x 6)</td>
<td>1,80,000</td>
<td></td>
</tr>
<tr>
<td>Special Allowance (INR 5,000 x 6)</td>
<td>30,000</td>
<td></td>
</tr>
<tr>
<td>Bonus</td>
<td>3,00,000</td>
<td></td>
</tr>
<tr>
<td>[Even though bonus is paid in an overseas bank account after the commencement of his overseas assignment, however, since it pertains to services rendered in India, it would be taxable in India]</td>
<td>9,30,000</td>
<td></td>
</tr>
</tbody>
</table>
### Salary from services rendered in Country “Q” (October 2018 - March 2019)

<table>
<thead>
<tr>
<th>Description</th>
<th>INR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Basic Salary [See Note (i)]</td>
<td>3,93,680</td>
</tr>
<tr>
<td>Cost of Living Allowance [See Note (i)]</td>
<td>2,81,200</td>
</tr>
<tr>
<td><strong>Less: Standard deduction u/s 16(ia)</strong></td>
<td></td>
</tr>
<tr>
<td></td>
<td>40,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>15,64,880</td>
</tr>
</tbody>
</table>

### Income from House Property at Mumbai

<table>
<thead>
<tr>
<th>Description</th>
<th>INR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Annual Value [See Note (ii)]</td>
<td>6,00,000</td>
</tr>
<tr>
<td><strong>Less: Standard deduction @ 30%</strong></td>
<td>(1,80,000)</td>
</tr>
<tr>
<td></td>
<td>4,20,000</td>
</tr>
</tbody>
</table>

### Income from Other Sources

<table>
<thead>
<tr>
<th>Description</th>
<th>INR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest earned from investment of security deposit (INR 1,00,000 @10%)</td>
<td>10,000</td>
</tr>
<tr>
<td>Interest earned on saving bank account with Country “Q” [QGD 150 x INR 48.61]</td>
<td>7,292</td>
</tr>
<tr>
<td>Interest on Securities of a Country “Q” company [QGD 5000 x INR 48.52]</td>
<td>2,42,600</td>
</tr>
<tr>
<td>Interest on bonds issued by Country “P” Government</td>
<td>30,000</td>
</tr>
<tr>
<td>Dividend from a Country “Q” Company (QGD 1000 x INR 48.52)</td>
<td>48,520</td>
</tr>
<tr>
<td><em>(Dividend from foreign company is taxable in India)</em></td>
<td></td>
</tr>
<tr>
<td><strong>Gross Total Income</strong></td>
<td>3,38,412</td>
</tr>
</tbody>
</table>

### Less: Deductions under Chapter VI-A

<table>
<thead>
<tr>
<th>Description</th>
<th>INR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deduction u/s 80DD</td>
<td>75,000</td>
</tr>
<tr>
<td><em>(Flat deduction of INR 75,000 is allowed in respect of medical treatment of dependent disabled, irrespective of the expenditure incurred)</em></td>
<td></td>
</tr>
<tr>
<td>Deduction u/s 80GG [See Note (iii)]</td>
<td>60,000</td>
</tr>
<tr>
<td><strong>Total Income</strong></td>
<td>21,88,292</td>
</tr>
</tbody>
</table>

### Total Income (rounded off)

**Total Income (rounded off)**

21,88,290

---

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

<table>
<thead>
<tr>
<th>Particulars</th>
<th>INR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax on INR 21,88,290</td>
<td>4,68,987</td>
</tr>
<tr>
<td><strong>Add: Health and education cess @4%</strong></td>
<td>18,759</td>
</tr>
<tr>
<td>Tax Liability</td>
<td>4,87,746</td>
</tr>
<tr>
<td><strong>Less: Foreign Tax Credit [See Note (v)]</strong></td>
<td></td>
</tr>
</tbody>
</table>
- on salary income 98,709
- on interest income 36,390

Net tax liability 1,35,099
Net tax liability (rounded off) 3,52,647

Notes:

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

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

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

### Overseas salary for the period October 2018 to March 2019:

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

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

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

Deduction shall be lower of the following:

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

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

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

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

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

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

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

**Calculation of foreign tax credit**

<table>
<thead>
<tr>
<th>Doubly taxed Salary Income</th>
<th>INR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Basic Salary</td>
<td>3,93,680</td>
</tr>
<tr>
<td>Cost of Living Allowance</td>
<td>2,81,200</td>
</tr>
<tr>
<td><strong>Less: Standard deduction (40,000 x 6,74,880/16,04,880)</strong></td>
<td>16,821</td>
</tr>
<tr>
<td><strong>Doubly taxed salary income</strong></td>
<td><strong>6,58,059</strong></td>
</tr>
</tbody>
</table>

**Computation of foreign tax credit on doubly taxed salary income:**

**Lower of:**
- Tax withheld in Country “Q” on salary income at 15% = 98,709
- Tax payable in India on salary income@22.29% (INR 4,87,746/ INR 21,88,290) = 1,46,681

**Foreign tax credit = 98,709**

<table>
<thead>
<tr>
<th>Double taxed Interest Income</th>
<th>INR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest Income on Securities of Country “Q” company</td>
<td>2,42,600</td>
</tr>
</tbody>
</table>

**Computation of foreign tax credit on doubly taxed interest income:**

**Lower of:**
- Tax withheld in Country “Q” on interest income at 15%, which is also the rate as per the DTAA = 36,390
<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax payable in India on interest</td>
<td>54,076</td>
</tr>
<tr>
<td>income@22.29%</td>
<td></td>
</tr>
<tr>
<td>Foreign tax credit</td>
<td>36,390</td>
</tr>
</tbody>
</table>

*Note – Questions based on interpretation of articles of a DTAA may have alternate views.*
I. ANSWERS TO MCQs (Most appropriate answers)
1. (a)
2. (d)
3. (c)
4. (a)
5. (c)

II. ANSWERS TO DESCRIPTIVE QUESTION

Answer to Q.1:
Computation of total income of Mr. Arjun Batra for the A.Y.2019-20

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

Computation of tax liability of Mr. Arjun Batra for A.Y.2019-20

<table>
<thead>
<tr>
<th></th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax on Rs.35.7 lakhs, being non-agricultural income [Rs.32.5 lakhs] + agricultural income [Rs.3.2 lakhs]</td>
<td></td>
</tr>
<tr>
<td>Tax on LTCG of Rs.8 lakhs@20%</td>
<td>1,60,000</td>
</tr>
<tr>
<td>(+) Tax on other income of Rs.27.7 lakhs</td>
<td>6,43,500</td>
</tr>
<tr>
<td></td>
<td>8,03,500</td>
</tr>
</tbody>
</table>
(-) Tax on Rs.5.7 lakhs, being agricultural Income [Rs.3.2 lakhs] + Basic Exemption Limit [Rs.2.5 lakhs]  

<table>
<thead>
<tr>
<th>Add: Health and education cess @4%</th>
<th>26,500</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>7,77,000</td>
</tr>
<tr>
<td></td>
<td>31,080</td>
</tr>
<tr>
<td></td>
<td><strong>8,08,080</strong></td>
</tr>
</tbody>
</table>

Indian rate of tax = \( \frac{8,08,080 \times 100}{32,50,000} = 24.864\% \)

Less: Rebate u/s 91 on income of Country E + Country F  

Tax payable in India  

Tax payable (Rounded off)  

<table>
<thead>
<tr>
<th>Computation of average rate of tax in Country E</th>
<th>Rs. in lakhs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross rental receipts from commercial property [No deduction is allowed from this in Country E]</td>
<td>2.0</td>
</tr>
<tr>
<td>Share income from partnership firm (loss) to be ignored</td>
<td>-</td>
</tr>
<tr>
<td>Business income</td>
<td>2.2</td>
</tr>
<tr>
<td>STCG from sale of vacant site on 1-11-2018</td>
<td>15.0</td>
</tr>
<tr>
<td>Agricultural income [Exempt in Country E]</td>
<td>-</td>
</tr>
<tr>
<td><strong>Total income</strong></td>
<td><strong>19.2</strong></td>
</tr>
</tbody>
</table>

**Rates of tax in Country E**

<table>
<thead>
<tr>
<th></th>
<th>Rs. in lakhs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Upto 3 lakhs</td>
<td>Nil</td>
</tr>
<tr>
<td>3 to 6 lakhs</td>
<td>15%</td>
</tr>
<tr>
<td>Above 6 lakhs</td>
<td>22%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>19.2</strong></td>
</tr>
</tbody>
</table>

Average rate of tax in Country E = \( \frac{3.354 \times 100}{19.2} = 17.469\% \)

**Doubly Taxed Income (in Country E)**

<table>
<thead>
<tr>
<th></th>
<th>Rs. in lakhs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross rental receipts from commercial property (Rs.2 lakhs – Rs.0.6 lakhs, being 30% of Rs.2 lakhs)</td>
<td>1.4</td>
</tr>
<tr>
<td>Share of loss from partnership firm</td>
<td>(1.0)</td>
</tr>
<tr>
<td>Business income</td>
<td>2.2</td>
</tr>
<tr>
<td>STCG from sale of vacant site on 1-11-2018</td>
<td>15.0</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>17.6</strong></td>
</tr>
</tbody>
</table>

Double Taxation Relief at India rate of tax or rate of tax in Country E, whichever is lower

Double Taxation Relief = 17.469% of Rs.17.6 lakhs = Rs.3,07,454

**Doubly Taxed Income (in Country F)**

<table>
<thead>
<tr>
<th></th>
<th>Rs. in lakhs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross rental receipts from commercial property [Rs.3 lakhs (-) 30% of Rs.3 lakhs]</td>
<td>2.1</td>
</tr>
<tr>
<td>Business income</td>
<td>3.3</td>
</tr>
<tr>
<td>Share of loss from partnership firm</td>
<td>(1.5)</td>
</tr>
<tr>
<td>Agricultural income</td>
<td>1.8</td>
</tr>
<tr>
<td><strong>Total income</strong></td>
<td><strong>5.7</strong></td>
</tr>
</tbody>
</table>

Rate of Tax in Country F  

Double Taxation Relief at Indian rate of tax (24.864%) or rate of tax in Country F  

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<table>
<thead>
<tr>
<th>(27%), whichever is lower</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Double Taxation Relief = 24.864% of Rs.5.7 lakhs = Rs.1,41,725</td>
<td></td>
</tr>
<tr>
<td>Double Taxation Relief [Country E &amp; Country F] = Rs.3,07,454 + Rs.1,41,725</td>
<td>4,49,179</td>
</tr>
</tbody>
</table>
I. ANSWERS TO MCQs (Most appropriate answers)
1. (b)
2. (b)
3. (a)
4. (a)
5. (d)

II. ANSWERS TO DESCRIPTIVE QUESTIONS

Answer to Q.1:

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

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

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Mauritius</th>
<th>India</th>
<th>Total</th>
<th>% of (3) to total in (4)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Value of assets</td>
<td>Rs.2 lakhs</td>
<td>Rs.50,000</td>
<td>Rs.2,50,000</td>
<td>20.00%</td>
</tr>
<tr>
<td>Number of employees</td>
<td>3</td>
<td>1</td>
<td>4</td>
<td>25.00%</td>
</tr>
<tr>
<td>Payroll expenses on employees</td>
<td>Rs.15 lakhs</td>
<td>Rs.5 lakhs</td>
<td>20</td>
<td>25.00%</td>
</tr>
</tbody>
</table>

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

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income from transactions where both purchases and sales are from/to associated enterprises</td>
<td>0</td>
</tr>
<tr>
<td>Total income by way of dividend and interest</td>
<td>4,00,000</td>
</tr>
<tr>
<td>Total income (Income from Product Sales from Modern Bazaar plus income by way of dividend and interest)</td>
<td>15,00,000</td>
</tr>
</tbody>
</table>

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

Percentage of passive income to total income = 4/15 × 100 = 27%
In this case, the passive income is less than 50% of the company’s total income. Hence, the passive income test is met and the company has its Active Business Outside India.

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

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

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

Answer to Q.2:

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

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

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

(b) RB Pvt. Ltd. is liable to deduct equalization levy of Rs.60,000 from the amount of Rs.10 lakhs payable to Facebook Inc. In case it fails to so deduct equalization levy, it shall, notwithstanding such failure, be liable to pay the levy to the credit of the Central Government by 7th April, 2019. Further, penalty of an amount equal to Rs. 60,000 would be attracted for failure to deduct equalization levy. Also, disallowance of the expenditure of Rs.10 lakhs would be attracted under section 40(a)(ib) while computing business income of RB Pvt. Ltd.

(c) Section 10(50) of the Income-tax Act, 1961 exempts income arising from providing specified service of online advertisement, which are subject to equalization levy, from income-tax.
SOLUTION TO CASE STUDY 6

I. ANSWERS TO MCQs (Most appropriate answers)
1. (c)
2. (d)
3. (d)
4. (c)
5. (b)

II. ANSWERS TO DESCRIPTIVE QUESTIONS

Answer to Q.1:

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

Further, Explanation 6 to section 9(1)(i), provides that the share or interest in a company or entity registered or incorporated outside India, shall be deemed to derive its value substantially from the assets (whether tangible or intangible) located in India, if on the specified date, the value of Indian assets:
- exceeds the amount of INR 10 crores; and
- represents at least 50% of the value of all assets owned by the company, or entity, as the case may be

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

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

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

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

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

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

In the instant case, specified date is 31.05.2019
Fair value of assets of Singapore Intermediary Co as on 31.5.2019 - INR 50 crores
Fair value of Ind Co as on 31.5.2019 (without reduction of liabilities) - INR 200 crores
Fair value of Ind Co as held by Singapore Intermediary Co (20%) - INR 40 crores

Since, the value of assets located in India i.e., INR 40 crores exceeds INR 10 crores and also exceeds 50% of the value of assets of Singapore Intermediary Co, the shares of Singapore Intermediary Co would be deemed to derive its value substantially from assets located in India.
Hence, the shares of Singapore Intermediary Co would be deemed to be a capital asset situated in India and the capital gains from transfer of shares of Singapore Intermediary Co would be deemed to accrue or arise in India. Accordingly, the gains would be taxable in the hands of US Co in India as per the Income-tax Act, 1961. However, the provisions of the applicable DTAA would need to be examined.

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

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

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

In the instant case, specified date is 31.05.2019

Fair value of assets of Mauritius Intermediary Co as on 31.5.2019 - INR 60 crores
Fair value of Ind Co as on 31.5.2019 (without reduction of liabilities) - INR 200 crores
Fair value of Ind Co as held by Mauritius Intermediary Co (25%) - INR 50 crores

Since, the value of assets located in India i.e., INR 50 crores exceeds INR 10 crores and also exceeds 50% of the value of assets of Mauritius Intermediary Co, shares of Mauritius Intermediary Co would be deemed to derive its value substantially from assets located in India.

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

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

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

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

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

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

In the instant case, specified date is 31.05.2019

Fair value of assets of Australian Intermediary Co as on 31.5.2019 - INR 300 crores
Fair value of Ind Co as on 31.5.2019 (without reduction of liabilities) - INR 200 crores
Fair value of Ind Co as held by Australian Intermediary Co (51%) - INR 102 crores
Since, the value of assets located in India i.e., INR 102 crores exceeds INR 10 crores but it does not represent at least 50% of the value of assets of Australian Intermediary Co, shares of Australian Intermediary Co would not be deemed to derive its value substantially from assets located in India.

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

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

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

In the instant case, specified date is 31.03.2019

Fair value of assets of Spain Intermediary Co as on 31.3.2019 - INR 12 crores

Fair value of Ind Co as on 31.3.2019 (without reduction of liabilities) - INR 200 crores

Fair value of Ind Co as held by Spain Intermediary Co (4%) - INR 8 crores

Since, the value of assets located in India i.e., INR 8 crores does not exceed INR 10 crores, shares of Spain Intermediary Co would not be deemed to derive its value substantially from assets located in India.

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

Accordingly, it would not be necessary to examine the provisions of the applicable DTAA.
I. ANSWERS TO MCQs

<table>
<thead>
<tr>
<th>MCQ No.</th>
<th>Answer</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>(d)</td>
</tr>
<tr>
<td>2.</td>
<td>(c)</td>
</tr>
<tr>
<td>3.</td>
<td>(d)</td>
</tr>
<tr>
<td>4.</td>
<td>(b)</td>
</tr>
<tr>
<td>5.</td>
<td>(d)</td>
</tr>
</tbody>
</table>

II. ANSWERS TO DESCRIPTIVE QUESTIONS

Answer to Q.1

Sigma Ltd., India and Epsilon Ltd., Country B are deemed to be associated enterprises, since Epsilon Ltd. holds shares carrying 26.66% \( \left[ \frac{1,40,000 \times 100}{5,25,000} \right] \), voting power in Sigma Ltd, from the information given in Exhibit A. Since Epsilon Ltd. is a non-resident, the transactions of purchase by Sigma Ltd. of goods manufactured by Epsilon Ltd. for sale in India would fall within the meaning of “international transaction” under section 92B. Therefore, transfer pricing provisions would be attracted in this case and the arm’s length price has to be applied to such transactions.

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

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

(1) Failure to report transactions with Epsilon Ltd. would attract penalty of ₹ 111.28 lakhs, being @ 200% of the amount of tax payable on under reported income of ₹ 2 crore, since it is a case of misreporting of income referred under section 270A(9) read with section 270A(8).

### Computation of penalty leviable under section 270A

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Under-reported income [₹ 8 crore – ₹ 6 crore]</td>
<td>2,00,00,000</td>
</tr>
<tr>
<td><strong>Tax payable on under-reported income:</strong></td>
<td></td>
</tr>
<tr>
<td>Tax on under-reported income of ₹ 2 crore plus total income of ₹ 6 crore declared [25% of ₹ 8 crore + surcharge@ 7% + HEC@4%]</td>
<td>2,22,56,000</td>
</tr>
<tr>
<td>Less: Tax on total income declared [25% of ₹ 6 crore + Surcharge@7% + HEC@4%]</td>
<td>1,66,92,000</td>
</tr>
<tr>
<td>Penalty leviable@200% of tax payable on under-reported income</td>
<td>55,64,000</td>
</tr>
</tbody>
</table>

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Failure to report the transaction and maintain the requisite records as required under section 92D in relation to international transaction makes it liable for penalty under section 271AA which would be 2% of the value of international transaction with Epsilon Ltd.\(^1\)

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

**Answer to Q.2**

(a) Xylo Inc. is a specified foreign company in relation to Alpha Ltd. Therefore, the condition of Alpha Ltd. holding shares carrying not less than 26% of the voting power in Xylo Inc. is satisfied. Hence, Xylo Inc. and Alpha Ltd. are deemed to be associated enterprises. Therefore, provision of user documentation services by Alpha Ltd., an Indian company, to Xylo Inc., a foreign company, is an international transaction between associated enterprises, and consequently, the provisions of transfer pricing are attracted in this case.

Preparation of user documentation services falls within the definition of “software development services”, and hence, is an eligible international transaction. Since Alpha Ltd. is providing software development services to a non-resident associated enterprise and has exercised a valid option for safe harbour rules, it is an eligible assessee.

Since the value of international transaction entered does not exceed \(\text{₹} \, 100\) crore, Alpha Ltd. should have declared an operating profit margin of not less than 17% in relation to operating expense, to be covered within the safe harbour rules. However, since Alpha Ltd. has declared an operating profit margin of only 14.71% \(\left[\frac{10 \times 100}{68}\right]\), the same is not in accordance with the circumstance mentioned in Rule 10TD. Hence, it is not binding on the income-tax authorities to accept the transfer price declared by Alpha Ltd.

(b) Fulcrum Ltd. and Gigo Inc. are deemed to be associated enterprises since Fulcrum Ltd. appoints more than half of the Board of Directors of Gigo Inc. Manufacture and export of non-core auto components is an eligible international transaction. Since Fulcrum Ltd. is engaged in original manufacture of non-core auto components and export of the same, it is an eligible assessee.

Fulcrum Ltd. should have declared an operating profit margin of not less than 8.5% in relation to operating expense, to be covered within the scope of safe harbour rules. In this case, since Fulcrum Ltd. has declared an operating profit margin of 5.55% \(\left[\frac{1 \times 100}{18}\right]\), the same is not in accordance with the circumstance mentioned in Rule 10TD. Hence, it is not binding on the income-tax authorities to accept the transfer price declared by Fulcrum Ltd in respect of such international transaction.

(c) Yale Inc., a foreign company, is a subsidiary of Buttons & Bows Ltd., an Indian company. Hence, Yale Inc. and Buttons & Bows Ltd. are associated enterprises. Therefore, provision of call centre services by Buttons & Bows Ltd., an Indian company, to Yale Inc., a foreign company, is an international transaction between associated enterprises, and consequently, the provisions of transfer pricing are attracted in this case.

Call centre services with the use of information technology falls within the definition of “information technology enabled services”, and is hence, an eligible international transaction. Since Buttons & Bows Ltd. is providing call centre services to a non-resident associated enterprise and has exercised a valid option for safe harbour rules, it is an eligible assessee.

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\(^1\) Since the value of international transaction is not given in the question, computation of penalty is not possible in this case.
Since the aggregate value of transactions entered into in the P.Y.2018-19 exceeds ₹ 100 crore but does not exceed ₹ 200 crore, Buttons & Bows Ltd. should have declared an operating profit margin of not less than 18% in relation to operating expense, to be covered within the scope of safe harbour rules. In this case, since Buttons & Bows Ltd. has declared an operating profit margin of 20% \[\frac{32 \times 100}{160}\], the same is in accordance with the circumstance mentioned in Rule 10TD. Hence, the income-tax authorities shall accept the transfer price declared by Buttons & Bows Ltd. in respect of such international transaction.

The safe harbour rules shall not apply in respect of eligible international transactions entered into with an associated enterprise located in a notified jurisdictional area. Therefore, in respect of (c) above, if Yale Inc. is located in a NJA, the safe harbour rules shall not be applicable, irrespective of the operating profit margin declared by the assessee.