CASE STUDY 1

Athena Ltd. is a company specializing in manufacture of electronic products such as hair straighteners and curlers. Athena Ltd. was incorporated in Country A in September 2011.

Athena Ltd. set up its own manufacturing facility by July 2012 and set up its first retail store in December 2012 in Country A. The retail store displayed and sold the various variants of straighteners and curlers that it had manufactured. The products are sold under Athena’s registered trade mark. The first retail store showed tremendous success and sales. Given the success, between the years 2013 to 2016, Athena grew its network of retail stores in Country A. By the end of 2016, it had set up a total of ten retail stores in Country A.

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

Athena Ltd. seeks to expand its presence to other countries including India in the previous year 2017-18. India is a potential market and seems to be a profitable move for the company.

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

Stage I:

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

The functions to be discharged by such professionals include authoring a detailed project report enumerating the domestic landscape of the Indian legal and business regulations that would govern the proposed business in India. For example, what are the legal and regulatory compliances required for setting up a business? What is the projected growth trend of the hair care industry? Who are the market rivals and what is their respective market share? The project report would also include financial projections regarding the profitability for next five years.
The professionals are expected to work independently but can raise any queries to the board of directors of Athena Ltd. These professionals will be given two months to complete the report and present the findings to the board of directors. The remuneration of the professionals would be taken care of, by Athena Ltd.

Pursuant to the strategy, Mr. Hari, Mr. Rajesh and Mr. Ravi were hired by Athena Ltd. on March 1, 2017. Their monthly remuneration were fixed at INR 75,000, INR 82,000 and INR 80,000 respectively, for the two month period. The report was duly submitted by them to the board of Athena Ltd. on April 30, 2017. The board was happy to receive the report and duly considered the findings submitted.

**Stage II:**

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

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

After a host of interviews, Mr. Shyam was found eligible for the position of the agent. The terms of engagement of Mr. Shyam were fixed for four months. Mr. Shyam acted as an agent from June 2017 to September 2017. He received a remuneration of INR 1,50,000 per month for the performance of his functions, as described above.

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

**Stage III:**

The third step is to launch and sell the products in India using e-commerce, given the wide spread use of digital means such as websites and phone based apps by Indians for shopping online. The website, www.athena.in, was designed and hosted such that Indian users can make use of its services for placing orders in India. The website was hosted on a server based in Cayman Islands, owned and operated by Athena Ltd. The business was carried on through the server, which carries on the entire set of operations. The Indian user merely has to click on the desired product and fill in the details of the desired address for delivery and make payment using a payment gateway, after which the order is confirmed and delivery is ensured.
In order to enable the delivery of the straighteners and curlers to Indian customers, Athena Ltd. identified warehouse(s) where the stock can be maintained and from which the orders of the customers can be satisfactorily met. Athena Ltd. directly supplied the stock from the Country A entity to the local warehouses.

The website was functional for the said purpose in October, 2017 and thereafter, online sales were effected through the website at the price decided by Athena Ltd. During October 1, 2017 to December 31, 2017 Athena Ltd. was able to sell 2500 units of hair straighteners and 1500 units of hair curlers to customers based in India. The hair dryer was priced at INR 2,500 while the hair curler was priced at INR 3,500.

**Stage IV:**

As a fourth step, the board of Athena Ltd. reviewed the strategies adopted. Encouraged by the positive market response in India, the board of Athena Ltd. decided to set up a branch in Mumbai in January, 2018. Mr. Garg and Mr. Patnaik, who are residing in Mumbai, are now entrusted with spearheading the Indian operations and expansion strategy. Sales were effected through the Mumbai branch from January, 2018 itself.

**Additional facts:**

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

The company enters into talks with Google Inc. for hosting the desired advertisements. It negotiated a sum of INR 30,00,000, which is paid to Google Inc. in March, 2018 for online advertising services.

Google Inc does not have a permanent establishment in India.

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

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

**I. MULTIPLE CHOICE QUESTIONS**

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

1. The income earned by Athena Ltd. from sale of hair straighteners and hair curlers in India during the period from June, 2017 to December, 2017 –
   
   (a) Would not be taxable in India, since no business connection is established on account of Mr. Shyam not having authority to conclude contracts on behalf of Athena Ltd.
   
   (b) Would be taxable in India, since business connection would be established on account of Mr. Shyam securing orders in India wholly for Athena Ltd.
   
   (c) Would not be taxable in India, since Athena Ltd. does not have a PE in India
   
   (d) Would be taxable in India, since Athena Ltd. has a PE in India
2. Dividend from an Indian company is exempt in the hands of a non-resident shareholder by virtue of section 10(34). Can such income be subject to tax in his hands in accordance with the provisions of the tax treaty?

(a) Yes, since the provisions of the treaty override the domestic law
(b) No, due to the non-aggravation principle
(c) No, due to the equivalent beneficiary principle
(d) No, due to allocation of taxing rights principle.

3. Which of the following may be viewed by the tax authorities as a tax avoidance measure undertaken by Athena Ltd.?

(a) Choosing Google Inc., a company not having a PE in India, for advertising its products.
(b) Hosting the website on a server based in Cayman islands
(c) Both (a) and (b)
(d) Entering into limited period engagements with persons resident in India.

4. In respect of remuneration of INR 1,50,000 per month paid by Athena Ltd. to Mr. Shyam, which of the following statements is correct, having regard to the provisions of the Income-tax Act, 1961 (provisions of DTAA may be ignored) –

(a) No tax is deductible at source as per the provisions of the Income-tax Act, 1961 since Athena Ltd. is a foreign company and is not resident in India
(b) Tax has to be deducted at source under section 192 at the average rate of income-tax computed on the basis of the rates in force.
(c) Tax has to be deducted at source at the rates in force under section 195
(d) Tax has to be deducted at source@5%

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

(a) Only an employee of Athena Ltd.
(b) Only a trustee of Athena Ltd.
(c) Only an agent of Athena Ltd.
(d) All the above

6. As per the DTAA with Country A, which of the following statements is correct? –

(a) The DTAA applies only to taxes on income
(b) The DTAA applies both in respect of taxes on income and capital
(c) The DTAA applies only to persons who are resident of Country A in respect of taxes on income and capital
(d) The DTAA applies only to persons who are resident of India in respect of taxes on income.

7. Which of the following is ordinarily **not** a function served by a tax treaty?
   (a) Relieving economic double taxation
   (b) Imposing a fresh tax liability
   (c) Boosting mutual trade and investment in the two Contracting States
   (d) Allocating taxing rights

8. Which of the following statements reflects the **incorrect** position?
   (a) Domestic tax laws are irrelevant while considering application of the provisions of a DTAA
   (b) Provisions of Income-tax Act, 1961 empower the Union Government to enter into tax treaties for relieving double taxation
   (c) Provisions of a DTAA overrides the provisions of domestic laws unless the latter are more beneficial for a taxpayer
   (d) In the absence of a DTAA, domestic tax laws provide unilateral relief to tackle double taxation

9. Which of the following is **not** a principle incorporated in the Vienna Convention on Law of Treaties?
   (a) Preparatory work of the treaty can be used as a supplementary means of interpretation
   (b) A State which is a third party cannot be bound by the terms of a bilateral tax treaty without its consent
   (c) Violation of any term of the tax treaty by one Contracting State entitles the other Contracting State to terminate the treaty
   (d) Ordinarily, each authenticated version of a treaty in more than one language carries equal force

10. Which article has been introduced in the India-Mauritius tax treaty to specifically target the practice of treaty shopping?
    (a) Elimination of double taxation
    (b) Limitation of benefits
    (c) Most Favoured Nation clause
    (d) Non-discrimination

II. DESCRIPTIVE QUESTIONS

1. In relation to the income earned during previous year 2017-18, does Athena Ltd. have a permanent establishment in India? Answer the question in relation to activities undertaken in each of four stages in the case study. (**10 Marks**)

2. (a) (i) What may be viewed as a strategy which has been adopted by Athena Ltd. to avoid tax in India in the third stage? Examine. (**3 Marks**)
(ii) Which action plan of BEPS addresses the tax challenges arising out of the strategy adopted by Athena Ltd. in the third stage? What are the recommendations thereunder to address such challenges?  

(4 Marks)

(b) From the following hypothetical situation given below, determine whether Athena Ltd satisfies the active business test for determination of place of effective management under the Income-tax Act, 1961:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Country A</th>
<th>Country B</th>
<th>India</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Foreign currency equivalent</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Value of assets</td>
<td>INR 400 lakhs</td>
<td>INR 100 lakhs</td>
<td>INR 210 lakhs</td>
</tr>
<tr>
<td>Number of employees</td>
<td>30</td>
<td>10</td>
<td>20</td>
</tr>
<tr>
<td>Payroll expenses on employees</td>
<td>INR 160 lakhs</td>
<td>INR 35 lakhs</td>
<td>INR 65 lakhs</td>
</tr>
<tr>
<td>Number of Board Meetings</td>
<td>10</td>
<td>2</td>
<td>4</td>
</tr>
</tbody>
</table>

3. (a) Examine the tax implications under the Indian tax laws, in respect of fees paid for online advertising services.  
(b) In respect of the fees referred to in (a) above, examine the requirement, if any, under the Indian tax laws to deduct tax at source and the consequences of non-deduction at source.  
(c) Is there any provision incorporated in the Indian tax laws to avoid double taxation of such income [i.e., fees referred to in (a) above] in India? Examine.  

(3 Marks)

(3 Marks)

(2 Marks)
CASE STUDY 2

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 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.2013-14 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 2017 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 2017-18, 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, 2017 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.2017-18, Shivam paid rent of INR 25,000 per month in respect of the said accommodation.

On July 31, 2017, the company announced a bonus of INR 3,00,000 for the previous financial year (i.e. F.Y.2016-17). As a retention policy, such bonus was paid after the first half of the financial year i.e. in October 2017. Shivam received the bonus amount in his salary account with the bank in Country Q.

Shivam had invested his overseas salary in purchase of securities of a Country “Q” company which yielded an interest income of QGD 5000 due as on March 31, 2018. 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 1000 was credited to his bank account on March 31, 2018. Just like Indian tax laws, dividend paid by Country “Q” Company is exempt in the hands of shareholders.

On 31.03.2018, 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 correct 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.

2. Mr. Arvind opened a bank account in Country P on 1.7.2015. He has made deposits of foreign currency equivalent to INR 5 lakhs on 1.7.2015, INR 7 lakhs on 1.10.2015, INR 12 lakhs on 1.9.2017 and INR 25
The deposit of INR 12 lakhs on 1.9.2017 is made out of the withdrawal of earlier deposits made on 1.7.2015 and 1.12.2015 with the said bank. Further, out of INR 25 lakhs deposited by him on 1.3.2018, Mr. Arvind withdrew INR 2 lakhs on 31.3.2018. The value of an undisclosed asset in form of bank account is:

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

3. Which of the following statements does not hold good in the case of OECD Model Convention? :

(a) OECD Model lays emphasis on the right of the State of Residence to tax income.  
(b) The relevant article of the Convention providing for determination of business profits of a PE, does not provide for deduction of expenses  
(c) The relevant article relating to PE of the Convention explicitly deals with mechanism of Service PE  
(d) It is essentially a model treaty between two developed nations

4. To address the problem of dual residency, under OECD Model Convention, certain rules are provided. The rules are to be applied:

(a) At the discretion of competent authority of the respective countries based on permanent home and nationality of the assessee  
(b) Sequentially in order of nationality, permanent home, centre of vital interest and habitual abode  
(c) Sequentially in order of permanent home, centre of vital interest, habitual abode and nationality  
(d) Only if an assessee is not able to produce Tax Residency Certificate from the respective country.

5. 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

6. 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

7. Form 67 has to be filed mandatorily on or before the due date of filing of return of income -

(i) if the assessee claims foreign tax credit in his return of income for the year in which such corresponding income was offered to tax
(ii) if the assessee owns directly, or as a beneficial owner, any foreign assets
(iii) if there is a carry backward of loss of the current year resulting in refund of foreign tax for which credit has been claimed in an earlier previous year.

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

8. While interpreting the treaty entered into by India with Country P, the Budget Speech of Shri Arun Jaitley was relied upon to understand the intent at the time of signing the treaty. Which law of interpretation has been followed in this case?

(a) Liberal Interpretation
(b) Subjective Interpretation
(c) Purposive Interpretation
(d) Objective Interpretation

9. An application for advance ruling was made on 31.05.2017 in relation to a transaction proposed to be undertaken by Mr. James, a resident of Country P. On 07.07.2017, he decides to withdraw the said application. Such application:

(a) cannot be withdrawn once filed
(b) can be withdrawn on 07.07.2017 only with special permission of Principal Chief Commissioner
(c) cannot be withdrawn since 30 days from date of application have passed
(d) can be withdrawn on 07.07.2017 with permission of the AAR, if the circumstances of the case so justify
10. Ms. Arvind acquired a flat in Country P in the P.Y. 2013-14 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. 2013-14 and earlier years. This asset comes to the notice of the Assessing Officer in the year 2017-18. If the value of the flat on 1.4.2017 is INR 90 lakhs, the amount chargeable to tax in the year 2017-18 would be:

(a) INR 90 lakhs  
(b) INR 70 lakhs  
(c) INR 54 lakhs  
(d) INR 30 lakhs

II DESCRIPTIVE QUESTIONS

1. (i) With reference to the DTAA between India and Country “Q”, examine whether Shivam is a resident in India or Country “Q” in the year 2017-18.  

(ii) The Competent Authority in India has made a request to the concerned official in Country “Q” to provide certain information in order to prevent tax avoidance in India. The Country “Q” tax officer denied the request stating that they are not obliged to provide such information as Country “Q” will not get any revenue benefit by doing so. Is the officer justified in his denial? Examine.

Will your answer change, if the officer denied stating that exchange of such information would be contrary to public policy?

2. (a) (i) 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.

(ii) Can Cure House Inc. approach the Authority of Advance Ruling to determine its tax liability arising from project undertaken in India? Is Sudha eligible to file an application for advance ruling to determine her tax liability arising from the project? Examine.

(b) India has a DTAA with Country Q but does not have a DTAA with Country N. Examine the significance of the concepts of business connection and permanent establishment in bringing to tax business income earned by a resident of Country Q and Country N in India.

3. Determine the total income and tax liability of Shivam for the previous year 2017-18 as per the provisions of the Income-tax Act, 1961. Advance tax calculations may be ignored. Ignore the perquisite value of rent free accommodation provided to Shivam in Country Q. Indicate reasons for treatment of each item. Working Notes should form part of your answer.
EXHIBIT I

Telegraphic Transfer Buying Rate

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

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<thead>
<tr>
<th>Date</th>
<th>Exchange Rate (INR)</th>
<th>Date</th>
<th>Exchange Rate (INR)</th>
</tr>
</thead>
<tbody>
<tr>
<td>30.09.2017</td>
<td>45.95</td>
<td>31.01.2018</td>
<td>47.83</td>
</tr>
<tr>
<td>31.10.2017</td>
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<td>28.02.2018</td>
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<td>30.11.2017</td>
<td>45.10</td>
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</tr>
<tr>
<td>31.12.2017</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

(1) "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.

(2) "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.

(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) ;

   (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 25

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”.

ARTICLE 28

EXCHANGE OF INFORMATION

1. The competent authorities of the Contracting States shall exchange such information as is foreseeably relevant for carrying out the provisions of this Agreement or to the administration or enforcement of the domestic laws concerning taxes of every kind and description imposed on behalf of the Contracting States, or of their political sub-divisions or local authorities, insofar as the taxation thereunder is not contrary to the Agreement. The exchange of information is not restricted by Articles 1 and 2.

2. Any information received under paragraph 1 by a Contracting State shall be treated as secret in the same manner as information obtained under the domestic laws of that State and shall be disclosed only to persons or authorities (including courts and administrative bodies) concerned with the assessment or collection of the enforcement or prosecution in respect of, the determination of appeals in relation to the taxes referred to in paragraph 1, or the oversight of the above. Such persons or authorities shall use the information only for such purposes. They may disclose the information in public court proceedings or in judicial decisions.

3. In no case shall the provisions of paragraphs 1 and 2 be construed so as to impose on a Contracting State the obligation:

(a) to carry out administrative measures at variance with the laws and administrative practice of that or of the other Contracting State;

(b) to supply information which is not obtainable under the laws or in the normal course of the administration of that or of the other Contracting State;

(c) to supply information which would disclose any trade, business, industrial, commercial or professional secret or trade process, or information the disclosure of which would be contrary to public policy.

4. If information is requested by a Contracting State in accordance with this Article, the other Contracting State shall use its information gathering measures to obtain the requested information, even though that other State may not need such information for its own tax purposes. The obligation contained in the preceding sentence is subject to the limitations of paragraph 3 but in no case shall such limitations be construed to permit a Contracting State to decline to supply information solely because it has no domestic interest in such information.
5. In no case shall the provisions of paragraph 3 be construed to permit a Contracting State to decline to supply information solely because the information is held by a bank, other financial institution, nominee or person acting in an agency or a fiduciary capacity or because it relates to ownership interests in a person.

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 - 3

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

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

Assignment A

Client Name: Connors & Ann, Country X

Nature of Assignment: Connors & Ann had entered into a joint venture agreement with an Indian party in March, 2017 for construction of a nuclear thermal power plant in Tamil Nadu, India during the financial year 2017-18.

Additional Details:

- As per the scope of work, the firm had
  - advised on all aspects of structuring and drafting, negotiation, construction contract and maintenance contracts;
  - advised on procurement structures, multi contract/onshore offshore structures;
  - provided specialised project finance expertise and ensured to reduce the risks associated with operating in foreign jurisdiction;
  - advised on tax and regulatory implications from a Country X law perspective; and
  - attended meetings with project sponsors, negotiated floating rate issues and advisory on any other overseas jurisdiction related regulatory aspects etc.

- The execution of work was done partly from India and partly from Country X office.
- The firm’s employees and partners were in India for 120 days.

The firm’s billing model for the services rendered were as follows:

- each partner and employee of the firm who was involved in doing work for the clients was required to maintain detailed time sheets recording the time spent by them on such work; the said time sheets separately showed the time spent on doing such work in India and outside India;
- the time so spent was multiplied by the hourly billing rates applicable to each respective partner/employee as specified in the terms of appointment between the firm and the client;
- the bills so raised were paid to the firm by the client outside India.

Based on the above details, the firm is of the view that the income attributable to the services rendered in India would be taxable in India. The said income would be arrived at based on “estimation of fees with reference to the fees rates at which such services could have been procured from corresponding professionals acting in India”.

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The firm intends to claim the following expenditure -

(a) direct costs allocated on the basis of number of hours spent at the pro-rated Country X salary cost; and

(b) general overheads have been allocated @5% of income on an ad-hoc basis.

**Assignment B**

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

**Nature of Assignment:** Vidyut India has entered into a contract with an Indian construction company for construction of a pharma research and development unit in India. Vidyut India also has a group entity, Vidyut Z Inc, in Country Z, from whom necessary inputs are obtained for construction of the pharma research and development centre. The construction agreement provided that the law in Country Y will govern the contract. There is currently a dispute in the contract and as per the agreement, the adjudication proceedings were initiated on 30th August 2017. Gryffindors Y is a registered firm in Country Y engaged by Vidyut India to represent it in the adjudication proceedings in India. Further, as part of the adjudication proceedings, site visits are essential in India and Country Z. For the site visit in Country Z, Gryffindors Z, a Country Z registered partnership firm was engaged for which Vidyut India would compensate the Country Z firm separately.

**Additional Details:**

- As per the terms of agreement, the activities are to be carried on in Country Y, Country Z and India.
- Except a site visit and an adjudication hearing in Chennai between 21st and 24th September, 2017, no other activity is carried on in India by Gryffindors Y. The total time spent in India was 6 days between 19th September and 24th September, 2017.
- Meanwhile, another site visit in Country Z was for 10 days for which partners from Gryffindors Z undertook the visit and provided its report to Gryffindors Y, Country Y. For the time spent by the Country Z firm, it had raised an invoice to Vidyut India.
- Apart from the 6 days in India and 10 days in Country Z, major part of the adjudication proceedings were at Country Y.
- Gryffindors Y produced a tax residency certificate from Country Y. It is also to be noted that Gryffindors Y is a fiscally transparent entity as per the tax laws of Country Y. Gryffindors Y is only liable for trade tax in Country Y.
- Gryffindors Z produced a tax residency certificate from Country Z tax authorities certifying that it is a tax resident of Country Z. It is also to be noted that Gryffindors Z is a fiscally transparent entity as per the Country Z tax laws.

**Assignment C**

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

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

**Additional Details:**

- The scope of work for the firm shall be the following:
Phase I: Education & Training

Phase II: Acquisition Transaction

Phase III: Regulatory approval for the transaction.

As part of the first phase, on education and training, the firm will provide a detailed document to Abhimanyu India on the legal framework on banking and regulatory laws in Country X. Further, apart from the document, the firm will provide presentation and discuss the various legal and regulatory requirements in Country X for setting up a bank branch or acquiring a bank in Country X.

The presentation to be made by the firm will be to the bank officials of Abhimanyu India. The presentation will be made from the law firm’s office in Country X. The purpose of the training is to ensure that if the bank sets up a branch or office in Country X, the said officials will be deputed to the Country X entity.

The work shall be undertaken by the firm from its office in Country X and there will be no visit in India.

As mentioned previously, the firm is a tax resident of Country X and is a fiscally transparent entity for tax purpose in Country X.

Phase II and Phase III are subject to the conditions and legal environment being favourable, and hence, the happening of the same is not certain. However, Phase I: Education is certain and a fee of foreign currency equivalent to Rs.1,50,000 has been agreed upon by the firm to render Phase I services, which would be paid in Country X.

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

I. MULTIPLE CHOICE QUESTIONS

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

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

   (a) Juridical double taxation
   (b) Territorial double taxation
   (c) Economic double taxation
   (d) Municipal double taxation

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

   (a) The UN Model Convention
   (b) The OECD Model Convention
   (c) Either (a) or (b) [Except in case of USA, where US Model Convention is used]
   (d) The Vienna Convention
3. Can benefit of India-Country X tax treaty be availed by M/s. Gryffinders LLP (“the firm”), Country X in respect of income earned by it in India from Assignment A, which is taxable in both India and Country X, by virtue of the respective domestic tax laws?

(a) Yes, since the income is subject to tax in both countries albeit in the hands of different persons

(b) No, since as per the laws of Country X, the firm is a fiscally transparent entity. Hence, there is no double taxation of income in its hands.

(c) Yes, since the firm’s employees and partners stayed in India for more than 100 days. Hence, the requisite condition for availing treaty benefit under the DTAA is satisfied.

(d) Yes, since the execution of work was done partly from India and partly from Country X. Hence, treaty benefit can be availed.

4. A fiscally transparent entity means –

(a) An entity entitled to concessional rate of tax

(b) An entity enjoying tax pass through status

(c) An entity entitled to benefits of DTAA

(d) An entity which is subject to distribution tax on profits distributed by it.

5. What are the tax implications under the Income-tax Act, 1961 in respect of income earned from assignment A by M/s. Gryffindors LLP, a Country X based partnership firm (You may ignore the provisions of the DTAA for the purpose of answering this question) -

(a) the entire income from the assignment is taxable in India

(b) Only income attributable to the services rendered in India is taxable in India

(c) No part of the income is taxable in India since the firm does not have a permanent establishment in India

(d) No part of the income is taxable in India since the income was received outside India.

6. In order to claim relief under the tax treaty in India, a non-resident -

(a) should have a business presence in India

(b) should produce his Permanent Account Number

(c) should produce Tax Residency Certificate (TRC)

(d) should produce his income-tax return filed in the home country.

7. As per the provisions of the Income-tax Act, 1961, which of the following is not an objective of the Central Government to enter into tax treaty with another Country:

(a) For granting relief in respect of income-tax chargeable to tax in India and the other country

(b) For enabling round tripping of unaccounted money into India
8. When a term used in a tax treaty is not defined in the tax treaty or in the Act, but the same is defined subsequently through a notification in the Official Gazette by the Central Government, then, in such a case:

(a) The notification shall take effect from the date of its publication in the Official Gazette
(b) The notification shall be deemed to be effective from the date when the tax treaty came into force
(c) The notification shall be deemed to be effective from the date when the tax treaty was last modified
(d) The notification shall take effect from 1st April and be effective from the current assessment year.

9. In order to invoke the tax treaty for a person who is a dual resident i.e. tax resident in both the countries, which rule may be applied under the relevant article of the tax treaties to resolve the issue?

(a) Force of Attraction
(b) Tie-breaker
(c) Equivalent beneficiary
(d) Non-discrimination

10. Under the provisions of the Income-tax Act, 1961, the term “Person” would not include:

(a) A body corporate incorporated in a country outside India
(b) A Limited Liability Partnership (LLP)
(c) Indian branch of a foreign company
(d) A co-operative society

II. DESCRIPTIVE QUESTIONS

1. (i) For making the payment to Gryffindors Y and Gryffindors Z, Vidyu India Limited’s tax advisor has opined that the Country Y firm and the Country Z firm are not eligible to access India-Country Y DTAA and India-Country Z DTAA, respectively, even though TRC has been provided by such firms. The Indian client’s tax advisor has formed this view based on Article 1 read with the relevant articles of the India-Country Y DTAA and India Country Z DTAA coupled with the fact that both the firms are fiscally transparent entities as per the tax laws of the respective countries. Examine the correctness of the view taken by the tax adviser by analysing the relevant Articles of the India-Country Y DTAA and India Country Z DTAA

   (6 Marks)

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

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

(5 Marks)

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

(4 Marks)

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

(4 Marks)

(iii) Assuming that the above-referred income is chargeable to tax in India, how can the tax liability of the firm be mitigated? Your answer should be based on the relevant provision(s) of the Income-tax Act, 1961.  

(4 Marks)

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

(3 Marks)

EXHIBIT A

Extract of the relevant Articles of India - Country X DTAA

ARTICLE 1

SCOPE OF THE CONVENTION

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

2. This Convention extends to the territory of each Contracting State, including its territorial sea, and to those areas of the exclusive economic zone or the continental shelf adjacent to the outer limit of the territorial sea of each State over which it has, in accordance with international law, sovereign rights for the purpose of exploration and exploitation of the natural resources of such areas, and references in this Convention to the Contracting State or to either of them shall be construed accordingly.

ARTICLE 2

TAXES COVERED

1. The taxes which are the subject of this Convention are:

(a) in Country X:

(i) the income-tax;

(ii) the corporation tax;

(iii) the capital gains tax; and

(iv) the petroleum revenue tax;

(hereinafter referred to as "Country X tax");
(b) in India;

the income-tax including any surcharge thereon;

(hereinafter referred to as "Indian tax").

2. This Convention shall also apply to any identical or substantially similar taxes which are imposed by either Contracting State after the date of signature of this Convention in addition to, or in place of, the taxes of that Contracting State referred to in paragraph 1 of this Article. The competent authorities of the Contracting States shall notify each other of any substantial changes which are made in their respective taxation laws.

ARTICLE 3 (EXTRACT)

GENERAL DEFINITIONS

1. In this Convention, unless the context otherwise requires:

(f) the term "person" includes an individual, a company, a body of persons and any other entity which is treated as a taxable unit under the taxation laws in force in the respective Contracting States;

ARTICLE 4

FISCAL DOMICILE

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

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

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

ARTICLE 5

PERMANENT ESTABLISHMENT

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

2. The term "permanent establishment" shall include especially:

(a) a place of management;

(b) a branch;

(c) an office;

(d) a factory;

(e) a workshop;
(f) premises used as a sales outlet or for receiving or soliciting orders;

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

(h) a mine, an oil or gas well, quarry on other place of extraction of natural resources;

(i) an installation or structure used for the exploration or exploitation of natural resources;

(j) a building site or construction, installation or assembly project or supervisory activities in connection therewith, where such site, project or supervisory activity continues for a period of more than six months, or where such project or supervisory activity, being incidental to the sale or machinery or equipment, continues for a period not exceeding six months and the charges payable for the project or supervisory activity exceed 10 per cent of the sale price of the machinery and equipment;

(k) the furnishing of services including managerial services, other than those taxable under Article 13 (Royalties and fees for technical services), within a Contracting State by an enterprise through employees or other personnel, but only if:

(i) activities of that nature continue within that State for a period or periods aggregating more than 90 days within any twelve month period; or

(ii) services are performed within that State for an enterprise within the meaning of paragraph 1 of Article 10 (Associated enterprises) and continue for a period or periods aggregating more than 30 days within any twelve-month period:

Provided that for the purposes of this paragraph an enterprise shall be deemed to have a permanent establishment in a Contracting State and to carry on business through that permanent establishment if it provides services or facilities in connection with, or supplies plant and machinery on hire used or to be used in, the prospecting for, or extraction or production of, mineral oils in that State.

ARTICLE 13

ROYALTIES AND FEES FOR TECHNICAL SERVICES

1. Royalties and fees for technical services arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.

2. However, such royalties and fees for technical services may also be taxed in the Contracting State in which they arise and according to the law of that State; but if the beneficial owner of the royalties or fees for technical services is a resident of the other Contracting State, the tax so charged shall not exceed:

(a) in the case of royalties within paragraph 3(a) of this Articles, and fees for technical services within paragraphs 4(a) and (c) of this Article,—

(i) during the first five years for which this Convention has effect;

(aa) 15 per cent of the gross amount of such royalties or fees for technical services when the payer of the royalties or fees for technical services is the Government of the first-mentioned Contracting State or a political sub-division of that State, and

(bb) 20 per cent of the gross amount of such royalties or fees for technical services in all other cases; and
(ii) during subsequent years, 15 per cent of the gross amount of such royalties or fees for technical services; and

(b) in the case of royalties within paragraph 3(b) of this Article and fees for technical services defined in paragraph 4(b) of this Article, 10 per cent of the gross amount of such royalties and fees for technical services.

3. For the purposes of this Article, the term "royalties" means:

(a) payments of any kind received as a consideration for the use of, or the right to use, any copyright of a literary, artistic or scientific work, including cinematography films or work on films, tape or other means of reproduction for use in connection with radio or television broadcasting, any patent, trade mark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience; and

(b) payments of any kind received as consideration for the use of, or the right to use, any industrial, commercial or scientific equipment, other than income derived by an enterprise of a Contracting State from the operation of ships or aircraft in international traffic.

4. For the purposes of paragraph 2 of this Article, and subject to paragraph 5, of this Article, the term "fees for technical services" means payments of any kind of any person in consideration for the rendering of any technical or consultancy services (including the provision of services of a technical or other personnel) which:

(a) are ancillary and subsidiary to the application or enjoyment of the right, property or information for which a payment described in paragraph 3(a) of this article is received; or

(b) are ancillary and subsidiary to the enjoyment of the property for which a payment described in paragraph 3(b) of this Article is received; or

(c) make available technical knowledge, experience, skill know-how or processes, or consist of the development and transfer of a technical plan or technical design.

5. The definition of fees for technical services in paragraph 4 of this Article shall not include amounts paid:

(a) for services that are ancillary and subsidiary, as well as inextricably and essentially linked, to the sale of property, other than property described in paragraph 3(a) of this Article;

(b) for services that are ancillary and subsidiary to the rental of ships, aircraft, containers or other equipment used in connection with the operation of ships, or aircraft in international traffic;

(c) for teaching in or by educational institutions;

(d) for services for the private use of the individual or individuals making the payment; or

(e) to an employee of the person making the payments or to any individual or partnership for professional services as defined in Article 15 (Independent personal services) of this Convention.

6. The provisions of paragraphs 1 and 2 of this Article shall not apply if the beneficial owner of the royalties or fees for technical services, being a resident of a Contracting State, carries on business in the other Contracting State in which the royalties or fees for technical services arise through a permanent
establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the right, property or contract in respect of which the royalties or fees for technical services are paid is effectively connected with such permanent establishment or fixed base. In such case, the provisions of Article 7 (Business profits) or Article 15 (Independent personal services) of this Convention, as the case may be, shall apply.

7. Royalties and fees for technical services shall be deemed to arise in a Contracting State where the payer is that State itself, a political sub-division, a local authority or a resident of that State. Where, however, the person paying the royalties or fees for technical services, whether he is a resident of a Contracting State or not, has in a Contracting State a permanent establishment or a fixed base in connection with which the obligation to make payments was incurred and the payments are borne by that permanent establishment or fixed base then the royalties or fees for technical services shall be deemed to arise in the Contracting State in which the permanent establishment or fixed base is situated.

8. Where, owing to a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the royalties or fees for technical services paid exceeds for whatever reason the amount which would have been paid in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In that case, the excess part of the payments shall remain taxable according to the law of each Contracting State, due regard being had to the other provisions of this Convention.

9. The provisions of this Article shall not apply if it was the main purposes or one of the main purposes of any person concerned with the creation or assignment of the rights in respect of which the royalties or fees for technical services are paid to take advantage of this Article by means of that creation or assignment.

EXHIBIT B

Extract of the relevant Articles of India - Country Y DTAA

| ARTICLE 1 |
| PERSONAL SCOPE |
| This Agreement shall apply to persons who are residents of one or both of the Contracting States. |

| ARTICLE 2 |
| TAXES COVERED |

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

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

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

(a) in the Federal Republic of Country Y:

    income-tax,
corporation-tax, capital tax, and trade tax

(hereinafter referred to as "Country Y tax");

(b) in the Republic of India,

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

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

ARTICLE 3 (EXTRACT)

GENERAL DEFINITIONS

1. For the purposes of this Agreement, unless the context otherwise requires, -

(d) the term "person" includes an individual, a company and any other entity which is treated as a taxable unit under the taxation laws in force in the respective Contracting States;

ARTICLE 4 (EXTRACT)

RESIDENT

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

ARTICLE 14

INDEPENDENT PERSONAL SERVICES

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

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

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

2. The term "professional services" includes independent scientific, literary, artistic, educational or teaching activities, as well as the independent activities of physicians, surgeons, lawyers, engineers, architects, dentists and accountants.
ARTICLE 1
PERSONAL SCOPE
This Agreement shall apply to persons who are residents of one or both of the Contracting States.

ARTICLE 2
TAXES COVERED
1. The taxes to which this Agreement shall apply are:
   (a) in the case of India: the Income-tax including any surcharge thereon; and
   (b) in the case of Country Z: the federal, cantonal and communal taxes on income (total income, earned income, income from capital, industrial and commercial profits, capital gains, and other items of income).

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

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

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

ARTICLE 3 (EXTRACT)
GENERAL DEFINITIONS
1. In this Agreement, unless the context otherwise requires:
   (d) the term "person" includes an individual, a company, a body of persons, or any other entity which is taxable under the laws in force in either Contracting State;

ARTICLE 4
FISCAL DOMICILE
1. For the purposes of this Convention, the term "resident of a Contracting State" means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management, place of incorporation, or any other criterion of a similar nature, provided, however, that:
(a) this term does not include any person who is liable to tax in that State in respect only of income from sources in that State; and

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

ARTICLE 14

INDEPENDENT PERSONAL SERVICES

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

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

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

2. The term "professional services" includes services performed in the exercise of independent scientific, literary, artistic, educational or teaching activities as well as in the exercise of the independent activities of physicians, surgeons, lawyers, engineers, architects, dentists and accountants.
SOLUTION TO CASE STUDY 1

I. ANSWERS TO MCQs (Most appropriate answers)

1. (c)  
2. (b)  
3. (b)  
4. (d)  
5. (d)  
6. (b)  
7. (b)  
8. (a)  
9. (c)  
10. (b)
II. ANSWERS TO DESCRIPTIVE QUESTIONS

Answer to Q.1:

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

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

Third stage: The traditional meaning and understanding of a fixed place PE connotes a physical space which is at the disposal of the non-resident enterprise and through which the latter conducts its business. With respect to a website, it has been held that it is merely a software. In the absence of the server supporting the website being located in India (here, it is in Cayman Islands), there can be no PE liability for Athena Ltd. The server, through which business is carried on, is located in Cayman Islands, a no tax jurisdiction, and not in India. Furthermore, a warehouse in India would not constitute a PE as per Article 5(4) of the India-Country A DTAA.

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

Answer to Q.2(a):

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

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

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

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

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

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

• Modifying the existing Permanent Establishment (PE) rule to provide whether an enterprise engaged in fully de-materialized digital activities would constitute a PE, if it maintained a significant digital presence in another country's economy.
• A virtual fixed place of business PE in the concept of PE i.e., creation of a PE when the enterprise maintains a website on a server of another enterprise located in a jurisdiction and carries on business through that website
• Imposition of a final withholding tax on certain payments for digital goods or services provided by a foreign e-commerce provider or imposition of a equalisation levy on consideration for certain digital transactions received by a non-resident from a resident or from a non-resident having PE in other contracting state.

Answer to Q.2(b)

The process of determination of POEM is primarily based on the fact as to whether or not the company is engaged in active business outside India.

A company shall be said to be engaged in “active business outside India”

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

Passive income is the aggregate of, -

(i) income from the transactions where both the purchase and sale of goods is from/to its associated enterprises; and
(ii) income by way of royalty, dividend, capital gains, interest or rental income;
It can be seen that the value of assets in India is only 29.58% of the total assets of the company, the number of employees in India is only 33.33% 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 active business to be outside India.

**Passive income** = income from transactions where both purchases and sales are from/to associated enterprises + total income by way of dividend and interest = Rs.110 lakhs + Rs.35 lakhs = Rs.145 lakhs

Percentage of passive income to total income = 145/250 × 100 = 58%

In this case, the passive income is more than 50% of the company’s total income. Hence, the passive income test has failed, consequent to which the company cannot be said to have active business outside India.

**Answer to Q.3:**

(a) Equalization 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, Google Inc is a non-resident not having PE in India. It receives consideration of Rs.30 lakhs from Athena Ltd., a non-resident having PE in India, for online advertisement services provided by it. Hence, equalization levy@6% on Rs.30 lakhs is attracted in the hands of Google Inc.

In the hands of Athena Ltd., the amount of Rs.30 lakhs paid to Google Inc. would be allowable as business expenditure, provided equalization levy has been deducted at source.

(b) Athena Ltd. is liable to deduct equalization levy of Rs.1.80 lakhs from the amount of Rs.30 lakhs payable to Google 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, 2018. Further, penalty of an amount equal to Rs.1.80 lakhs would be attracted for failure to deduct equalization levy. Also, disallowance of the expenditure of Rs.30 lakhs would be attracted under section 40(a)(ib) while computing business income of Athena 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 2

I. ANSWERS TO MCQs (Most appropriate answers)

1. (d)
2. (c)
3. (c)
4. (c)
5. (c)
6. (b)
7. (c)
8. (b)
9. (d)
10. (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 2017, he stayed in India during the P.Y. 2017-18 for 183 days. Therefore, he is a resident in India for the P.Y.2017-18.

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

i) He is a resident in atleast 2 out of 10 years preceding the relevant previous year, and
ii) His total stay in India in last seven years preceding P.Y. 2017-18 is 730 days or more.

Thus, Shivam is Resident and Ordinarily Resident in India for the P.Y.2017-18.
As per Country “Q” tax residency rules, Shivam qualifies to be resident for the year 2017-18 in Country “Q”, since he stays for 182 days (more than 180 days) in Country “Q” in the Financial Year 2017-18.

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 2017-18. 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) Article 28 of India-Country “Q” DTAA deals with the international exchange of information between the tax authorities of the countries. The purpose is wider than mere tax compliances; it is also meant to counter tax evasion and avoidance. The competent authorities of the two Contracting States can exchange information which is ‘foreseeably relevant’ for the proper application of agreement or for the administration or enforcement of their domestic laws, as long as taxation under the laws is not inconsistent with the treaty agreement.

Paragraph 3 of the Article lists the types of information, the request for which either country is not obligated to comply.

However, paragraph 4 of the Article further clarifies that even though obligation to provide information is subject to the limitation contained in paragraph 3, the requested country cannot decline to supply information solely because it has no domestic interest in such information.

Accordingly, Country “Q” tax authorities are not justified in denying to provide information stating that it will not get any revenue benefit by providing such information. Country “Q” is obligated to provide the requested information, even if it has no revenue interest in the case to which the request relates.

However, in case the reason of denial is in accordance with the specific limitations contained in paragraph 3, then, Country “Q” tax authorities shall be under no obligation to provide the requested information. Hence, denial by tax authorities on the ground that exchange of such information would be contrary to public policy is justified.
2. (a) (i) 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.

(ii) As per section 245N(b)(A)(I), an application for advance ruling can be made *inter-alia* by a non-resident in relation to a transaction which has been undertaken or is proposed to be undertaken by it.

Hence, Cure House Inc., a non-resident applicant, can file an application to Authority of Advance Ruling, along with the prescribed fees, for determination in relation to the transaction undertaken by it in India i.e., rendering consultancy services in the field of medicine.

As per section 245N(b)(A)(III), a resident applicant who has undertaken or has proposed to undertake one or more transactions of value of INR 100 crore or more in total can file an application for Advance Ruling for determination by the AAR in relation to his/her tax liability arising out of such transactions and such determination shall include the determination of any question of law or of fact specified in the application.

In the present case, since the project value is only INR 70 crore, Sudha, a resident Indian cannot file an application with AAR for determination of her tax liability arising out of the said project.

(b) Section 9(1)(i) requires existence of business connection for deeming business income to accrue or arise in India. DTAAs may, however, provide that business income is taxable only if there is a permanent establishment in India.

Therefore, in cases covered by DTAAs, where there is no permanent establishment in India, business income cannot be brought to tax due to existence of business connection as per section 9(1)(i). However, in cases not covered by DTAAs, business income attributable to business connection is taxable.

Hence, business income earned by a resident of Country Q can be brought to tax only if he has a PE in India. However, business income of a resident of Country N attributable to his business connection in India, can be brought to tax in India.

3. **Computation of total income of Shivam for A.Y. 2018-19**

<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><em>Salary from services rendered in India (April - September 2017)</em></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>
</tbody>
</table>

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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.

<table>
<thead>
<tr>
<th>Salary from services rendered in Country “Q” (October 2017 - March 2018)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Basic Salary [See Note (i)]</td>
</tr>
<tr>
<td>Cost of Living Allowance [See Note (ii)]</td>
</tr>
<tr>
<td><strong>Total</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Income from House Property at Mumbai</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Annual Value [See Note (iii)]</td>
</tr>
<tr>
<td>Less: Standard deduction @ 30%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Income from Other Sources</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest earned from investment of security deposit (INR 1,00,000 @10%)</td>
</tr>
<tr>
<td>Interest earned on saving bank account with Country “Q” [QGD 150 x INR 48.61] [See Rule 115 in Note (i)]</td>
</tr>
<tr>
<td>Interest on Securities of a Country “Q” company [QGD 5000 x INR 48.52] [See Rule 115 in Note (i)]</td>
</tr>
<tr>
<td>Interest on bonds issued by Country “P” Government</td>
</tr>
<tr>
<td>Dividend from a Country “Q” Company (QGD 1000 x INR 48.52) [See Rule 115 in Note (i)]</td>
</tr>
</tbody>
</table>

(Dividend of foreign Company is taxable in India)

<table>
<thead>
<tr>
<th>Gross Total Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>3,38,412</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Less: Deductions under Chapter VI-A</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deduction u/s 80DD</td>
</tr>
</tbody>
</table>

(Flat deduction of INR 75,000 is allowed in respect of medical treatment of dependent disabled, irrespective of the expenditure incurred)

| Deduction u/s 80GG [See Note (iii)] | 60,000 | 1,35,000 |

<table>
<thead>
<tr>
<th>Total Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>22,28,292</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Total Income (rounded off)</th>
</tr>
</thead>
<tbody>
<tr>
<td>22,28,290</td>
</tr>
</tbody>
</table>

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### Computation of tax liability of Shivam for A.Y. 2018-19

<table>
<thead>
<tr>
<th>Particulars</th>
<th>INR</th>
<th>INR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax on INR 22,28,290</td>
<td>4,80,987</td>
<td></td>
</tr>
<tr>
<td>Add: Education cess @2%</td>
<td></td>
<td>9,620</td>
</tr>
<tr>
<td>Secondary higher education cess @1%</td>
<td></td>
<td>4,810</td>
</tr>
<tr>
<td>Tax Liability</td>
<td>4,95,417</td>
<td></td>
</tr>
<tr>
<td>Less: Foreign Tax Credit [See Note (v)]</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- on salary income</td>
<td>1,01,232</td>
<td></td>
</tr>
<tr>
<td>- on interest income</td>
<td>36,390</td>
<td>1,37,622</td>
</tr>
<tr>
<td><strong>Net tax liability</strong></td>
<td>3,57,795</td>
<td></td>
</tr>
<tr>
<td><strong>Net tax liability (rounded off)</strong></td>
<td>3,57,800</td>
<td></td>
</tr>
</tbody>
</table>

**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 last day of the month immediately preceding the month in which the income is due i.e. rate as on 28.02.2018
- **Interest earned on other than securities** i.e. interest on bank deposits- last day of the previous year i.e. rate as on 31.03.2018
- **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 28.02.2018

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

**Overseas salary for the period October 2017 to March 2018:**

<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 17</td>
<td>1400</td>
<td>1000</td>
<td>45.95</td>
<td>64,330</td>
<td>45,950</td>
</tr>
<tr>
<td>Nov 17</td>
<td>1400</td>
<td>1000</td>
<td>46.85</td>
<td>65,590</td>
<td>46,850</td>
</tr>
<tr>
<td>Dec 17</td>
<td>1400</td>
<td>1000</td>
<td>45.10</td>
<td>63,140</td>
<td>45,100</td>
</tr>
<tr>
<td>Jan 18</td>
<td>1400</td>
<td>1000</td>
<td>46.95</td>
<td>65,730</td>
<td>46,950</td>
</tr>
<tr>
<td>Feb 18</td>
<td>1400</td>
<td>1000</td>
<td>47.83</td>
<td>66,962</td>
<td>47,830</td>
</tr>
<tr>
<td>Mar 18</td>
<td>1400</td>
<td>1000</td>
<td>48.52</td>
<td>67,928</td>
<td>48,520</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>8400</strong></td>
<td><strong>6000</strong></td>
<td></td>
<td><strong>3,93,680</strong></td>
<td><strong>2,81,200</strong></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 22,88,290 = INR 5,72,073
- Actual rent – 10% of adjusted total income = INR 3,00,000 (25,000*12) – INR 2,28,829 (10% of 22,88,290) = INR 71,171

**Adjusted total income** = Gross total income after providing for deduction under section 80C to 80U but before deduction under section 80GG = INR 23,63,292 – INR 75,000 = INR 22,88,292 (rounded off to INR 22,88,290).

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.2018-19 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 25 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:

<table>
<thead>
<tr>
<th>Calculation of foreign tax credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Doubly taxed Salary Income</td>
</tr>
<tr>
<td>Basic Salary</td>
</tr>
<tr>
<td>Cost of Living Allowance</td>
</tr>
<tr>
<td><strong>Doubly taxed salary income</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% | 1,01,232 |
- Tax payable in India on salary income@22.23% | 1,50,046 |

**Foreign tax credit** | **1,01,232**
**Double taxed Interest Income**

<table>
<thead>
<tr>
<th>Description</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:**

<table>
<thead>
<tr>
<th>Description</th>
<th>INR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax withheld in Country Q on interest income at 15%, which is also the rate as per the DTAA</td>
<td>36,390</td>
</tr>
<tr>
<td>Tax payable in India on interest income@22.23%</td>
<td>53,930</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. (c)  
2. (d)  
3. (a)  
4. (b)  
5. (a)  
6. (c)  
7. (b)  
8. (b)  
9. (b)  
10. (c)

II. ANSWERS TO DESCRIPTIVE QUESTIONS

Answer to Q.1

(i) The eligibility of partnership firms for tax treaty benefits have been a controversial area and is a classic case of economic double taxation. This is due to the fact that each country has its own methodology to tax partnership firms. For instance, India taxes the income of a partnership in the firm’s hands, but the Contracting State, in this case, Country Y and Country Z, taxes such income in the hands of the partner directly, treating the partnership as “fiscally transparent entity”. In both cases, the income is subject to tax in both countries albeit in the hands of different persons i.e., in the hands of the partners in the country of residence and in the hands of the firm in the source country, namely, India.

The conditions for eligibility of benefits under the DTAA are provided in Article 1 read along with the other relevant articles of the DTAA. These conditions have to be fulfilled including the condition that the entity has to be a person and resident of the either of the contracting states.

(a) As per Article 3(1)(d) of the India-Country Y DTAA, the term ‘person’ includes any entity which is treated as a taxable unit under the tax laws in force in the respective States.

In order to be eligible for the DTAA, it has to be seen whether the partnership firm is a resident of the Contracting State. Article 4(1) of the India-Country Y DTAA defines a “resident of a Contracting State” to mean a person “liable to tax in that State by reason of his domicile, residence, place of management or any other criterion of similar nature”.

As per Article 2 of the India-Country Y DTAA, the scope of the DTAA extends to both income-tax and trade tax as may be levied under the laws of Country Y. Since trade tax is being levied on the Gryffindors Y partnership firm, it can be held that the firm is “liable to tax” and therefore the requirement in Article 4 gets satisfied. Accordingly, Gryffindors Y partnership firm shall be eligible to access the India-Country Y DTAA based on this line of reasoning.
(b) As per Article 3(1)(d) of the India-Country Z DTAA, the term ‘person’ includes any other entity which is taxable under the laws in force in the either Contracting States.

Article 4(1) of the India-Country Z DTAA defines a “resident of a Contracting State” to mean any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management, place of incorporation, or any other criterion of a similar nature. Further, in the case of income derived or paid by a partnership, this term applies only to the extent that the income derived by such partnership, is subject to tax in that State as the income of a resident, either in its hands or in the hands of its partners.

Thus, Article 4(1) of the treaty clearly provides that in the case of income derived or paid by a partnership, the term “resident of a contracting state”, in case of a firm, applies to the extent that the income derived by such partnership, is subject to tax in that State as the income of a resident, either in its hands or in the hands of its partners. The article clearly permits a firm to be treated as a resident of a contracting state in respect of income which is either liable to tax in its hands or in the hands of the partners. Therefore, Gryffindors Z partnership firm would be entitled to the benefits of the India-Country Z tax treaty, even though it is a fiscally transparent entity as per the tax laws of Country Z.

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

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

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

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

As per sub-section (11) and (12) of section 2 of the Finance Act, 2017, the amount of income-tax as increased by the applicable surcharge shall be further increased by an additional surcharge to be called “Education cess” and “secondary and higher education cess”. Therefore, education cess and secondary and higher education cess are nothing but an additional surcharge. Since as per the DTAAs, taxes covered include any surcharge on income-tax, additional surcharge called as education cess and SHEC are also included therein.

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

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Answer to Q.2

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

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

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

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

(iii) Assuming that the income earned by Country X is taxable in India, M/s Gryffindors LLP, a Country X based partnership firm, can mitigate the tax by taking recourse to the grossing up provisions under section 195A of the Income-tax Act, 1961. In such a case, the resident payer shall have to bear the burden of tax on payments due to the non-resident. The amount paid by the resident payer will be considered as net of tax payment and the payment is required to be grossed up for calculation of tax liability. The grossed-up amount will be treated as the amount agreed to be paid and tax shall be calculated at the prescribed rate on the gross amount. Such tax would be payable by Abhimanyu Holdings Bank Ltd., India, in this case. Therefore, the Country X firm, being non-resident in India, can enter into a suitable agreement based on which the firm will not bear the Indian tax liability, even if taxes are to be withheld. The tax liability would be borne by Abhimanyu Holdings Bank Ltd., India, the payer, in this case.
(iv) The Country X firm, being a non-resident, may apply for an advance ruling under section 245N for determination of tax liability in relation to a transaction which is proposed to be undertaken by it with a view to avoiding litigation and providing certainty. Therefore, in this case, the Country X firm can make an application to the Authority of Advance Rulings in the prescribed form and manner to determine its taxability in India for the proposed Assignment C to be undertaken by it.

Note – Questions based on interpretation of articles of a DTAA may have alternate views.
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Question 1

Sigma Corporation Ltd. (SCL), is a company incorporated under the Companies Act, 2013, having factory and registered office in Mumbai. It is engaged in manufacture, purchase and sale of men’s wear, selling various kinds of garment products according to the requirement of the buyers across the world. The company has sold different garment products in the Financial Year 2017-18 to different vendors in the Indian and outside Indian market, including sale of T-shirts to one its associated enterprises, namely, John Miller of UK, to whom it had sold 2,50,000 pieces at the rate of ₹1,000 per piece.

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

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

(a) Sales to third parties had been made with a specialized packaging for which 3% margin is included in the selling price.
(b) Tagging on the product purchased is being required by the other clients for which cost was ₹3 per piece, whereas in case of sales made to John Miller of UK, no tagging is to be done.
(c) Products sold to third parties involve a credit period of 6 months for which 0.5% per month margin on selling price is ensured by Sigma Corporation Ltd.

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

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

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

The Suggested Answers for Final Paper 6C: International Taxation, in so far as they relate to questions involving application of the provisions of Indian tax laws, are based on the provisions of direct tax laws as amended by the Finance Act, 2017.
The withholding tax treaty rates with India on dividend income paid from Cyprus is 15 percent and when paid from Spain is 20 percent.

The Chief Financial Officer (CFO) of the company appraised the Board of Directors that the matters of the company pending before the tax authorities are involving several issues for which a show cause notice for A.Y. 2015-16 has been issued by the A.O. The issues of concern as has been raised in this notice in brief are:

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

(ii) The transactions entered into with the associated enterprises during the previous year for determination of ALP have been referred by the AO to the TPO on 22.12.2017 for the reason of under-reporting.

(iii) The total international transactions carried out by the company during the previous year were of ₹ 200 crores and why penal action should not be taken against the company for the defaults stated in para-1.

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

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

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

Required:

(a) (i) Determine the Arm’s Length Price (ALP) of the transactions of sale of T-shirts during the year to the AE John Miller of UK and its probable impact on the income of the company for A.Y.2018-19. 

(6 Marks)

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

(4 Marks)

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

(7 Marks)
(ii) Discuss whether the total tax liability in Cyprus or in Spain would be the least for operating a foreign branch or a wholly owned subsidiary of the parent company. (3 Marks)

(c) (i) What will be the consequences for the defaults specified by the Assessing Officer in the show cause notice of not maintaining the records, not obtaining the report from the auditors and under reporting of ALP of the international transactions? (5 Marks)

(ii) What will be the impact on the time limit for completion of assessment by the AO because of reference so made to the TPO and if the company gets a stay for a period of 30 days over the proceedings, then, what will be the fate of the assessment proceedings? (5 Marks)

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

(1) Two methods were found suitable for determination of the Arm's Length Price (ALP). As per CUP methods, it was found to be ₹ 1,200 per unit and as per resale price method, it was ₹ 1,250 per unit. The ALP per unit will be taken as
(A) ₹ 1,200 since it is more favourable to the assessee
(B) ₹ 1,250 since it is more favourable to the Department
(C) ₹ 1,225
(D) None of the above

(2) An assessee having specified domestic transactions covered by section 92BA, should furnish audit report, if the value of such transactions exceeds
(A) ₹ 2 crores
(B) ₹ 20 crores
(C) ₹ 10 crores
(D) None of the above

(3) An assessee deriving income from profits of business of an eligible industrial undertaking for which 100% deduction is available u/s 80-1B has entered into international transactions with an associated enterprise for ₹ 200 crores. The TPO has made an addition of ₹ 15 crores in respect of the ALP. The normal GP margin is 10%. The additional deduction u/s 80-IB which can be claimed by the assessee on account of the increase in the ALP is
(A) Nil
(B) ₹ 20 crores
(C) ₹ 25 crores
(D) ₹ 15 crores
(4) The OECD member countries have accepted the concept of Arm's Length Price (ALP) for reaping the following benefit:

(A) Minimises double taxation
(B) Real taxable profits can be determined
(C) Artificial price distortion is reduced
(D) All the three above

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

(A) Purchase, sale or lease of tangible or intangible property
(B) Provision of service
(C) Lending or borrowing money
(D) Any of the above

(6) Mr. Dhanush holds shares in both L Ltd., and M Ltd. In the context of transfer pricing provisions,

(A) L Ltd. and M Ltd. can never be associated enterprises.
(B) L Ltd. and M Ltd. are deemed associated enterprises if Mr. Dhanush holds 26% or more of voting power in each of these companies.
(C) L Ltd. and M Ltd. are deemed associated enterprises if Mr. Dhanush holds 26% or more of voting power in L Ltd., which in turn holds 26% or more of voting power in M Ltd.
(D) L Ltd. and M Ltd. are deemed associated enterprises if Mr. Dhanush holds totally 52% or more combined voting power in both these companies.

(7) The book value of assets of SCL is ₹200 crores, whereas the market value of the said assets is ₹80 crores. Sun Ltd. has advanced a loan of ₹45 crores. In the context of transfer pricing provisions, SCL and Sun Ltd. are

(A) Not associated enterprises
(B) Associated enterprises, considering the book value of assets of SCL and its borrowings from Sun Ltd.
(C) Deemed to be associated enterprises, considering the book value of assets of SCL and its borrowings from Sun Ltd.
(D) Deemed to be associated enterprises considering the market value of assets of SCL and its borrowings from Sun Ltd.
(8) J Ltd. is controlled by Rajeev (HUF). K Ltd. is controlled by Raghav (sole proprietor of RR & Co.), a close relative of Rajeev, a member of Rajeev (HUF). For the purpose of transfer pricing provisions,

(A) J Ltd. and K Ltd. are deemed associated enterprises.
(B) Rajeev HUF, J Ltd. and K Ltd., are deemed associated enterprises.
(C) RR & Co., Rajeev HUF, J Ltd. and K Ltd., are deemed associated enterprises.
(D) There is no associate enterprise relationship involved in this.

(9) There is an arrangement between SCL and Q Ltd., which are associated enterprises. Such arrangement is oral and is also not intended to be legally enforced. For transfer pricing purposes, such arrangement-

(A) is not treated as a "transaction" because it is not in writing.
(B) is not treated as a "transaction" because it is not intended to be legally enforced.
(C) is treated as a "transaction".
(D) is not treated as a "transaction" for (A) and (B) above.

(10) The ALP determined by the TPO for some product is ₹2,000 per unit sold by SCL. Considering the tolerance band permitted by the CBDT, the tolerated international transaction price for a transaction with an associated enterprise can be upto

(A) ₹1,960
(B) ₹2,040
(C) ₹2,060
(D) None of the above

(11) Following can be an applicant for advance ruling:

(A) Non-resident entering into a transaction
(B) Resident entering into a transaction with a non-resident
(C) Resident entering into a transaction with another resident
(D) (A) or (B)

(12) An applicant for advance ruling may withdraw an application within days from the date of the application.

(A) 30
(B) 60
(C) 90
(D) 120
(13) Composition of AAR is as under:

(A) A Chairman, Vice-Chairman and Revenue Member
(B) A Chairman, Vice-Chairman and Law Member
(C) A Chairman and such number of Vice-Chairman, Revenue Members and Law Members as the Central Government may, by notification, appoint.
(D) Chairman, Vice-Chairman, Law Member and Revenue Member

(14) Following can make an application for advance ruling:

(A) Department
(B) Applicant
(C) Central Government
(D) All above

(15) Application for advance ruling is not allowed in the following situations:

(A) When the question involved is already pending before any income-tax authority.
(B) Where it is for determining the fair market value of a property.
(C) Excepting in exceptions, where the transaction in question is designed for avoidance of tax.
(D) Any one of the above

(1 x 15 = 15 Marks)

(e) Fill up blanks:

(i) The applicant desiring rollback of the APA may furnish the request for rollback provision in Form No. 3CEDA with proof of payment of an additional fee of _______.

(ii) The transfer pricing provisions contained in Section 92 shall not apply if the same has the effect of _____________ chargeable to tax.

(iii) If there is an arrangement between SCL and TFL (an associate enterprise) for mark up of a semi-finished product and sale thereafter, the ideal method for determining the ALP is ___________ method.

(iv) In a case where the aggregate value of international transactions exceeds ₹ _______, it will be obligatory for the assessee to maintain the stipulated information and documents required for transfer pricing purposes.

(v) Where SCL has maintained proper records and documents, and the TPO has made some adjustments to the ALP, thereby increasing the total income by, say, ₹ 2.68 crores, the penalty leviable u/s 270A will be ₹ ___________.

(1 x 5 = 5 Marks)

Answer

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

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

**Computation of Arm’s Length Price**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sale price of T-shirt</td>
<td>1,200</td>
</tr>
<tr>
<td><strong>Less: Differences to be adjusted</strong></td>
<td></td>
</tr>
<tr>
<td>- Margin on specialized packaging (1,200 x 3%)</td>
<td>36</td>
</tr>
<tr>
<td>- Margin for providing 6 months' credit facility (₹1200 x (0.5% x 6 months))</td>
<td>36</td>
</tr>
<tr>
<td>- Cost of tagging of ₹ 3 per piece</td>
<td>3</td>
</tr>
<tr>
<td>Adjusted sale price per T-shirt</td>
<td>1,125</td>
</tr>
</tbody>
</table>

Arm’s Length value of the sale transaction (₹ 1,125 x 2,50,000) = ₹ 28,12,50,000

**Less: Transaction value of sales to AE (₹ 1,000 x 2,50,000)** = ₹ 25,00,00,000

Total Income of SCL Ltd to be increased by = ₹ 3,12,50,000

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

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

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

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

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

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

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Cyprus</th>
<th>Spain</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Branch Subsidiary</td>
<td>Branch Subsidiary</td>
</tr>
<tr>
<td>Tax rate in the foreign country</td>
<td>20%</td>
<td>20%</td>
</tr>
<tr>
<td>Tax on profit repatriations/withholding tax on dividend</td>
<td>-</td>
<td>15% of 80% = 12%</td>
</tr>
<tr>
<td>Total tax paid in the foreign country</td>
<td>20%</td>
<td>32%</td>
</tr>
<tr>
<td>Tax payable in India</td>
<td>30%</td>
<td>12%</td>
</tr>
</tbody>
</table>

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

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Cyprus</th>
<th>Spain</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Branch Subsidiary</td>
<td>Branch Subsidiary</td>
</tr>
<tr>
<td>Foreign Tax Credit</td>
<td>20%, if such credit is available in respect of branch profit tax (assuming that full credit is available in respect of branch profit tax)</td>
<td>12%</td>
</tr>
<tr>
<td>Net tax payable</td>
<td>30%</td>
<td>32%</td>
</tr>
</tbody>
</table>

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

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

| Foreign Tax Credit | 0%, assuming such credit is not available in respect of branch profit tax | 12% | 0%, assuming such credit is not available in respect of branch profit tax | 11.25% |
In Situation 2, where FTC is not available in respect of branch profit tax, it would be advisable to establish a subsidiary in Cyprus.

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

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

(ii) **Total tax liability**

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

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

Hence, from the tax incidence point of view, the tax liability will remain the same. Choice of the country has to be determined based on other factors.
Where alternative view has been taken for Qn. 1(b)(i)

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

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

(c) (i) Consequences for the defaults specified by the AO in the show cause notice

<table>
<thead>
<tr>
<th>(i)</th>
<th>Not maintaining the records</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Section 271AA provides that the Assessing Officer or Commissioner (Appeals) may direct SCL, i.e., the person entering into an international transaction in this case, to pay penalty@2% of the value of the international transaction entered into by it, if SCL fails to keep and maintain any such document and information as required by section 92D(1) and section 92D(2). No penalty will be leviable under this section, if SCL can show that there was reasonable cause for the failure.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>(ii)</th>
<th>Not obtaining the report from the auditors</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>As per section 271BA, if SCL fails to furnish a report from an accountant as required by section 92E, the Assessing Officer may direct SCL to pay, by way of penalty, a sum of ₹ 1 lakh. No penalty will be leviable under this section, if SCL can show that there was reasonable cause for the failure.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>(iii)</th>
<th>Under reporting of ALP of the international transaction</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Under section 270A, penalty@50% of tax payable on under-reported income is leviable. In this case, SCL has not maintained proper records of international transaction, the under-reported income will not be excluded for levy of penalty.</td>
</tr>
</tbody>
</table>

(ii) Where a reference is made to the TPO under section 92CA(1) during the course of proceeding for assessment or reassessment, an additional time period of 12 months is available for completion of assessment/ reassessment in such cases over and above the time limit of 21 months. Thus, the revised time limit in respect of A.Y. 2017-18 or earlier assessment years shall be 33 months from the end of the assessment year in which the income was first assessable.

In computing the above period of limitation, the period during which the assessment proceeding is stayed by an order or injunction of any court, shall be excluded.

Section 92CA(3A) provides that where reference is made to the Transfer Pricing Officer for determination of arm’s length price of international transactions, the Transfer Pricing Officer shall make an order at least 60 days before the expiry of the above time limit of 33 months for making an order of assessment by the Assessing Officer.
Where assessment proceedings are stayed by any court and the time available to the Transfer Pricing Officer for making an order is less than 60 days, then, such remaining period shall be extended to 60 days.

Accordingly, for the A.Y. 2015-16 (in the present case) the Assessing Officer has to complete the assessment proceedings by 30.1.2019, within 33 months (plus the stay period of 30 days) from the end of assessment year i.e., 31.3.2016.

The TPO is required to make the order for determination of Arm’s Length Price 60 days prior to 30.1.2019 i.e., by 1.12.2018.

(d)  
1. D  
2. B  
3. A  
4. D  
5. D  
6. B  
7. A  
8. A  
9. C  
10. D  
11. D  
12. A  
13. C  
14. B  
15. D

(e)  
(i) ₹ 5 lakh  
(ii) Reducing the income  
(iii) Profit split  
(iv) ₹ 1 crore/₹ 99,99,999  
(v) Nil

Question 2  
About the company

Rup Ram Limited (RRL), is a domestic company, with its head office located at Mumbai. The company has several divisions dealing in manufacture, purchase and sale of several products.
RRL possesses the following assets as on 31-3-2018, whose book values are as under:

<table>
<thead>
<tr>
<th>Type of asset</th>
<th>(₹ in crores)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Intangible assets</td>
<td>20</td>
</tr>
<tr>
<td>Land and Building</td>
<td>250</td>
</tr>
<tr>
<td>Plant and Machinery</td>
<td>140</td>
</tr>
<tr>
<td>Vehicles</td>
<td>25</td>
</tr>
</tbody>
</table>

The market value of these assets as on 31-3-2018 is ₹750 crores.

Information from Manager, HR

Manager, Human Resources (HR) Division informs you that as on 31-3-2018, there were 340 employees, in the rolls of RRL, resulting in wages/salary payments to the tune of ₹11.2 crores.

Subsidiary’s presence in India

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

The subsidiary has assets present in India. It has 40 godowns in India, whose market value as on 31-3-2018 is ₹40 crores, the book value being ₹25 crores, split into ₹10 crores for land component and balance for building portion. WDV as on 31-3-2018 for income-tax purposes is ₹13.2 crores.

Other fixed assets (all purchased on 14-6-2017) are to the tune of ₹10 crores (WDV for the purposes of the Income-tax Act, 1961 (Act) ₹8.6 crores). Besides these, there is no other asset in India.

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

Assets position of SWC outside India

<table>
<thead>
<tr>
<th></th>
<th>As on 1-4-2017</th>
<th>As on 31-3-2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>No. of godowns owned</td>
<td>10</td>
<td>11</td>
</tr>
<tr>
<td>(All values in ₹Crores)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Godowns : Land portion</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(Book value)</td>
<td>8</td>
<td>12</td>
</tr>
<tr>
<td>(Market value)</td>
<td>20</td>
<td>25</td>
</tr>
<tr>
<td>Godowns : Building part</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(Book value)</td>
<td>5</td>
<td>12</td>
</tr>
<tr>
<td>(Market value)</td>
<td>4.5</td>
<td>11</td>
</tr>
<tr>
<td>Godowns : Building part (WDV for taxation)</td>
<td>4.2</td>
<td>10.2</td>
</tr>
</tbody>
</table>
Employees strength of SWC

There are 30 persons employed in India, for whom annual payment of ₹1.2 crores is incurred by SWC. There are 10 other persons, who, though not directly employed by SWC, perform the work like other employees. Outlay to them is ₹34 lakhs. All these employees are residents in India,

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

Income pattern from Indian operations of SWC

The income earned by SWC during the year ended 31-3-2018 from its Indian operations as well as other operations is as under:

<table>
<thead>
<tr>
<th>Type of Income</th>
<th>(£ in crores)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>In India</td>
</tr>
<tr>
<td>From sale made to RRL</td>
<td>42</td>
</tr>
<tr>
<td>From purchases made from RRL and sold to third parties</td>
<td>10</td>
</tr>
<tr>
<td>Income from other trading operations with third parties</td>
<td>5</td>
</tr>
<tr>
<td>Dividends and interest</td>
<td>8</td>
</tr>
</tbody>
</table>

Technical know how

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

Sponsorship activities

RRL utilized the services of Graham Stokes, a British cricketer for playing in an important cricket league matches for a team sponsored by the company. He was paid a sum of ₹25 lakhs for playing in such matches. In addition, RRL paid him a sum of ₹6.76 lakhs for appearing in company’s advertisement for its product. Graham Stokes has incurred an expenditure of ₹1.2 lakhs in India for earning the said income.

Brian Thorpe, an ex-cricketer hailing from London, was used as a match referee in the said cricket tournaments. He was paid a sum of ₹5 lakhs for his services.

Required:

(a) Find the most suitable alternative to the following (option to be given in capital letters A, B, C or D)
(i) The person responsible for making payment of income by way of interest or dividends in respect of bonds or Global Depository Receipts referred to in section 115AC, shall deduct tax at the rate of

(A) 10%

(B) 10.3%

(C) 20%

(D) (B) or at the rate specified in the DTAA, whichever is lower.

(ii) The rate of deduction of tax from interest payable to a foreign company (located in a country with which there is no DTAA) by an Indian company on borrowings made on 12-6-2017 in foreign currency from sources outside India is

(A) 5.15%

(B) 10.3%

(C) 15.45%

(D) None of the above

(iii) Surcharge applicable to a foreign company whose total income is ₹1.2 crores is

(A) Nil

(B) 2%

(C) 7%

(D) 10%

(iv) Following income which is accruing or arising outside India, directly or indirectly, is not deemed to be income accruing or arising in India:

(A) Through or from any business connection in India.

(B) Through or from any property in India.

(C) Through transfer of capital asset located outside India.

(D) Through or from any asset or sources of income in India.

(v) Remuneration received for services rendered in India by a foreign national employed by foreign enterprise is exempt, if the number of days stay in India of such foreign national does not exceed

(A) 60 days

(B) 90 days

(B) 30 days

(D) None of the above
(vi) A resident in relation to his tax liability arising out of one or more transactions valuing ₹ ________ in total which has been undertaken or is proposed to be undertaken would be eligible to be an applicant for advance ruling:

(A) 60 crore or more  
(B) 80 crore or more  
(C) 100 crore or more  
(D) 200 crore or more

(vii) An applicant, who has sought for an advance ruling, may withdraw the application within ____________.

(A) 30 days from the date of the application  
(B) 30 days from the end of the month in which the application has been made  
(C) 60 days from the date of the application.  
(D) 60 days from the end of the month in which the application has been made

(viii) In case of a non-notified resident, the AAR will not allow an application in respect of certain matters. The following is not covered in the hit list:

(A) Matter pending with income-tax authorities/tribunal/court.  
(B) Determination of fair market value of a property.  
(C) Relates to a transaction or issue which is designed prima facie for avoidance of income-tax.  
(D) Whether an arrangement, which is proposed to be undertaken by any person being a resident or a non-resident, is an impermissible avoidance arrangement as referred to in Chapter X-A or not.

(ix) The advance ruling given by the Authority for Advance Ruling (AAR) is not binding on the following person(s):

(A) On the applicant who sought the ruling.  
(B) On the other person to the transaction entered into by the applicant, if it is a non-resident.  
(C) On the other person to the transaction entered into by the applicant, whether it is resident or non-resident.  
(D) On the Principal Commissioner or Commissioner and the income-tax authorities subordinate to the Principal Commissioner or Commissioner who has jurisdiction over the application.

(x) Following income from 'Salaries' which is payable by _______ would be deemed to accrue or arise in India:

(A) The Government to a citizen of India for services rendered outside India.
(B) The Government to a non-resident for services rendered outside India.

(C) The Government to a non-citizen or non-resident for services rendered outside India.

(D) The Government or any other person to a non-citizen or non-resident for services rendered outside India.  

(1 x 10 = 10 Marks)

(b) State with reasons, whether the following statements are true or false:

(i) When interest payable to a non-resident by the Government or a public sector bank within the meaning of section 10(23D), deduction of tax shall be made at the time of payment thereof in cash or by the issue of a cheque or draft or by any other mode, or at the time of credit of such interest to the account of the non-resident, whichever is earlier. 

(2 Marks)

(ii) Where payment is made to a non-resident, even if such non-resident falls within the specified class notified by the CBDT, even if the payment is not chargeable to tax in India, the payer has to make an application to the Assessing Officer, before making the impugned payment.

(5 Marks)

(iii) Where any interest is payable by a person resident in India, the same is deemed to accrue or arise in India

(3 Marks)

(c) Graham Strokes and Brian Thorpe wish to avail the special provisions applicable to non-residents. The Managing Director of RRL wants to know about the obligation to deduct tax at source from the payments made to the aforesaid two persons.

If in both the situations above, there is an agreement between RRL and the two British persons that the tax payable on such income in India will be borne by RRL, then, what is the amount of tax to be deducted at source?

Assume that there is no DTAA provision, conferring a lower rate of withholding tax.

(7 Marks)

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

(4 Marks)

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

(6 Marks)
(f) The Board of Directors wish to know whether the foreign subsidiary SWC will be regarded as a company engaged in active business outside India for POEM purposes. Advise them suitably. The Board is also looking for your suggestions in this regard. (13 Marks)

Answer

(a) (i) D

(ii) A

(iii) B

(iv) C

(v) B

(vi) C

(vii) A

(viii) D

(ix) C

(x) A

(b) (i) The statement is false.

As per the proviso to section 195(1), in the case of interest payable by the Government or a public sector bank within the meaning of section 10(23D), deduction of tax shall be made only at the time of payment thereof in cash or by the issue of a cheque or draft or by any other mode.

(ii) The statement is true/partly true.

Under section 195(2), where the person responsible for paying any such sum chargeable to tax under the Act (other than salary) to a non-resident, considers that the whole of such sum would not be income chargeable in the hands of the recipient, he may make an application to the Assessing Officer to determine, by general or special order, the appropriate proportion of such sum so chargeable. When the Assessing Officer so determines the appropriate proportion, tax shall be deducted under section 195(1) only on that proportion of the sum which is so chargeable.

Section 195(7) provides that, notwithstanding anything contained in sections 195(1) and 195(2), the CBDT may, by notification in the Official Gazette, specify a class of persons or cases, where the person responsible for paying to a non-corporate non-resident or to a foreign company, any sum, whether or not chargeable under the provisions of this Act, shall make an application to the Assessing Officer to determine, by general or special order, the appropriate proportion of sum chargeable to tax. Where the Assessing Officer determines the appropriate proportion of the sum chargeable, tax shall be deducted under section 195(1) on that proportion of the sum which is so chargeable.
Consequently, where the CBDT specifies a class of persons or cases, the person responsible for making payment to a non-corporate non-resident or a foreign company in such cases has to mandatorily make an application to the Assessing Officer, whether or not such payment is chargeable under the provisions of the Act.

In other cases, the person responsible for making payment, if he considers that the whole of such sum would not be income chargeable to tax in the hands of the recipient, may make an application to the Assessing Officer.

(iii) The statement is true/partly true.

As per section 9(1)(v)(b), income by way of interest payable by a resident is deemed to accrue arise in India.

However, if interest is payable in respect of any debt incurred or money borrowed and used, for the purposes of a business or profession carried on by such person outside India or for the purposes of making or earning any income from any source outside India, such interest would not be deemed to accrue or arise in India.

(c) (i) As per section 115BBA, ₹ 25 lakhs earned by Graham Strokes, a non-resident sports person, who is not a citizen of India, from participation in cricket matches and ₹ 6.76 lakhs from advertisement i.e., ₹ 31.76 lakhs earned by him totally is chargeable to tax@20.6%.

No deduction is allowable in respect of any expenditure to earn such income.

Section 194E requires tax deduction at source @20.6% from such income paid to a non-resident sportsperson.

\[
\text{TDS} = \₹ 31.76 \text{lakhs} \times 20.6\% = \₹ 6,54,256
\]

Section 195A provides that if such tax is to be borne by the person by whom the income is payable, RRL, in this case, then the net amount of ₹ 31.76 lakhs payable has to be grossed up in the following manner:

\[
\₹ 31.76 \text{lakhs} \times 100/79.4 \quad (\text{i.e.,} \quad 100 - 20.6) = \₹ 40 \text{ lakhs}
\]

\[
\text{TDS} = \₹ 40 \text{lakhs} \times 20.6\% = \₹ 8,24,000
\]

(ii) A match referee is, however, not a sportsperson. Therefore, he is not entitled to the benefit of section 115BBA. The rate at which the sum of ₹ 5 lakhs received by him would be taxable at normal rates.

Tax would be deductible under section 195 at the rates in force, i.e., 30.9%.

\[
\text{TDS} = \₹ 5,00,000 \times 30.9\% = \₹ 1,54,500
\]

Applying the grossing up provisions under section 195A,

\[
\₹ 5 \text{lakhs} \times 100/69.1 \quad (\text{i.e.,} \quad 100 - 30.9) = \₹ 7,23,589
\]

\[
\text{TDS} = \₹ 7,23,589 \times 30.9\% = \₹ 2,23,589
\]
(d) As per section 245S(1), the advance ruling pronounced under section 245R by the Authority for Advance Rulings shall be binding only on the applicant who had sought it and in respect of the transaction in relation to which advance ruling was sought. It shall also be binding on the Principal Commissioner/Commissioner and the income-tax authorities subordinate to him, in respect of the concerned applicant and the specific transaction.

In view of the above provision, RRL cannot use the advance ruling, obtained on an identical issue by Silver LLC, a sister concern of Jew Inc., in its assessment proceedings.

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

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

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

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

(e) This issue came up before the AAR in, Nuclear Power Corporation of India Ltd. In Re, [2012] 343 ITR 220, wherein it was held that an advance ruling is not only applicant specific, but is also transaction specific. The advance ruling is on a transaction entered into or undertaken by the applicant. That is why section 245S specifies that a ruling is binding on the applicant, the transaction and the Principal Commissioner or Commissioner of Income-tax and those subordinate to him, and not only on the applicant.

What is barred by the first proviso to section 245R(2) of the Act in the context of clause (i) thereof is the allowing of an application under section 245R(2) of the Act where “the question raised in the application is already pending before any Income-tax authority, or Appellate Tribunal or any court”. The significance of the dropping of the words, “in the applicant’s case” with effect from June 1, 2000, cannot be wholly ignored.

On the basis of this view expressed by the AAR in the above case, explaining the impact of the dropping of the words “in the applicant’s case” with effect from 1.6.2000, a view can be taken that the AAR can reject the application made by Jew Inc before the AAR on the ground that similar issue is pending before the Assessing Officer in respect of the same transaction i.e., provision of technical know to RRL.

Note – The issue relates to the admission or rejection of the application filed before the Advance Rulings Authority on the grounds specified in clause (i) of the first proviso to subsection (2) of section 245R of the Income-tax Act, 1961.
The first proviso to section 245R(2) has been substituted by the Finance Act, 2000 with effect from 1.6.2000. Clause (i) of the first proviso, prior to and post amendment, reads as follows:

<table>
<thead>
<tr>
<th>Prior to 1.6.2000</th>
<th>On or After 1.6.2000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Provided that the Authority shall not allow the application <strong>except in the case of a resident applicant</strong> where the question raised in the application is already pending <strong>in the applicant’s case</strong> before any income-tax authority, the Appellate Tribunal or any court;</td>
<td>Provided that the Authority shall not allow the application where the question raised in the application is already pending before any income-tax authority or Appellate Tribunal or any court.</td>
</tr>
</tbody>
</table>

The words “except in the case of a resident applicant” and “in the applicant’s case” has been removed in clause (i) of the first proviso with effect from 1.6.2000. However, the Explanatory Memorandum to the Finance Act, 2000, explaining the impact of the substitution, reads as follows “It is proposed to substitute the proviso to provide that the Authority shall not allow the application when the question raised is already pending in the applicant’s case before any income-tax authority, Appellate Tribunal or any court in regard to a non-resident applicant and resident applicant in relation to a transaction with a non-resident”. Therefore, according to the intent expressed in the Explanatory Memorandum, the AAR shall not allow the application both in the case of resident and non-resident applicant if the question raised is already **pending in the applicant’s case** before any income-tax authority. Thus, an alternative view is possible on the basis of the AAR ruling in Ericsson Telephone Corporation India AB v. CIT (1997) 224 ITR 203, which continues to hold good even after the amendment, if we consider the intent expressed in the Explanatory Memorandum. Accordingly, based on this view, the AAR can allow the application made by Jew Inc., even if the question raised in the application is pending before the Assessing Officer in RRL’s case.

(f) A company shall be said to be engaged in “active business outside India” for POEM, if

- the passive income is not more than 50% of its total income; and
- less than 50% of its total assets are situated in India; and
- less than 50% of total number of employees are situated in India or are resident in India; and
- the payroll expenses incurred on such employees is less than 50% of its total payroll expenditure.
Snow White & Co. Inc (SWC) shall be regarded as a company engaged in active business outside India for POEM purpose only if it satisfies all the four conditions cumulatively.

**Condition 1: Passive income test**
The passive income of SWC should not be more than 50% of its total income

<table>
<thead>
<tr>
<th>Passive Income</th>
<th>Rs. in crores</th>
</tr>
</thead>
<tbody>
<tr>
<td>From sales made by SWC to RRL [See Note below]</td>
<td>-</td>
</tr>
<tr>
<td>From purchases made from RRL and sold to third parties</td>
<td>-</td>
</tr>
<tr>
<td>Dividend and Interest</td>
<td>13</td>
</tr>
<tr>
<td>Total passive global income</td>
<td>13</td>
</tr>
<tr>
<td>Total income of SWC</td>
<td>155</td>
</tr>
<tr>
<td>Percentage of passive income earned</td>
<td>8.4%</td>
</tr>
</tbody>
</table>

**Total income of SWC during the P.Y. 2017-18 is ₹155 crores**, being ₹65 crores in India [₹42 crores + ₹10 crores + ₹5 crores + ₹8 crores] and ₹90 crores outside India [₹15 crores + ₹70 crores + ₹5 crores]

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

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

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

**Condition 2: Assets Test**
SWC should have less than 50% of its total assets situated in India

**Value of assets is determined in the following manner:**

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

<table>
<thead>
<tr>
<th>Particulars</th>
<th>In India (` in crores)</th>
<th>Outside India (` in crores)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Godowns (building portion only), being depreciable asset, at average of its WDV as on 31.3.2017 and as on 31.3.2018</td>
<td>$6.7 + 13.2 \over 2 = 9.95$</td>
<td>$4.2 + 10.2 \over 2 = 7.20$</td>
</tr>
<tr>
<td>Other fixed assets, being depreciable assets, at average of its WDV as on 31.3.2017 and as on 31.3.2018</td>
<td>$0 + 8.6 \over 2 = 4.30$</td>
<td>$4.2 + 10.2 \over 2 = 7.20$</td>
</tr>
<tr>
<td>Land [Value as per books of account on 31.3.2018]</td>
<td>10.00</td>
<td>12.00</td>
</tr>
<tr>
<td>Total</td>
<td>24.25</td>
<td>26.40</td>
</tr>
</tbody>
</table>

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

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

Condition 3: Number of employees test

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

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

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

Therefore, number of employees situated in India or are resident in India is 40 i.e., $30 + 10^1$

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

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

---

1 It is assumed that the number of employees are same throughout the year, in the absence of information to the contrary in the question.
Since employees situated in India or are residents in India of SWC are less than 50% of its total employees, the third condition (Number of employees test) is satisfied for active business outside India test.

<table>
<thead>
<tr>
<th>Condition 4: Payroll expenses Test</th>
</tr>
</thead>
<tbody>
<tr>
<td>The payroll expenses incurred on employees situated in India or residents in India should be less than 50% of its total payroll expenditure</td>
</tr>
</tbody>
</table>

Payroll expenditure on employees situated in India or are residents in India is ₹ 1.54 crores i.e., ₹ 1.20 crores plus ₹ 0.34 crores

Total payroll expenditure of SWC is ₹ 4.54 crores being expenditure on employees situated in India or are residents in India and expenditure on employees outside India [i.e., ₹ 1.54 crores + ₹ 3 crores].

Percentage of payroll expenditure on employees situated in India or are resident in India to total payroll expenditure is ₹ 1.54 crores/₹ 4.54 crores x 100 = 33.92%

Since payroll expenditure on employees situated in India or are residents in India of SWC is less than 50% of its total payroll expenditure, the fourth condition (Payroll expenses test) is also satisfied.

Conclusion:
Since SWC satisfies all the above four conditions cumulatively, SWC will be regarded as a company engaged in active business outside India

Suggestions to the Board of Directors
The following suggestions may be offered to the Board of Directors:
(a) Income from transactions with associated enterprises like RRL should be scrupulously and constantly monitored, so that the conditions above continue to be satisfied in future years;
(b) Steps may be taken to improve trade with unrelated third parties;
(c) Percentage of Indian assets to total assets is almost 48%. If there is any plan to acquire assets in India, it must be ensured that this does not cross 50%
(d) Percentage of employees situated in India or are resident in India to the total number of employees is 48.78%. In case of any future employment, this ratio has to be borne in mind.

Question 3
About the assessee
The assessee is a famous movie actor Mr. Ajitabh Khan (AK). He has business interest in few other nations as well. He is a resident in India for the Assessment Year 2018-19.

About yourself
You are the CEO with CA background. You have sound knowledge of the Indian and Foreign tax laws. The date on which various events happened and have been summarized in this case study is 31-3-2018.
A phone call has been received from the Manager (Legal) that a search is being conducted by the Income-tax department at one of the premises of the assessee. No further details are available now.

E-mail from Taxation Manager at 18.00 hours

The Taxation Manager has emailed you the summarized information of income earned by AK during the year ended 31-3-2018 as under: (₹ in crores)

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

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

Phone call from Manager (Legal) 20.30 hours

The search conducted by the IT Department has come to an end. It appears that some incriminating documents have been unearthed. It is likely that it has come to the notice of the Department that the assessee has earned income of ₹ 12 crores (as converted into INR) in Dubai during the Financial Year 2015-16, which has not been reflected in the return of income filed by AK for the Assessment Year 2016-17 or in any other year.

Further, the presence of certain building, in Panama Islands, which are not appearing in the books of account and financial statements filed with the IT Department. These buildings were purchased for 35.2 million USD on 12-3-2014. For acquiring this asset, brokerage of 2% has been paid to a real estate agent.

Additionally, there are materials to show that the assessee owns 5 rare pieces of art work, acquired on 12-6-2016 in Macau Islands for a price of 3.8 million USD.

E-mail from International Division Manager at 21.00 hours

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

<table>
<thead>
<tr>
<th>Type of Income</th>
<th>L</th>
<th>M</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loss from house property (Computed)</td>
<td>1.3</td>
<td>-</td>
</tr>
<tr>
<td>Business income:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Own</td>
<td>7.2</td>
<td>2.9</td>
</tr>
<tr>
<td>Share income from partnership firm</td>
<td>4.8</td>
<td>-</td>
</tr>
<tr>
<td>Agricultural income</td>
<td>-</td>
<td>1.2</td>
</tr>
</tbody>
</table>
In country L, share income is not exempt and loss from house property is not eligible for being set off against other income. In country M, agricultural income is also chargeable to income-tax.

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

**Inputs from Forex Team (Email received at 21.15 hours)**

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

<table>
<thead>
<tr>
<th>Date</th>
<th>1-4-2013</th>
<th>12-3-2014</th>
<th>1-7-2015</th>
<th>31-3-2016</th>
<th>1-4-2016</th>
<th>1-6-2016</th>
<th>1-4-2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 USD = INR</td>
<td>64.05</td>
<td>64.50</td>
<td>65.10</td>
<td>64.75</td>
<td>65.20</td>
<td>65.40</td>
<td>65.55</td>
</tr>
</tbody>
</table>

**Email from Xavier LLP (Registered valuers) at 23.45 hours**

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

<table>
<thead>
<tr>
<th>Sl. No.</th>
<th>Description of Asset</th>
<th>Date</th>
<th>Amount (million USD)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Buildings in Panama Island</td>
<td>01-07-2015</td>
<td>38</td>
</tr>
<tr>
<td></td>
<td></td>
<td>31-03-2016</td>
<td>38</td>
</tr>
<tr>
<td></td>
<td></td>
<td>01-04-2017</td>
<td>40</td>
</tr>
<tr>
<td>2</td>
<td>Art pieces in Macau</td>
<td>12-06-2016</td>
<td>4</td>
</tr>
<tr>
<td></td>
<td></td>
<td>01-04-2017</td>
<td>4.2</td>
</tr>
</tbody>
</table>

**Payment made to foreign player**

Mr. Ajmal Kamal, a non-resident player, was called for one of the Asian Premier League Matches, for which ₹ 20 lakhs was paid to him. The withholding tax mentioned in the DTAA with the nation in which the said actor resides, is 15%.

**Required:**

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

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

   (A) 5
(B) 3.2

(C) 3.8

(D) None of the above

(ii) Under the BM Act, the rate of exchange to be adopted for conversion purposes will be the rate specified by

(A) RBI

(B) SBI

(C) Central Government

(D) CBDT

(iii) The Assessing Officer has detected undisclosed foreign income of ₹3 crores earned during the year ended 31-3-2017. There is foreign loss of ₹1.2 crores also, hitherto not shown in the income-tax return filed for the Assessment Year 2017-18. The quantum of undisclosed foreign income assessed under the BM Act will be

(A) ₹1.8 crores

(B) ₹1.2 crores

(C) ₹3 crores

(D) None of the above

(iv) Unquoted shares acquired in Tokyo on 21-3-2016 came to the notice of the Assessing Officer on 12-3-2018. There is no explanation of the source for the same. The converted value of the shares on 21-3-2016, 1-4-2016, 1-4-2017 and 1-4-2018 are ₹12, 13, 14 and 15 crores, respectively. The undisclosed foreign income representing the value of the undisclosed foreign asset, as per the BM Act is

(A) ₹12 crores

(B) ₹13 crores

(C) ₹14 crores

(D) ₹15 crores

(v) Under the BM Act, a tax authority below the rank of Commissioner can retain the impounded books normally for a period of

(A) 120 days

(B) 90 days

(C) 60 days

(D) 30 days
(vi) In a typical Tax Convention based on OECD model or UN model, the definition of the term "national" is primarily relevant to the Article dealing with __________.
   (A) Persons covered / General scope
   (B) Non-discrimination
   (C) Resident
   (D) Credit Method

(vii) Controlled Foreign Corporations (CFCs) are ___________ entities incorporated in an overseas low tax jurisdiction.
   (A) Corporate
   (B) Non-Corporate
   (C) Both corporate and Non-corporate
   (D) None of the above

(viii) Existence of a __________ in a jurisdiction is a pre-requisite for the purpose of taxation of business profit of an enterprise in that jurisdiction, major Tax Convention:
   (A) Business connection
   (B) Permanent establishment
   (C) Business or professional connection
   (D) Any connection giving rise to the said profit

(ix) For the purpose of equalization levy, "specified service" means
   (A) Online advertisement
   (B) Any provision for digital advertising space or any other facility or service for the purpose of online advertisement.
   (C) Specified Service also includes any other service as may be notified by the Central Government.
   (D) All of the above.

(x) Following is not an anti-tax avoidance measure in the context of international taxation:
   (A) TIEAS
   (B) POEM
   (C) GAAP
   (D) Transfer pricing provisions

(b) Test the correctness of the following statements, with brief reasons:

   (i) A tax authority under the BM Act shall be deemed to be a civil court for all intents and purposes.  

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(ii) Any payment received for online advertisement will attract equalization levy of 6% (3 Marks)

(iii) ABC Ltd. is a domestic company. It has a foreign subsidiary FGH Inc., in a tax haven. If the place of effective management is found to be in India, under the CFC legislation, the entire income of can be taxed in India and FGH Inc., can be treated as a domestic company for several other purposes as well. (4 Marks)

(c) Discuss whether AK has fulfilled the requisite conditions for grant of relief under section 91. (5 Marks)

(d) AK wants to know the income-tax liability for the Assessment Year 2018-19, with workings. You are required to provide the same. (11 Marks)

(e) Discuss briefly about the amount of TDS applicable for payment to Ajmal Kamal. (3 Marks)

(f) In respect of the foreign income and foreign assets unearthed by the Department during the search, discuss the tax implications under the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 (BM Act). AK wants to know the year of taxability and the tax amount. Your answer should also cover discussion on the applicable provisions concerned. (11 Marks)

Answer

(a) (i) B  
(ii) A  
(iii) C  
(iv) C  
(v) D  
(vi) B  
(vii) A  
(viii) B  
(ix) D  
(x) C

(b) (i) The statement is not correct. A tax authority shall be deemed to be a civil court for the purposes of section 195 of the Code of Criminal Procedure, 1973, which provides for prosecution for contempt of lawful authority of public servants, for offences against public justice and for offences relating to documents given in evidence.
However, he would not be so deemed for the purposes of Chapter XXVI of the Code of Criminal Procedure, 1973, containing the provisions as to offences affecting the administration of justice.

Therefore, the statement that a tax authority shall be deemed to be civil court for all intents and purposes is not correct.

(ii) The statement is not correct.

Chapter VIII of the Finance Act, 2016, titled "Equalisation Levy", provides for an equalisation levy of 6% of the amount of consideration for specified services, which includes online advertisement, received or receivable by a non-resident not having permanent establishment in India, from a resident in India who carries out business or profession, or from a non-resident having permanent establishment in India.

Therefore, only if payment is received by a non-resident not having a PE in India, would provisions of equalization levy be attracted and not otherwise.

(iii) The statement is partly correct.

As per section 6(3), a foreign company FGH Inc. would be resident in India in any previous year, if, its place of effective management, in that year, is in India. Therefore FGH Inc. would be a resident in India by virtue of section 6(3) of the Income-tax Act, 1961 and its entire income would be taxable in India.

If FGH Inc. becomes a resident on account of its POEM being in India, the provisions of tax deduction at source under Chapter XVII-B as applicable to income received by a resident, would be attracted in respect of income received by FGH Inc.

The rate of tax applicable to FGH Inc. would be the tax rate applicable to a foreign company and not a domestic company. Further, the provisions of dividend distribution tax under section 115-O would not be attracted in the hands of FGH Inc. in respect of the dividend distributed by it, since FGH Inc. is not a domestic company.

In effect, the provisions of the Income-tax Act, 1961 relating to companies resident in India would apply to FGH Inc. However, it cannot be treated as a domestic company for the purposes of the Act.

(c) Conditions to be fulfilled to claim relief u/s 91

In the case of income arising to an assessee in countries with which India does not have any double taxation agreement, relief would be granted under section 91 provided all the following conditions are fulfilled:

(a) The assessee is a resident in India during the previous year in respect of which the income is taxable.

(b) The income accrues or arises to him outside India.

(c) The income is not deemed to accrue or arise in India during the previous year.
(d) The income in question has been subjected to income-tax in the foreign country in the hands of the assessee.

(e) The assessee has paid tax on the income in the foreign country.

(f) There is no agreement for relief from double taxation between India and the other country where the income has accrued or arisen.

Ajitabh Khan is resident for the A.Y. 2018-19. He has income accrues or arises in Country L and Country M and such income is not deemed to accrue or arise in India. The income earned in Country L and Country M is chargeable to tax there and AK has also paid income-tax on such income there. India does not have a Double taxation avoidance agreement with Country L and Country M.

AK has fulfilled the necessary conditions for grant of relief u/s 91.

(d) Since Ajitabh Khan is resident in India for the P.Y. 2017-18, his global income would be subject to tax in India. Therefore, income earned by him in Country L & M would be taxable in India. He is however entitled to deduction under section 91, since India does not have a DTAA with Country L & M, and all conditions under section 91 are satisfied.

### Computation of tax liability of Ajitabh Khan for A.Y.2018-19

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>I Income from house property</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income from house property in India</td>
<td>4,30,00,000</td>
<td></td>
</tr>
<tr>
<td>Less: Loss from house property in Country L</td>
<td>1,30,00,000</td>
<td>3,00,00,000</td>
</tr>
<tr>
<td><strong>II Profits and gains of business or profession</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Business income in India</td>
<td></td>
<td></td>
</tr>
<tr>
<td>From being the owner of cricket team in Asian Premier League</td>
<td>12,40,00,000</td>
<td></td>
</tr>
<tr>
<td>From acting in movies</td>
<td>9,41,50,000</td>
<td>21,81,50,000</td>
</tr>
<tr>
<td>Business income in Country L</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Own</td>
<td>7,20,00,000</td>
<td></td>
</tr>
<tr>
<td>Share income from firm²</td>
<td>4,80,00,000</td>
<td>12,00,00,000</td>
</tr>
<tr>
<td>Business income in Country M</td>
<td>2,90,00,000</td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>36,71,50,000</td>
<td></td>
</tr>
</tbody>
</table>

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

An alternate view that the share income from foreign firm is also exempt under section 10(2A) may also be possible, in which case, the answer would accordingly undergo a change.
### Income from Other Sources

Agricultural income from Country M  \( \text{₹} 1,20,00,000 \)

### Gross Total Income

\( \text{₹} 40,91,50,000 \)

### Less: Deductions under Chapter VI-A

**Under section 80C**
- PPF  \( \text{₹} 1,20,000 \)
- LIC  \( \text{₹} 2,00,000 \)
- Total  \( \text{₹} 3,20,000 \), restricted to  \( \text{₹} 1,50,000 \)

**Total Income**  \( \text{₹} 40,90,00,000 \)

### Computation of tax liability:

**Tax on total income**  \( \text{₹} 12,25,12,500 \)

\([30\% \times (\text{₹} 40,80,00,000 + \text{₹} 1,12,500)]\)

**Add:** Surcharge@15% (since his total income exceeds ₹1 crore)  
\( \text{₹} 1,83,76,875 \)

**Add:** Education Cess & SHEC @3%  
\( \text{₹} 42,26,681 \)

**Total**  \( \text{₹} 14,51,16,056 \)

**Tax liability (rounded off)**  \( \text{₹} 14,51,16,060 \)

**Less:** Deduction under section 91  
[See Working Notes 1 & 2 below]  
\( \text{₹} 2,72,60,000 \)

**Net Tax liability (rounded off)**  \( \text{₹} 11,78,56,060 \)

### Working Note 1: Computation of deduction under section 91

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deduction under section 91 in respect of income doubly taxed in India and Country L</td>
<td></td>
</tr>
<tr>
<td>Doubly taxed income:</td>
<td></td>
</tr>
<tr>
<td>Country L (i.e., ₹ 7.2 crores, being business income (+) ₹ 4.8 crores, being taxable share income from firm (-) ₹ 1.3 crores, loss from house property)</td>
<td>₹ 10,70,00,000</td>
</tr>
<tr>
<td>Lower of Indian rate of tax and rate of tax in Country L</td>
<td>18%</td>
</tr>
<tr>
<td>[See Working Note 2 below]</td>
<td></td>
</tr>
<tr>
<td>Deduction u/s 91 = 18% \times ₹ 10.70 crores</td>
<td>₹ 1,92,60,000</td>
</tr>
</tbody>
</table>
Deduction under section 91 in respect of income doubly taxed in India and Country M

Doubly taxed income:
Country M (i.e., ₹ 2.9 crores, being business income (+) ₹ 1.2 crores, being taxable agricultural income) € 4,10,00,000
Lower of Indian rate of tax and rate of tax in Country M [See Working Note 2 below] 19.51%
Deduction u/s 91 = 19.512% x ₹ 4.10 crores

Deduction under section 91 2,72,60,000

Working Note 2: Computation of average rate of tax in India, Country L & M

<table>
<thead>
<tr>
<th></th>
<th>Average rate of tax in India</th>
<th>35.48%</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1)</td>
<td>Average rate of tax in India</td>
<td>35.48%</td>
</tr>
<tr>
<td></td>
<td>[14,51,16,060 x 100/40,90,00,000]</td>
<td></td>
</tr>
<tr>
<td>(2)</td>
<td>Average rate of tax in Country L</td>
<td>18%</td>
</tr>
<tr>
<td></td>
<td>[2,16,00,000 x 100/12,00,00,000]</td>
<td></td>
</tr>
<tr>
<td>(3)</td>
<td>Average rate of tax in Country M</td>
<td>19.512%</td>
</tr>
<tr>
<td></td>
<td>[80,00,000 x 100/4,10,00,000]</td>
<td></td>
</tr>
</tbody>
</table>

Where any income referred to in section 115BBA is payable to a non-resident non-citizen sportsman, the person responsible for making payment is liable to deduct tax at source @20% on such income under section 194E.

Income referred to in section 115BBA includes income by way of participation in India in any game or sport.

Payment of ₹ 20 lakh by Ajitabh Khan to Mr. Ajmal Kamal, a non-resident, for participation in one of the Premier League Matches is income referred to in section 115BBA, hence, Ajitabh Khan is liable to deduct tax at source on such payment @20% under section 194E.

Since Ajmal Kamal is a non-resident, the amount of tax to be deducted would be increased by education cess @2% and secondary and higher education cess @1%. So, the effective rate of tax to be deducted by Mr. Ajitabh Khan is 20.6%.

However, DTAA of India with the other Country in which Mr. Ajmal Kamal resides, provides for withholding tax at 15%.

Section 90(2) of Income-tax Act, 1961 provides that where the Central Government has entered into a DTAA with a country outside India, then, in respect of an assessee to whom

---

3 It is logical to assume that Mr. Ajmal Kamal is a non-citizen, since the question mentions that he is a foreign player.
such agreement applies, the provisions of act shall apply to the extent they are more beneficial to the assessee.

Therefore, Mr. Ajitabh Khan is liable to deduct tax @15%, being the most beneficial rate contained in the DTAA, from payment of ₹ 20 lakhs made to Mr. Ajmal Kamal, a non-resident sportsperson.

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

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

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

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

In this case, search by IT department is conducted on Mr. Ajitabh Khan’s, a resident, premises on 31.3.2018 and undisclosed foreign income and assets were found. The undisclosed foreign income would be charged to tax@30% in the P.Y.2015-16. The undisclosed foreign asset would be charged to tax@30% in the P.Y.2017-18, being the year in which it came to the notice of the Assessing Officer. The Assessing Officer may direct penalty, in addition to tax payable by him, a sum equal to three times the tax so computed and ₹ 10 lakh for not disclosing foreign assets and income.

**Undisclosed foreign income**

Undisclosed foreign income of ₹ 12 crores earned in Dubai during the F.Y.2015-16 is chargeable to tax in the A.Y.2016-17.

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

**Undisclosed foreign assets**

Though the building in Panama Islands was purchased in the P.Y.2013-14 and pieces of art work was acquired in the P.Y.2016-17 in Macau islands, the same is chargeable to tax in India under the Black Money Act in the A.Y.2018-19 only, since these assets came to the notice of the Assessing Officer in the P.Y.2017-18.
<table>
<thead>
<tr>
<th>Particulars</th>
<th>Million $</th>
<th>₹ (in crores)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Undisclosed foreign assets:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Building in Panama Islands</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Purchase price</td>
<td>35.200</td>
<td></td>
</tr>
<tr>
<td><em>Add:</em> Brokerage (2% of $ 35.2 million)</td>
<td>0.704</td>
<td></td>
</tr>
<tr>
<td>Cost of acquisition</td>
<td>35.904</td>
<td></td>
</tr>
<tr>
<td>Market value as on valuation date, being value on 1&lt;sup&gt;st&lt;/sup&gt; April of the previous year i.e., on 01.04.2017</td>
<td>40.00</td>
<td></td>
</tr>
<tr>
<td>Fair market value of building in Panama Islands [being higher of cost of acquisition and the price that the property shall ordinarily fetch if sold in the open market on the valuation date]</td>
<td>40.00</td>
<td></td>
</tr>
<tr>
<td>Relevant rate of exchange for the purpose of conversion into Indian currency [being the rate of exchange on 1&lt;sup&gt;st&lt;/sup&gt; April of the previous year i.e., on 01.04.2017] - 65.55</td>
<td></td>
<td>262.200</td>
</tr>
<tr>
<td>Fair market value in Indian currency in crores (40 million x 65.55/10)</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>5 pieces of art work</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cost of acquisition</td>
<td>3.80</td>
<td></td>
</tr>
<tr>
<td>Market value as on valuation date, being value on 1&lt;sup&gt;st&lt;/sup&gt; April of the previous year i.e., on 01.04.2017</td>
<td>4.20</td>
<td></td>
</tr>
<tr>
<td>Fair market value [being higher of cost of acquisition and the price that the artistic work shall ordinarily fetch if sold in the open market on the valuation date]</td>
<td>4.20</td>
<td></td>
</tr>
<tr>
<td>Relevant rate of exchange for the purpose of conversion into Indian currency [being the rate of exchange on 1&lt;sup&gt;st&lt;/sup&gt; April of the previous year i.e., on 01.04.2017] – 65.55</td>
<td></td>
<td>27.531</td>
</tr>
<tr>
<td>Fair market value in Indian currency in crores (4.2 million x 65.55/10)</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total undisclosed foreign assets</strong></td>
<td></td>
<td><strong>289.731</strong></td>
</tr>
<tr>
<td>Tax payable @ 30%</td>
<td></td>
<td><strong>86.92</strong></td>
</tr>
</tbody>
</table>
CASE STUDY 1

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. 2017-18.

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 1.11.2017</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 1.3.2018</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 31-3-2018:

<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 22-3-2018 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.

Mail from Taxation Manager of Country E on 30-4-2018

As per this mail, there is clear information that undisclosed income is earned in country E to the tune of Rs.5 lakhs relating to the previous year 2016-17 and about the existence of undisclosed gold jewellery purchased on 21-4-2016. 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 1-4-2018 and Rs.5.3 lakhs as on 30-4-2018.

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. Any term used in a DTAA with a foreign country and not defined in the agreement or the Act but assigned a meaning in the notification issued by the Central Government in the Official Gazette, shall have the meaning assigned in such notification and shall be effective from the -
   (a) Date of the DTAA
   (b) Date of the notification
   (c) Date of publication of the Official Gazette
   (d) None of the above.

2. In case of conflict between the provisions of the DTAA and the Income-tax Act, 1961, then,
   (a) The provisions of the Act will always prevail over the DTAA.
   (b) The provisions of the DTAA will always prevail over the Act.
   (c) The provisions of the Act will apply to the extent they are more beneficial to the assessee
   (d) The issue will be resolved by mutual consent of the Contracting States

3. Where a person derives income from a nation with which India does not have a DTAA, such person is given credit in India in the following manner:
   (a) Entire tax paid in the foreign country is allowed as deduction.
   (b) Tax paid in the foreign country on income which is doubly taxed, is allowed as deduction.
   (c) Tax paid on income which is doubly taxed, is allowed as deduction, at the Indian rate of tax only.
   (d) Tax paid on income which is doubly taxed, is allowed as deduction, at the Indian rate of tax or rate of tax of the foreign country, whichever is lower.

4. 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.

5. 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.12,000
(d) Rs.1,932

6. Assume that Arjun had acquired a factory building in Country Z for Rs.24 lakhs on 21-3-2015, 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 20-5-2017. The market value of the asset as on 1-4-2017 is Rs. 40 lakhs. The value of undisclosed foreign asset as per section 5 of the 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

7. Continuing the facts of MCQ 6., assume that the Assessing Officer has issued the notice under section 10(1) of the BM Act on 30-5-2018. The time limit for completion of assessment under the BM Act is

(a) 31-3-2021
(b) 30-5-2020
(c) 31-3-2023
(d) 30-5-2023

8. Taxes on income and on capital imposed on behalf of a Contracting State or of its political subdivisions or local authorities, irrespective of the manner in which they are levied, are covered in the following Model Convention(s):

(a) only in the OECD Model Convention
(b) only in the UN Model Convention
(c) only in the US Model Convention
(d) Both (a) and (b)

9. In the tax treaties based on OECD and UN Model Tax Conventions, where capital gains arises on alienation of an immovable property, such gains derived -

(a) Will always be taxed only in the place of residence of the taxpayer;
(b) Will always be taxed only in the place of location of the immovable property;
(c) Can be taxed in both States and appropriate relief allowed as per the terms of the DTAA in the place of residence;
(d) None of the above.
10. A separate article on “Independent Personal Services” is present –
   (a) Only in the OECD Model Convention
   (b) Only in the UN Model Convention
   (c) Only in the US Model Convention
   (d) Both in the OECD and UN Model Conventions

II. DESCRIPTIVE QUESTIONS

1. Ascertain the income-tax liability of Mr. Arjun Batra for the assessment year 2018-19.  
   (20 marks)

2. In respect of the mail received from the Taxation Manager of Country E on 30-4-2018, are there any tax 
   implications in the hands of Mr. Arjun in India? If so, in what year will the impugned items be taxed and 
   what is the rate of tax? Compute the tax liability on account of such items.  
   (10 Marks)

CASE STUDY 2

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, 2016.

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 2016, they find a small office space in a new business complex 
close to the city center of Port Louis, Mauritius and take it on lease hold basis for a year. They designate this 
office space as their registered office where the books of accounts will be kept and maintained.

By April 1, 2017, 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 2017-2018, the aggregate pay roll expenses for 
these three employees is Rs.15,00,000.

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

The first steps that Mrs. Indra and Mr. Raghu are to take as per the business plan is to finalize any two organic 
foods grown in Mauritius that will be marketable in New Delhi, India. During the financial year 2017-2018 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 2017 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 2017-2018, he is paid a salary of Rs.5,00,000.

During the financial year 2017-2018 the company has a total of four board meetings. Each of the meetings is attended by the three directors personally. The first, second and third meeting is held in Mauritius while the next meeting is held in New Delhi, India. Basically, there is a meeting in every quarter.

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

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

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

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

After the books of accounts have been closed for the previous year 2017-2018, it is assessed that the company made a profit of Rs.15,00,000. The profit comprised the following:

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

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

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

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

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

I. MULTIPLE CHOICE QUESTIONS

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

1. During the P.Y. 2015-16 and P.Y. 2016-17, Mr. Rai was in India on business visits from June 15, 2015 to August 31, 2015 and July 1, 2016 to September 28, 2016, respectively. During the previous year 2017-18, Mr. Rai was in India during April – May 2017 and November 2017. What is the residential status of Mr. Rai for previous years 2016-2017 and 2017-2018, 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 2017-18, 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 2017-2018, which of the following statements is true?
   (a) The resultant gain is a short-term capital gain taxable under the normal provisions of the Act.
   (b) The resultant gain is a short-term capital gain taxable@15% u/s 111A.
   (c) The resultant gain is a long-term capital gain taxable@20% u/s 112.
   (d) The resultant gain is a long-term capital gain exempt u/s 10(38).

4. Mr. Bhandari receives dividend payment from RB Pvt. Ltd. in his Indian bank account during 2017-2018 to the tune of Rs.1,50,000. Which of the following statements is true?
   (a) Mr. Bhandari is liable to pay tax on such dividend as it forms part of his total income
   (b) RB Pvt. Ltd. will have to pay a dividend distribution tax u/s 115-O on such payments
   (c) Mr. Bhandari is eligible for an exemption under section 10(34) in respect of such dividend.
   (d) Both (b) and (c)

5. Which of the following factors is not considered under the OECD Model Convention to determine the residence of an individual?
   (a) Habitual abode
   (b) Centre of vital interests
   (c) Own house in Calcutta given on rent for the last ten years
   (d) Flat taken on rent in Pune where he is living for the last ten years.

6. If a company is resident of two Contracting States, namely, Country X, being the place of incorporation, and Country Y, being the place of effective management, then, the company would be resident of Country Y, being the place of effective management as per -
   (a) Only the OECD Model Convention
   (b) Only the UN Model Convention
   (c) Only the US Model Convention
   (d) Both (a) and (b)

7. If a company is resident of two Contracting States, namely, Country X, being the place of incorporation, and Country Y, being the place of effective management, then, the company shall not be treated as a resident of either Country X or Country Y for the purpose of benefits provided by -
   (a) the OECD Model Convention only
   (b) the UN Model Convention only
   (c) the US Model Convention only
   (d) Both (a) and (b)
8. As per the OECD Model Convention, the term “Permanent Establishment” would not include -
(a) a branch
(b) an office for carrying out routine administrative work.
(c) a factory for manufacture of goods
(d) a warehouse for storage of goods

9. During the previous year 2018-19, RB Pvt. Ltd. entered into contracts for purchase and sale of barley grains with PB Pvt Ltd. PB Pvt Ltd. is a company incorporated in New Delhi. On account of which of the following facts, would the companies be considered to be associated enterprises?
(a) One of the four directors of PB Pvt. Ltd. is Mr. Bhandari
(b) RB Pvt. Ltd. owns 20% of shares in PB Pvt. Ltd.
(c) RB Pvt. Ltd. extended a loan of Rs.20 lakhs to PB Pvt. Ltd. when the book value of the latter is Rs.42 lakhs
(d) Mr. Bhandari owns 26% of shares in PB Pvt. Ltd.

10. In addition to the answer in question 9 above, what else needs to be proved for invoking a transfer pricing scrutiny as an international transaction?
(a) The transactions between the two companies are held on terms and prices which reflect market control
(b) The transactions are covered by the notified safe harbor rules
(c) RB Pvt. Ltd. is a non-resident company
(d) The aggregate value of the transactions is Rs.50,00,000 in the concerned Previous Year

II. DESCRIPTIVE QUESTIONS

1. The board decides to understand the matter at hand from a tax lawyer. Accordingly, Mr. Bhandari seeks a meeting with a tax lawyer on the question. The lawyer explains the following in an informal conversation:
RB Pvt. Ltd. would be considered to be a resident of India for tax purposes despite it having been incorporated in Port Louis, Mauritius. The reasons for the same are detailed as follows:
• Majority of the board of directors reside in India
• The place of incorporation of the company is irrelevant
• All the revenue generation activity is linked to India

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

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, 2017. Assume that Facebook does not have a permanent establishment in India.
(a) Is the fee paid for online advertisement services by RB Pvt. Ltd. to Facebook Inc. taxable in India? Discuss.

(b) If the answer to (a) is in the affirmative, is there any requirement to deduct tax at source? If tax is not so deducted, what would be the consequence?
(c) What is the provision incorporated in the Indian tax laws to avoid double taxation of such income? (2 Marks)

3. (a) RB Pvt. Ltd. wants a binding advice relating to their tax liability in India. They have been informed by Modern Foods that while making the payments relating to the product sales, taxes have to be withheld. Is there an avenue available under domestic law for obtaining such binding advice? (4 Marks)

(b) Should RB Pvt. Ltd. make such application or Modern Bazaar? The total value of the transactions between RB Pvt. Ltd. and Modern Bazaar is Rs.50,00,000 in the previous year 2017-2018. (3 Marks)

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

CASE STUDY 3

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>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 2012</td>
<td>Date of acquisition by Germany Co in Mauritius Intermediary Co - 1 April 2012</td>
<td>Date of acquisition by Cyprus Co in Australia Intermediary Co - 1 April 2012</td>
<td>Date of acquisition by UK Co in Spain Intermediary Co - 1 April 2012</td>
</tr>
<tr>
<td>Date of acquisition by Singapore Intermediary Co in Ind Co - 1 March 2017</td>
<td>Date of acquisition by Mauritius Intermediary Co in Ind Co - 1 April 2012</td>
<td>Date of acquisition by Australia Intermediary Co in Ind Co - 1 April 2012</td>
<td>Date of acquisition by Spain Intermediary Co in Ind Co - 1 April 2012</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 to be identified. The restructuring/exit is proposed to be undertaken on 31 May 2018 by each of the Groups.

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

<table>
<thead>
<tr>
<th>Group A</th>
<th>Group B</th>
<th>Group C</th>
<th>Group D</th>
</tr>
</thead>
<tbody>
<tr>
<td>Book value – INR 500 crores</td>
<td>Book value – INR 200 crores</td>
<td>Book value – INR 100 crores</td>
<td>Book value – INR 100 crores</td>
</tr>
<tr>
<td>Singapore Intermediary Co – 30 June 2017</td>
<td>Mauritius Intermediary Co – 31 December 2017</td>
<td>Australia Intermediary Co – 31 December 2017</td>
<td>Spain Intermediary Co - 31 March 2018</td>
</tr>
</tbody>
</table>

Ind Co follows 1 April - 31 March as the Financial Year and the book value of Ind Co as on 31 March 2018 was INR 100 crores.

The book values (after reduction of liabilities), fair market values (after reduction of liabilities) and liabilities of some of the entities as on 31 May 2018 (ie 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 31.3.2018 is same as it is on 31.05.2018
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. The provisions relating to taxation of indirect transfer of shares of an Indian company were introduced vide Finance Act, 2012, as a consequence of which of the following decisions of the Supreme Court -
   (a) McDowell & Co. Ltd. v. CTO
   (b) Vodafone International Holdings B.V. vs. UOI
   (c) Union Of India vs Azadi Bachao Andolan
   (d) CIT Vs Yokogawa India Limited

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

3. 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 2017
   (b) 31st December 2017
   (c) 31st March 2018
   (d) 31st May 2018

4. Assuming the transfer of shares of Singapore Intermediary Co by US Co is taxable in India and ignoring DTAA provisions, if any, what would be the rate of tax on the gains arising from such transfer:
   (a) 10%
   (b) 20%
   (c) 30%
   (d) 40%
   (Note – The above tax rates are excluding cess and surcharge, if any)

5. 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

6. Which of the following incomes is not deemed to accrue or arise in India under section 9(1)(i) of the Income-tax Act, 1961?
   (a) Income from any business connection in India
   (b) Income through or from any property in India

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(c) Income arising from transfer of a capital asset situate in India
(d) Income relating to operations which are confined to purchase of goods in India for the purpose of export

7. 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

8. 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

9. What are the penal consequences on Ind Co if it fails 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) INR 100,000
   (b) INR 500,000
   (c) 2% of the value of the transaction in respect of which there is a failure to report
   (d) There is no requirement on Ind Co to furnish information

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

II. DESCRIPTIVE QUESTIONS

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

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

US Co had acquire shares of Singapore Intermediary Co for INR 10 crores. (5 Marks)

(ii) As an alternative, Group A is also evaluating the option of transferring shares held by Singapore Intermediary Co in Ind Co to an unrelated Buyer for a consideration of INR 45 crores. Singapore Intermediary Co had acquire shares of Ind Co for INR 5 crores. Evaluate the capital gains chargeable to tax in India considering the provisions of the Income-tax Act, 1961 and the applicable DTAA. (4 Marks)

(iii) As an alternative to the (i) and (ii) above, if proposal of corporate restructuring is considered instead of exit proposal, Group A is evaluating the option of amalgamating US Co with another group company in US (US Co 2) as a result of which shares of Singapore Intermediary Co would be transferred to US Co 2. What are the conditions under the Income-tax Act, 1961 under which such transfer of shares of Singapore Intermediary Co to US Co 2 be exempt from capital gains tax in India? If the US Co has more than one undertaking, what is other option, if any, available with US Co to transfer shares of Singapore Intermediary Co by way of corporate restructuring without attracting income-tax in India under the Income-tax Act, 1961? (6 Marks)

EXHIBIT I

EXTRACTS OF ARTICLE ON CAPITAL GAINS FROM DOUBLE TAXATION AVOIDANCE AGREEMENTS

US-Singapore DTAA

No DTAA

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 resident in 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.

Cyprus-Australia DTAA

No DTAA

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.”

EXHIBIT II

RULE 11UC - DETERMINATION OF INCOME ATTRIBUTABLE TO ASSETS IN INDIA

(1) The income from transfer outside India of a share of, or interest in, a company or an entity referred to in clause (i) of sub-section (1) of section 9, attributable to assets located in India, shall be determined in accordance with the following formula, namely:—

\[ A \times \frac{B}{C} \]

Where;

A = Income from the transfer of share of, or interest in, the company or the entity computed in accordance with the provisions of the Act, as if, such share or interest is located in India;

B = Fair Market Value of assets located in India as on the specified date, from which the share or interest referred to in A derives its value substantially, computed in accordance with rule 11UB;

C = Fair Market Value of all the assets of the company or the entity as on the specified date, computed in accordance with rule 11UB;

Provided that if the transferor of the share of, or interest in, the company or the entity fails to provide the information required for the application of the aforesaid formula then the income from the transfer of such share or interest attributable to the assets located in India shall be determined in such manner as the Assessing Officer may deem suitable.
(2) The transferor of the share of, or interest in, a company or an entity that derives its value substantially from assets located in India, shall obtain and furnish along with the return of income a report in Form No.3CT duly signed and verified by an accountant providing the basis of the apportionment in accordance with the formula and certifying that the income attributable to assets located in India has been correctly computed.

EXHIBIT III

RULE 114DB - INFORMATION OR DOCUMENTS TO BE FURNISHED UNDER SECTION 285A

(1) Every Indian concern referred to in section 285A shall, for the purposes of the said section, maintain and furnish the information and documents in accordance with this rule.

(2) The information shall be furnished in Form No.49D electronically under digital signature to the Assessing Officer having jurisdiction over the Indian concern within a period of ninety days from the end of the financial year in which any transfer of the share of, or interest in, a company or entity incorporated outside India (hereafter referred to as "foreign company or entity") referred to in Explanation 5 to clause (i) of sub-section (1) of section 9 has taken place:

Provided that where the transaction in respect of the share or the interest has the effect of directly or indirectly transferring the rights of management or control in relation to the Indian concern, the information shall be furnished in the said Form within ninety days of the transaction.

(3) The Indian concern shall maintain the following along with its English translation, if the documents originally prepared are in foreign languages and produce the same when called upon to do so by any income-tax authority in the course of any proceeding to substantiate the information furnished under sub-rule (2), namely:—

(i) details of the immediate holding company or entity, intermediate holding company or companies or entity or entities and ultimate holding company or entity of the Indian concern;

(ii) details of other entities in India of the group of which the Indian concern is a constituent;

(iii) the holding structure of the shares of, or the interest in, the foreign company or entity before and after the transfer;

(iv) any transfer contract or agreement entered into in respect of the share of, or interest in, any foreign company or entity that holds any asset in India through, or in, the Indian concern;

(v) financial and accounting statements of the foreign company or entity which directly or indirectly holds the assets in India through, or in, the Indian concern for two years prior to the date of transfer of the share or interest;

(vi) information relating to the decision or implementation process of the overall arrangement of the transfer;

(vii) information in respect of the foreign company or entity and its subsidiaries, relating to,—

(a) the business operation;

(b) personnel;

(c) finance and properties;

(d) internal and external audit or the valuation report, if any, forming basis of the consideration in respect of shares, or the interest;

(viii) the asset valuation report and other supporting evidence to determine the place of location of the share or interest being transferred;

(ix) the details of payment of tax outside India, which relates to the transfer of the share or interest;
(x) the valuation report in respect of Indian asset and total assets duly certified by a merchant banker or accountant with supporting evidence;

(xi) documents which are issued in connection with the transactions under the accounting practice followed.

(4) Where there are more than one Indian concerns that are constituent entities of a group, the information may be furnished by any one Indian concern, if,—

(i) the group has designated such Indian concern to furnish information on behalf of all other Indian concerns that are constituent of the group, and

(ii) the information regarding the designated Indian concern has been conveyed in writing on behalf of the group to the Assessing Officer:

Provided that nothing contained in this sub-rule shall have effect if the designated Indian concern fails to furnish the information in accordance with the provisions of this rule.

(5) The Principal Director General of Income-tax (Systems) or Director General of Income-tax (Systems), as the case may be, shall specify the procedure for electronically filing of Form No.49D and shall also be responsible for evolving and implementing appropriate security, archival and retrieval policies in relation to the information so furnished under this rule.

(6) The information and documents specified in sub-rule (3) shall be kept and maintained for a period of eight years from the end of relevant assessment year.

Explanation : For the purposes of this rule,—

(i) "constituent entity" shall have the meaning as assigned to it in clause (d) of sub-section (9) of section 286;

(ii) "group" shall have the meaning as assigned to it in clause (e) of sub-section (9) of section 286;

(iii) "intermediate holding company or entity" means a company or an entity that has controlling interest in another company or entity and is itself controlled by, or is subsidiary of, another company or entity;

(iv) "immediate holding company or entity" means the company or the entity that directly maintains the controlling interest in the Indian concern;

(v) "ultimate holding company or entity" means a company or an entity that has ultimate control of the Indian concern directly or indirectly and such company or entity is not itself controlled by, or is subsidiary of, any other company or entity.]

EXHIBIT IV

EXTRACTS OF RULE 11UB – FAIR MARKET VALUE OF ASSETS IN CERTAIN CASES

(1) The fair market value of asset, tangible or intangible, as on the specified date, held directly or indirectly by a company or an entity registered or incorporated outside India (hereafter referred to as "foreign company or entity"), for the purposes of clause (i) of sub-section (1) of section 9, shall be computed in accordance with the provisions of this rule.

(2) Where the asset is a share of an Indian company listed on a recognised stock exchange on the specified date, the fair market value of the share shall be the observable price of such share on the stock exchange:

Provided that where the share is held as part of the shareholding which confers, directly or indirectly, any right of management or control in relation to the aforesaid company, the fair market value of the share shall be determined in accordance with the following formula, namely: —

Fair market value = (A+B)/C

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Where;

A = the market capitalisation of the company on the basis of observable price of its shares quoted on the recognised stock exchange;

B = the book value of liabilities of the company as on the specified date;

C = the total number of outstanding shares:

Provided further that where, on the specified date, the share is listed on more than one recognised stock exchange, the observable price of the share shall be computed with reference to the recognised stock exchange which records the highest volume of trading in the share during the period considered for determining the price.

(3) Where the asset is a share of an Indian company not listed on a recognised stock exchange on the specified date, the fair market value of the share shall be its fair market value on such date as determined by a merchant banker or an accountant in accordance with any internationally accepted valuation methodology for valuation of shares on arm's length basis as increased by the liability, if any, considered in such determination.
I. ANSWERS TO MCQs (Most appropriate answers)

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

II. ANSWERS TO DESCRIPTIVE QUESTIONS

Answer to Q.1:

Computation of total income of Mr. Arjun Batra for the A.Y.2018-19

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs. In lakhs</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Income from house property</strong></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>1.5</td>
</tr>
<tr>
<td><strong>Profits and gains of business or profession</strong></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>(2.5)</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><strong>Capital gains</strong></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 Jaipur 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><strong>Income from other sources</strong></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>- 3.0</td>
</tr>
</tbody>
</table>
### Gross Total Income

<table>
<thead>
<tr>
<th>Less: Deduction under Chapter VI-A: Section 80C – PPF</th>
<th>Total Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>34.0</td>
<td>32.5</td>
</tr>
</tbody>
</table>

#### Computation of tax liability of Mr. Arjun Batra for A.Y.2018-19

<table>
<thead>
<tr>
<th>Description</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>1,60,000</td>
</tr>
<tr>
<td>Tax on LTCG of Rs.8 lakhs@20%</td>
<td>6,43,500</td>
</tr>
<tr>
<td>(+) Tax on other income of Rs.27.7 lakhs</td>
<td>8,03,500</td>
</tr>
<tr>
<td>(-) Tax on Rs.5.7 lakhs, being agricultural Income [Rs.3.2 lakhs] + Basic Exemption Limit [Rs.2.5 lakhs]</td>
<td>26,500</td>
</tr>
<tr>
<td>Add: Education cess and SHEC@3%</td>
<td>7,77,000</td>
</tr>
<tr>
<td>Indian rate of tax = 8,00,310 x 100/32,50,000 = 24.625%</td>
<td>8,00,310</td>
</tr>
<tr>
<td>Less: Rebate u/s 91 on income of Country E + Country F</td>
<td>4,47,817</td>
</tr>
<tr>
<td>Tax payable in India</td>
<td>3,52,493</td>
</tr>
<tr>
<td>Tax payable (Rounded off)</td>
<td>3,52,490</td>
</tr>
</tbody>
</table>

#### Computation of average rate of tax in Country E

<table>
<thead>
<tr>
<th>Description</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 1-11-2017</td>
<td>15.0</td>
</tr>
<tr>
<td>Agricultural income [Exempt in Country E]</td>
<td>-</td>
</tr>
<tr>
<td>Total income</td>
<td>19.2</td>
</tr>
</tbody>
</table>

#### Rates of tax in Country E

<table>
<thead>
<tr>
<th>Tax Brackets</th>
<th>Rate</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>
</tbody>
</table>

Average rate of tax in Country E = 3.354 x 100/19.2 = 17.469%

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

<table>
<thead>
<tr>
<th>Description</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 1-11-2017</td>
<td>15.0</td>
</tr>
<tr>
<td>Double Taxation Relief at India rate of tax or rate of tax in Country E, whichever is lower</td>
<td>17.469%</td>
</tr>
</tbody>
</table>
Double Taxation Relief = 17.469% of Rs.17.6 lakhs = Rs.3,07,454

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

<table>
<thead>
<tr>
<th>Particulars</th>
<th>P.Y. 2016-17</th>
<th>P.Y 2018-19</th>
<th>Tax (@30%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross rental receipts from commercial property</td>
<td>Rs.3 lakhs (-) 30%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Business income</td>
<td>3.3</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Share of loss from partnership firm</td>
<td>(1.5)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Agricultural income</td>
<td>1.8</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total income</strong></td>
<td>5.7</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rate of Tax in Country F</td>
<td>27%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Double Taxation Relief at Indian rate of tax</td>
<td>24.625%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Double Taxation Relief at rate of tax in Country F, whichever is lower</td>
<td>24.625%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Double Taxation Relief [Country E &amp; Country F]</td>
<td>Rs.3,07,454 + Rs.1,40,363</td>
<td>4,47,817</td>
<td></td>
</tr>
</tbody>
</table>

**Answer to Q.2:**

Any undisclosed foreign income or foreign asset will be chargeable to tax under the provisions of Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 ("BM Act").

Any undisclosed foreign income will be taxed as the income of the previous year to which it pertains. Hence Rs 5 lakhs will be taxed as the income of the previous year 2016-17.

An undisclosed asset located outside India shall be charged to tax on its value in the previous year in which such asset comes to the notice of the Assessing Officer. Thus, the value of the undisclosed foreign asset will be taxed as the income of the previous year 2018-19.

The undisclosed asset is gold jewellery. The value of the same is the higher of:

- (a) Purchase price (Rs 4.2 lakhs), and
- (b) Value as on valuation date (1st April of the previous year) as per report of a Valuer recognized by the Government (Rs 5.2 lakhs).

The tax consequences are as under:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>P.Y. 2016-17</th>
<th>P.Y 2018-19</th>
<th>Tax (@30%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Undisclosed income</td>
<td>Rs.5,00,000</td>
<td>Rs.1,50,000</td>
<td></td>
</tr>
<tr>
<td>Undisclosed jewellery</td>
<td></td>
<td>Rs.5,20,000</td>
<td>Rs.1,56,000</td>
</tr>
</tbody>
</table>

**SOLUTION TO CASE STUDY 2**

I. **ANSWERS TO MCQs (Most appropriate answers)**

**MULTIPLE CHOICE QUESTIONS**

1. (b)  
2. (b)  
3. (a)  
4. (a)  
5. (c)  
6. (d)  
7. (c)
II. ANSWERS TO DESCRIPTIVE QUESTIONS

Answer to Q.1:

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

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

<table>
<thead>
<tr>
<th>(1)</th>
<th>(2)</th>
<th>(3)</th>
<th>(4)</th>
<th>(5)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Particulars</td>
<td>Mauritius</td>
<td>India</td>
<td>Total</td>
<td>% of (3) to total in (4)</td>
</tr>
<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, 2018. Further, penalty of an amount equal to Rs.60,000 lakhs would be attracted for failure to deduct equalization levy. Also, disallowance of the expenditure of Rs.10 lakhs would be attracted under section 40(a)(ib) while computing business income of RB Pvt. Ltd.

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

Answer to Q.3:

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

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

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

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

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

SOLUTION TO CASE STUDY 3

I. ANSWERS TO MCQs (Most appropriate answers)
1. (b)
2. (c)
3. (d)
II. ANSWERS TO DESCRIPTIVE QUESTIONS

Answer to Q.1:

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

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

- represents at least 50% of the value of all assets owned by the company, or entity, as the case may be

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

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

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

Further, section 90(2) provides that where the Indian Government has entered into DTAAAs 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 31.05.2018

Fair value of assets of Singapore Intermediary Co as on 31.5.2018 - INR 50 crores

Fair value of Ind Co as on 31.5.2018 (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 31.05.2018
Fair value of assets of Mauritius Intermediary Co as on 31.5.2018 - INR 60 crores
Fair value of Ind Co as on 31.5.2018 (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 31.05.2018
Fair value of assets of Australian Intermediary Co as on 31.5.2018 - INR 300 crores
Fair value of Ind Co as on 31.5.2018 (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 31.03.2018

Fair value of assets of Spain Intermediary Co as on 31.3.2018 - INR 12 crores

Fair value of Ind Co as on 31.3.2018 (without reduction of liabilities) - INR 200 crores

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

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

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

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

Answer to Q.2:

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

<table>
<thead>
<tr>
<th>S. No</th>
<th>Particulars</th>
<th>Amount (INR crores)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Full value of consideration for transfer of shares of Singapore Intermediary Co</td>
<td>50.00</td>
</tr>
<tr>
<td>2.</td>
<td>Cost of acquisition of shares of Singapore Intermediary Co</td>
<td>10.00</td>
</tr>
<tr>
<td>3.</td>
<td>Long-term capital gains</td>
<td>40.00</td>
</tr>
<tr>
<td>4.</td>
<td>Fair Market Value of all the assets of the Singapore Intermediary Co as on the specified date (31 May 2018)</td>
<td>50.00</td>
</tr>
<tr>
<td>5.</td>
<td>Fair Market Value of assets of the Singapore Intermediary Co located in India as on the specified date (31 May 2018) , i.e., Fair value of Ind Co as held by Singapore Intermediary</td>
<td>40.00</td>
</tr>
<tr>
<td>6.</td>
<td>Long-term capital gains (income) attributed to assets located in India [(3)*(5)/(4)]</td>
<td>32.00</td>
</tr>
<tr>
<td>7.</td>
<td>Long-term capital gains tax at 10% (as per section 112)</td>
<td>3.20</td>
</tr>
</tbody>
</table>

Notes:

1. The capital assets, being transferred, in the instant case, are the shares of Singapore Intermediary Co. Since, the shares of Singapore Intermediary Co have been held by US Co for more than 24 months, the capital gains would be long-term capital gains.

2. As per Rule 11UC, the income attributed to assets located in India would be based on the proportion of fair market value of assets located in India on the specified date, from which the share derives its value substantially to the fair market value of all assets of Singapore Intermediary Co.

3. As per section 112(1)(c)(iii), in case of a foreign company, the long term capital gain on unlisted securities is chargeable to tax @10% without indexation and fluctuation benefit.
4. The rate of 10% is excluding cess and surcharge, if any, depending on the total income of the company.

(ii) **Computation of capital gains chargeable to tax and tax amount in India on transfer of shares of Ind Co by Singapore Intermediary Co**

<table>
<thead>
<tr>
<th>S. No</th>
<th>Particulars</th>
<th>Amount (INR crores)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Full value of consideration for transfer of shares of Ind Co</td>
<td>45.00</td>
</tr>
<tr>
<td>2.</td>
<td>Cost of acquisition of shares of Ind Co</td>
<td>5.00</td>
</tr>
<tr>
<td>3.</td>
<td>Short-term capital gains (since shares of Ind Co have been held for less than 24 months)</td>
<td>40.00</td>
</tr>
<tr>
<td>4.</td>
<td>Short-term capital gains chargeable to tax @40%</td>
<td>14.00</td>
</tr>
</tbody>
</table>

**Note:** The rate of 40% is excluding cess and surcharge, if any, depending on the total income of the company

**Taxability as per India-Singapore DTAA**

Under the provisions of the Income-tax Act, 1961, the capital gains from transfer of shares of Ind Co would be chargeable to tax in India in the hands of Singapore Intermediary Co. However, the provisions of the India-Singapore DTAA can be applied to the extent they are more beneficial to the taxpayer.

As per Clause 4A of Article 13 of the India-Singapore DTAA, dealing with capital gains, gains arising 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. In the instant case, Singapore Intermediary Co acquired shares of Ind Co on 1 March 2017 (ie before 1 April 2017) and accordingly, the gains shall be taxable only in Singapore and not taxable in India.

(iii) **Amalgamation of US Co with another group company US Co 2**

As per section 47(viab), any transfer, in a scheme of amalgamation, of a capital asset, being a share of a foreign company, referred to in the *Explanation 5* to clause (i) of sub-section (1) of section 9, which derives, directly or indirectly, its value substantially from the share or shares of an Indian company, held by the amalgamating foreign company to the amalgamated foreign company, shall not be regarded as transfer, if—

(A) at least twenty-five per cent of the shareholders of the amalgamating foreign company continue to remain shareholders of the amalgamated foreign company; and

(B) such transfer does not attract tax on capital gains in the country in which the amalgamating company is incorporated;

Accordingly, in the instant case, if 25% of shareholders of US Co continue to remain shareholders of US Co 2 and if such transfer (by way of amalgamation) does not attract capital gains tax in US, then the amalgamation of US Co with US Co 2 would not be regarded as a ‘transfer’ under the Income-tax Act, 1961 and hence, not chargeable to tax in India.

**Other option available with US Co is to demerge its one or more undertaking**

As per section 47(vic), any transfer, in a scheme of demerger, of a capital asset, being a share of a foreign company, referred to in the *Explanation 5* to clause (i) of sub-section (1) of section 9, which derives, directly or indirectly, its value substantially from the share or shares of an Indian company, held by the demerged foreign company to the resulting foreign company, shall not be regarded as transfer, if—

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(A) the shareholders, holding not less than three-fourth in the value of the shares of the demerged foreign company, continue to remain shareholders of the resulting foreign company; and

(B) such transfer does not attract tax on capital gains in the country in which the amalgamating company is incorporated;

Accordingly, if three-fourth value of the shares of US Co continue to remain shareholders of resulting company and if such transfer (by way of demerger) does not attract capital gains tax in US, then the demerger of one or more undertaking of US Co would not be regarded as a ‘transfer’ under the Income-tax Act, 1961 and hence, not chargeable to tax in India.
DISCLAIMER

This Suggested Answers hosted on the website do not constitute the basis for evaluation of a candidate’s answers in the examination. The suggested answers are prepared by the Faculty of the Board of Studies with a view to assist the students in their education. While due care is taken in preparation of the answers, if any errors or omissions are noticed, the same may be brought to the attention of the Director of Studies. The Council of the Institute is not in anyway responsible for the correctness or otherwise of the answers published herein.

Further, in the Elective Papers which are Case Study based, the solutions have been worked out on the basis of certain assumptions/views derived from the facts given in the question or language used in the question. It may be possible to work out the solution to the case studies in a different manner based on the assumption made or view taken.
PAPER 6C: INTERNATIONAL TAXATION

The Question Paper comprises three case study questions. The candidates are required to answer any two case study questions out of three.

Answers in respect of Multiple Choice Questions are to be indicated in capital letters i.e., A or B or C or D, as the case may be.

Working Notes for the descriptive type questions should form part of the answer.

All questions relate to Assessment Year 2018-19, unless stated otherwise in the questions/case studies.

Case Study 1

Alpha Co Ltd. (ACL), having its registered office in Delhi, is engaged in multiple businesses. It has a Knowledge Process Outsourcing (KPO) service unit at Bengaluru, trading centre at Mumbai and manufacturing unit at Chennai. It has borrowed ₹200 crores from a leading bank in India for which 100% guarantee was given by the parent company, Gama Inc. of USA. The total borrowings of ACL was ₹1,000 crores.

Mumbai Unit

The unit in Mumbai buys mobile handsets from Gama Inc. The handsets are branded for which royalty at ₹100 per handset sold is paid to Gama Inc. Similar handsets to other customers in India are also sold by Gama Inc. The credit period offered to Alpha Co Ltd. is 2 months, whereas for the other customers, the credit period is 1 month. During the year, 15,00,000 handsets were bought for an aggregate sum of ₹2,400 crores from Gama Inc. The purchase could be assumed as uniform throughout the financial year 2017-18. The cost of capital may be adopted as 12% per annum. Similar handsets when supplied to other customers, Gama Inc. would have billed ₹2,640 crores (excluding interest component for the delay beyond 1 month). It may be assumed that the entire purchase has been sold out by 31st March, 2018.

Bengaluru Unit

The KPO unit in Bengaluru has been doing services to Gama Inc. The aggregate value of international transaction during the financial year 2017-18 is ₹180 crores. The unit incurred employee cost which is 50% in relation to operating expenses. The profit margin declared by the unit is 20%. (Note: The benchmark under Safe Harbour Rules is 21% for operating margin with employee cost ranging between 40% and 60%).

The Suggested Answers for Final Paper 6C: International Taxation, in so far as they relate to questions involving application of the provisions of Indian tax laws, are based on the provisions of direct tax laws as amended by the Finance Act, 2017.
Kolkata Liaison Office

Gama Inc. has a liaison office at Kolkata (opened with the permission of RBI), where the orders are booked for supply of mobile handsets directly to customers in India. The liaison office has no connection with any other unit of ACL. The salary and administrative expenses of liaison office are met directly by Gama Inc. During the financial year 2017-18, the liaison office procured orders for 1,00,000 handsets from various customers and by that Gama Inc. made a profit at 20% amounting to ₹ 50 crores (rupee translated). Assume that the exchange fluctuation did not impact the profit of Gama Inc.

Chennai unit

The manufacturing unit at Chennai is engaged in manufacture of automobile spare parts. It paid technical fee of ₹ 100 crores to Gama Inc. during the financial year 2017-18; tax was deducted at source and remitted in May, 2018. The unit also paid commission to overseas agents for booking export orders amounting to ₹ 25 crores for which no tax was deducted at source. It also employed persons for after-sales service in Europe and South Asia, for which salary was paid from India. The total salary payment to overseas employees was ₹ 40 crores and though the payments were made from Chennai, no tax was deducted at source. The payments of commission to the overseas agents were made outside India in foreign currency.

Other information

The assessment of the assessee, i.e. ACL, for assessment year 2017-18 is pending before the Assessing Officer who referred the matter to Transfer Pricing Officer (TPO) for determination of arm’s length price (ALP) in respect of the manufacturing unit at Chennai. The TPO, however, expanded the scope of his work by calling for details in respect of all other units of ACL.

Aggrieved with the expanded scope of work carried out by the TPO, ACL wants to approach the Dispute Resolution Panel (DRP), as similar issues for the assessment years 2015-16 to 2016-17 are pending before the Appellate Tribunal. The management of ACL also wants to enter into Advance Pricing agreement (APA) with rollback mechanism.

ACL presently proposes to commence a garment manufacturing unit at Kanpur. It wants to by raw materials from Beta Inc. Singapore. The agreement envisages a monthly supply of goods worth ₹ 30 crores for a period 3 years. It wants to seek advance ruling in this regard.

REQUIRED

As tax auditor of the company, you are requested to answer the following:

(a) (i) Determine the arm’s length price (ALP) of the transaction of sale of mobile handsets by Gama Inc. USA to the assessee and its impact on the assessable income for the assessment year 2018-19. (5 Marks)

(ii) Explain the procedures to be followed by the Assessing Officer before making reference to TPO. State whether the TPO can enlarge his scope of work by calling for details of KPO unit, Bengaluru and trading activity at Mumbai, when the...
Assessing Officer has made reference only in respect of the manufacturing unit at Chennai. (5 Marks)

(b) (i) Discuss the impact of non-deduction of tax at source on salary paid to employees outside India and commission paid to overseas agents by the manufacturing unit at Chennai. Also, state the consequence of delayed deduction of tax on fees for technical services paid to Gama Inc. (3 Marks)

(ii) Will the profit earned attributable to opening a liaison office at Kolkata by Gama Inc. be chargeable to tax in India? Will the ‘Force of Attraction Rule’ apply in this case? (4 Marks)

(iii) State the rate at which tax would have been deducted at source on the royalty payment to Gama Inc. If the royalty payment was disallowed to the extent of ₹ 20 crores, decide whether the company can seek refund of the excess tax deducted at source on the said royalty payment. (2 Marks)

(c) (i) What is Safe Harbour Rules? Can the assessee avail the benefit of these Rules in respect of the KPO unit? (3 Marks)

(ii) Advise the company on the possibility of approaching Dispute Resolution Panel (DRP) and state how it must be carried out. (4 Marks)

(d) Advise whether the company can go for APA. Would the rollback mechanism of APA help the company to avoid appeal proceedings which are pending at present? (4 Marks)

(e) Choose the most appropriate alternative for the following MCQs: (10 x 2 = 20 Marks)

(i) Alpha Co. Ltd. is required to carry out secondary adjustment if the primary adjustment exceeded
(A) ₹ 50 Lakhs
(B) ₹ 100 lakhs
(C) ₹ 200 lakhs
(D) ₹ 500 lakhs

(ii) Time limit available to ACL for filing modified return after advance pricing agreement (APA) is __________ (where the APA was entered into on 1-5-2018).
(A) 31-8-2018
(B) 31-7-2018
(C) 30-11-2018
(D) None of the above

(iii) The sale price of mobile handsets by Gama Inc. to ACL would have been taken as deemed ALP, if the ALP determined under section 92 by applying the most appropriate method does not exceed -
(A) ₹ 2,520 crores
(B) ₹ 2,472 crores
(C) ₹ 2,424 crores
(D) Insufficient/irrelevant data.

(iv) ACL can seek advance ruling for the supplies made to Beta Inc., Singapore in relation to its tax liability when the said transaction value is _____ or more.
(A) ₹ 10 crores
(B) ₹ 50 crores
(C) ₹ 100 crores
(D) ₹ 500 crores.

(v) The time limit for AAR to pronounce its ruling from the date of receipt of application of ACL is -
(A) 12 months
(B) 9 months
(C) 6 months
(D) 3 months

(vi) The advance ruling of the AAR is binding on -
(A) The applicant i.e. ACL
(B) Beta Co Ld. for whom the transaction is proposed by ACL
(C) CBDT
(D) Appellate Tribunal

(vii) Gama Inc. availed digital advertising space from Monaco Inc. of Japan for marketing its mobile handsets in India. Gama Inc. paid in Japan, US dollar 10,000 to Monaco Inc. (Assume the Indian rupee value as 6,50,000). The amount of equalisation levy payable by Gama Inc. is -
(A) @6% ₹ 39,000
(B) @10% ₹ 65,000
(C) @40% ₹ 2,60,000
(D) NIL

(viii) The penalty payable for failure to remit equalisation levy is -
(A) ₹ 100 for every day during which the failure continues
(B) ₹ 1,000 for every day during which the failure continues
(C) ₹10,000
(D) None of the above
(ix) ACL would not be liable for equalisation levy if it was -
(A) situated in North Eastern States
(B) situated in the Union Territory of Pondicherry
(C) situated in Jammu & Kashmir
(D) a domestic company in which public are not substantially interested
(x) When a foreign company deputed its employees for rendering service in India, a PE would have been automatically established as per U.N. Model Tax Convention, where the employees stay in India during the previous year is
(A) less than 90 days
(B) more than 90 days
(C) less than 180 days
(D) more than 183 days

Solution to Case Study 1

(a) (i) Alpha Co Ltd. (ACL), an Indian company and Gama Inc., a USA based company are associated enterprises as per section 92A, since Gama Inc. is the parent company of ACL. Thus, the transaction of purchase of mobile handsets by ACL from Gama Inc. would be an international transaction. The value of international transaction is to be worked out on the basis of Arm’s Length Price (ALP).

Gama Inc. is selling mobile handsets to unrelated customers, which would be the comparable uncontrolled transaction in this case. Such purchase price to unrelated customers has to be adjusted by taking into consideration the functional differences existing between the transactions of Gama Inc. with associated enterprise (ACL) and other unrelated parties.

Accordingly, the arm’s length price for purchase of mobile handsets has to be computed for working out the impact on assessable value as per CPU method.

**Computation of Arm’s Length Price**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹ in crores</th>
</tr>
</thead>
<tbody>
<tr>
<td>Purchase price of mobile handsets by unrelated parties from Gama Inc.</td>
<td>2,640</td>
</tr>
<tr>
<td>Adjustments for functional differences</td>
<td></td>
</tr>
<tr>
<td><strong>Add</strong>: Royalty payable by ACL [₹ 100 per mobile set x 15,00,000]</td>
<td>15</td>
</tr>
<tr>
<td><strong>Add</strong>: Cost of capital for 1 month credit which is not given to</td>
<td>24</td>
</tr>
</tbody>
</table>
unrelated party \[12\% \times \text{₹}200 \text{ crore (monthly average sales i.e., ₹2,400 crore/12 months)}\]

| Arm's Length Price of 15,00,000 sets | 2679 |

As per section 92(3), transfer pricing provisions shall not apply in cases where such application results in reduction of income chargeable to tax or increase in loss of the Indian entity. In the given case, if we consider ₹ 2,679 crores as purchase cost of ACL, the same would result in increase in the expenditure of ACL and consequent reduction in profits. Thus, transfer pricing provisions under the Income-tax Act, 1961 will not apply in this case. Consequently, there would be no impact on the assessable income of ACL for the A.Y.2018-19.

Note – In case it is assumed that ₹ 15 crores is not included in the price of ₹ 2400 crores, the adjustment of royalty of ₹ 15 crores paid/payable is not required. The ALP in such a case would be ₹ 2,664 crores. In such a case also, there will be no impact on the assessable income of ACL for the A.Y.2018-19.

(ii) As per section 92CA(1), where the Assessing Officer considers it necessary or expedient so to do, he may refer the computation of the arm's length price in relation to the international transaction entered by any person, being an assessee, to the Transfer Pricing Officer (TPO).

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

As per section 92CA(2A), the Transfer Pricing Officer (TPO) can also determine the ALP of other international transactions which comes to his notice subsequently in the course of proceedings before him, even though the same were not referred to him by the Assessing Officer.

In this case, the Assessing Officer has made reference to the TPO for determination of ALP in respect of the manufacturing unit at Chennai which shall be taken as the proceedings before him (TPO). The TPO can enlarge his scope of work during the course of proceedings before him pertaining to the Chennai unit, by calling for details of KPO Unit, Bengaluru and trading activity at Mumbai, since the same is within the powers conferred by section 92CA(2A).

(b) (i) Non-deduction of tax at source on salary paid to employees:

As per section 9(ii), income falling under the head "Salaries" would be deemed to accrue or arise in India if it is earned in India. Income payable for service rendered in India would be regarded as income earned in India.

Salary paid to employees (non-residents) outside India, would not be chargeable to tax in India, since such income is neither deemed to accrue or arise in India (as the employees had not rendered services in India) nor is such income received in India.

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Thus, no liability to deduct tax at source under section 192 would arise. Consequently, disallowance under section 40(a)(iii) would not be attracted.

**Non-deduction of tax at source on commission paid to overseas agents:**
Commission paid in foreign currency for booking export orders to overseas agents, who remain outside India, is not subject to tax in India, since no part of income would be deemed to accrue or arise in India. Consequently, there is no liability for deduction of tax at source. However, section 195(6) requires information relating to payment of such commission to be furnished in the prescribed form.

**Consequences of delayed deduction of tax on fees for technical services paid to Gama Inc.**
Fees for technical services has been paid during the previous year 2017-18 without deduction of tax at source. Since tax has not been deducted during the previous year 2017-18, the whole of the amount of technical fees which is chargeable to tax under the Income-tax Act, 1961 in the hands of Gama Inc. would be disallowed under section 40(a)(i) while computing income under the head “Profits and Gains of Business or Profession” for the P.Y. 2017-18 in the hands of ACL.

Subsequent deduction of tax at source would be possible by grossing up. Accordingly, the grossed up amount of fees for technical services would be disallowed during the previous year 2017-18, while computing income under the head “Profits and Gains of Business or Profession” in the hands of ACL.

Since tax has been deducted and remitted during the previous year 2018-19, such sum (the grossed up amount) would be allowed as deduction in that previous year.

(ii) The term "permanent establishment" means a fixed place of business through which the business of an enterprise is wholly or partly carried on.

However, the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity of a preparatory or auxiliary character would not constitute a permanent establishment.

In the present case, the liaison office of Gama Inc. would constitute permanent establishment, since its activities are not of preparatory or auxiliary character but for procuring orders for supply of mobile handsets directly to customers in India.

In the case of Jebon Corporation India, the Karnataka High Court held that securing and processing orders have led to the liaison office forming a PE in India. Consequently, the profits attributable to the PE would be chargeable to tax in India.

The Force of Attraction Rule implies that when a foreign enterprise sets up a PE in the State of Source, it brings itself within the fiscal jurisdiction of that State (State of Source) to such a degree that all profits that the enterprise derives from State of Source, whether through the PE or not, can be taxed by it (State of Source).
In the present case, since Gama Inc. is a USA based company, it is logical to assume that the taxability of profits attributable to the PE would be determined based on India-US DTAA, which has a Force of Attraction Rule. Since the India-US DTAA contains the Force of Attraction Rule, the same will apply in the present case.

Note - Relevant extract of the India-US tax treaty is not given in the question. It may be noted that the US Model Convention does not contain Force of Attraction Rule. Accordingly, from the examination point of view, the conclusion may also be given on the basis of the US Model Convention, i.e., since the US Model Convention does not contain the Force of Attraction Rule, it cannot be applied in the present case.

(iii) As per section 195, Alpha Co. Ltd. is required to deduct tax at source at rates in force, being 43.26% (i.e., @40% plus surcharge@5% (since the royalty exceeds ₹ 10 crores) and education cess and SHEC@3%) on the royalty amount paid to Gama Inc.

The CBDT Circular No.07/2007 dated 23.10.2007, as modified by Circular No.7/2011 dated 27.9.2011, allowed refund to the person making payment under section 195 in the circumstances indicated therein as the income does not accrue to the non-resident or if the income is accruing, no tax is due or tax is due at a lesser rate. The amount paid to the Government in such cases to that extent does not constitute tax. Since in the present case, there is disallowance of royalty payment, which does not fall under any of the situations listed in the said Circular, the company would not be eligible to claim refund of the excess tax deducted at source on the said royalty payment.

Note - As per second proviso to section 92C(4), the income of Gama Inc. cannot be recomputed as a result of determination of ALP of ACL. Consequently, Gama Inc. also is not eligible for any refund of tax.

(c) (i) Section 92CB provides that determination of arm’s length price under section 92C or section 92CA shall be subject to Safe Harbour Rules. Section 92CB(2) empowers the CBDT to prescribe Safe Harbour Rules.

‘Safe Harbour’ means circumstances in which the income-tax authorities shall accept the transfer price declared by the assessee. Accordingly, the CBDT has prescribed safe harbour rules.

Since the value of international transaction entered does not exceed ₹ 200 crore and the employee cost in relation to the operating expenses is 50% (i.e., more than 40% but less than 60%), ACL should have declared an operating profit margin of not less than 21% in relation to operating expense, to be covered within the safe harbour rules.
However, since ACL has declared an operating profit margin of only 20%, the same is not in accordance with the circumstance mentioned in Rule 10TD. Hence, ACL cannot avail the benefit of Safe Harbour Rules in respect of the KPO Unit.

(ii) As per section 144C(15), the following assessees are eligible for filing their objections before the Dispute Resolution Panel (DRP):

➢ Any foreign Company
➢ Any person in whose case variation arises on account of order of Transfer Pricing Officer

In this case, since the assessment of ACL is pending before the Assessing Officer who has referred the matter to TPO for determination of arm’s length price and had not passed the draft assessment order, it cannot approach the Dispute Resolution Panel (DRP) on the ground that TPO has expanded the scope of work. The draft order of assessment is a pre-requisite for ACL to approach the DRP with its objections.

If the Assessing Officer proposes to make, any variation in the income or loss returned which is prejudicial to the interest of ACL, he has to forward a draft order of assessment to the ACL. After receipt of the draft order containing variation in the income returned, ACL has to file its objections against such order before the DRP and the Assessing Officer within thirty days of receipt of the draft order from the Assessing Officer.

The DRP has to issue directions within 9 months from the end of the month in which the draft order is forwarded to ACL. The direction issued by the DRP would be ultimately binding on the Assessing Officer.

(d) In the facts of the case study, it is stated that the management of ACL wants to enter into the Advance Pricing Agreement (APA) with rollback mechanism. In this background, the advice as to whether ACL can go for APA is to be given.

APA may, subject to such prescribed conditions, procedure and manner, provide for determining the ALP or for specifying the manner in which ALP is to be determined in relation to an international transaction entered into by a person during any period not exceeding four previous years preceding the first of the previous years for which the APA applies in respect of the international transaction to be undertaken.

However, as per Rule 10MA, rollback provision shall not be provided in respect of an international transaction for a rollback year, if,-

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

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(ii) the application of rollback provision has the effect of reducing the total income or increasing the loss, as the case may be, of the applicant as declared in the return of income of the said year.

In case of ACL, though similar issues for A.Y. 2015-16 to A.Y. 2016-17 are pending with the Appellate Tribunal, since the Appellate Tribunal has not passed an order disposing appeal, ACL can go for APA with roll back mechanism.

Rule 10RA(4) provides that if any appeal filed by the applicant is pending before the Commissioner (Appeals), Appellate Tribunal or the High Court for a rollback year, on the issue which is subject matter of the rollback provision for that year, the said appeal to the extent of the subject covered under the agreement shall be withdrawn by the applicant.

Rule 10RA(5) provides that if any appeal filed by the Assessing Officer or the Principal Commissioner or Commissioner is pending before the Appellate Tribunal or the High Court for a rollback year, on the issue which is subject matter of the rollback provision for that year, the said appeal to the extent of the subject covered under the agreement, shall be withdrawn by the Assessing Officer or the Principal Commissioner or the Commissioner, as the case may be, within three months of filing of modified return by the applicant.

The rollback mechanism of APA would help in avoiding pending appeal proceedings, since in both the cases (i.e., a case where appeal is filed by the applicant and a case where appeal is filed by the Revenue), the appeal pending before the Appellate Tribunal has to be withdrawn.

(e)

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<thead>
<tr>
<th>Q. No.</th>
<th>Answer</th>
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<tbody>
<tr>
<td>(i)</td>
<td>(B)</td>
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<tr>
<td>(ii)</td>
<td>(A)</td>
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<td>(iii)</td>
<td>(D)</td>
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<td>(A)</td>
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<td>(vii)</td>
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</tr>
<tr>
<td>(viii)</td>
<td>(B)</td>
</tr>
<tr>
<td>(ix)</td>
<td>(C)</td>
</tr>
<tr>
<td>(x)</td>
<td>(D)</td>
</tr>
</tbody>
</table>
Case Study 2

Mr. Ram, born in India in the year 1960, left for employment in the United States in October, 1990. His family members, viz; his wife (Smt. Sita) and two sons were then residing at Chennai. He remitted US $ 50,000 to his wife’s joint bank account in Chennai on 16th April, 2011. She invested in her name, ₹ 12 lakhs in the shares of domestic companies on 14th April, 2012 and ₹ 13 lakhs on 25th March, 2015. The consideration for purchase of shares on both the occasions was met in foreign exchange (USD) and the values, as translated in INR terms, have been furnished.

On 28.03.2018, the shares purchased in April, 2012 were sold for ₹ 14 lakhs and the shares purchased in March, 2015 were sold for ₹ 17.50 lakhs. For both purchase and sale of shares, STT of ₹ 1,200 was paid.

<table>
<thead>
<tr>
<th>Date</th>
<th>Average of Telegraphic Transfer buying rate and selling rate of 1 US Dollar in Indian rupees.</th>
</tr>
</thead>
<tbody>
<tr>
<td>14.03.2012</td>
<td>₹ 60</td>
</tr>
<tr>
<td>25.03.2015</td>
<td>₹ 65</td>
</tr>
<tr>
<td>28.03.2018</td>
<td>₹ 70</td>
</tr>
</tbody>
</table>

Mr. Ram owned a vacant site at Chennai which had been acquired on 14.10.2009 for ₹ 7,40,000. It was sold on 20.03.2018 for ₹ 35 lakhs to Mr. Laxman, his younger brother (a resident at Chennai). The stamp duty valuation of the property was ₹ 40 lakhs. The entire sale proceeds of vacant site and shares were used for acquiring a residential property at Malaysia. He owns only one residential house in Mumbai and a commercial apartment at Singapore, owned since October, 2010.

Note: Cost inflation indices:


Smt. Sita (born and brought up in India) returned to India permanently in 2006. She has assets outside India in the form of immovable property, jewellery and bank deposits in Cayman Islands. Proceedings were initiated under Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 (“BM Act”) in June 2017. She owns a residential house property at Chennai besides an apartment in the United States occupied by Mr. Ram. She had been moving between India and USA frequently.

Mr. Ram’s first son Mr. Lava (born in India in 1985), an engineer, left India in May 2012 for permanently settling down in Australia. He acquired 50,000, 8% debentures of ₹ 100 each in a listed company in India, by remitting foreign exchange in May, 2014. He received debenture interest on 28.03.2018 for the year. He remitted ₹ 1 lakh by way of premium of life insurance policy taken in the year 2006 with capital sum assured of ₹ 12 lakhs. He has dividend income from listed domestic companies of ₹ 25,000 for the year.
Mr. Ram’s second son Mr. Kushwah (born in the year 1987 in India) is engaged in textile business at Surat. He has not filed return of income in India since assessment year 2010-11. He has a joint bank account in the United States along with Mr. Ram, with operating rights. The Assessing Officer has issued notice under section 148 for the assessment year 2010-11 onwards on 20th March, 2018.

Mr. Ram, his second son Mr. Kushwah and Mr. Ram’s four non-resident friends formed a company by name Bitra Inc. in the United Kingdom on 01.04.2015, which was engaged in trading business. The registered office of company is in Leicester (UK). The company has a branch in India since 01.06.2015. The company is a subsidiary company of Tatla Inc., Singapore in which the four non-resident friends hold 100% shareholding. The entire goods traded by Bitra Inc. in the UK and in India are purchased from Tatla Inc., Singapore.

The total activity profile of Bitra Inc. is given below:

<table>
<thead>
<tr>
<th>Financial year</th>
<th>2015-16</th>
<th>2016-17</th>
<th>2017-18</th>
</tr>
</thead>
<tbody>
<tr>
<td>Average value of total assets in India (₹ in Crores)</td>
<td>180</td>
<td>220</td>
<td>300</td>
</tr>
<tr>
<td>Total income of the company (₹ in Crores)</td>
<td>90</td>
<td>100</td>
<td>180</td>
</tr>
<tr>
<td>Total payroll expenses incurred by the company (₹ in Crores)</td>
<td>180</td>
<td>200</td>
<td>200</td>
</tr>
<tr>
<td>Average value of total assets of the company (₹ in Crores)</td>
<td>400</td>
<td>450</td>
<td>500</td>
</tr>
<tr>
<td>Total average number of employees in India</td>
<td>1,000</td>
<td>1,200</td>
<td>1,500</td>
</tr>
<tr>
<td>Total turnover (₹ in Crores)</td>
<td>1,000</td>
<td>1,300</td>
<td>1,700</td>
</tr>
<tr>
<td>Dividend from Indian companies (₹ in Crores)</td>
<td>50</td>
<td>60</td>
<td>100</td>
</tr>
<tr>
<td>Payroll expenses in India (₹ in Crores)</td>
<td>100</td>
<td>105</td>
<td>110</td>
</tr>
<tr>
<td>Total average number of resident employees in India</td>
<td>900</td>
<td>1,100</td>
<td>1,300</td>
</tr>
<tr>
<td>Turnover in India (₹ in Crores)</td>
<td>400</td>
<td>700</td>
<td>900</td>
</tr>
<tr>
<td>Total average employees of the company for the year</td>
<td>2,000</td>
<td>2,200</td>
<td>2,200</td>
</tr>
</tbody>
</table>

Note: All the Board meetings of the company were held outside India during the financial year 2017-18.

Ms. Karuna Kapoor born in the USA was appointed as the CEO of Bitra Inc. in India. She joined duty on 01.09.2017 at Mumbai. She was paid salary of ₹140 lakhs upto 31.03.2018. Tax was deducted on salary before 31.03.2018 but was remitted only on 14.08.2018.
Ms. Karuna Kapoor was born and brought up in the USA, but her grandparents were born in Karachi before the year 1940. She has never visited India previously.

REQUIRED
You are requested to answer the following issues arising from the above facts:

(a) (i) Mr. Ram wants you to compute his total income and tax thereon, including capital gains tax payable by him for the assessment year 2018-19. (6 Marks)

(ii) Mr. Laxman seeks your advice as regards deduction of tax at source on the payment made to Mr. Ram and tax implication of the transaction of purchase of land from brother Mr. Ram. (4 Marks)

(b) (i) Compute the total income of Mr. Lava and advise on the possibility of availing the benefits of Chapter XII-A deductions. (4 Marks)

(ii) Mr. Kushwah wants to know whether the Assessing Officer can issue notice under section 148 for the assessment year which is beyond 6 years? Advise him. (2 Marks)

(c) (i) Apply POEM test on Birta Inc. for the assessment year 2018-19 and briefly discuss the consequences thereof. (5 Marks)

(ii) After the POEM test, discuss briefly the legal procedure to be followed by the Assessing Officer for making assessment of Birta Inc. (2 Marks)

(iii) Will Birta Inc. be liable for book profit tax under section 115JB for the assessment year 2018-19? State the exceptions from the applicability of book profit tax in the case of foreign companies. (4 Marks)

(d) Determine the residential status of Ms. Karuna Kapoor for the Assessment Year 2018-19. (3 Marks)

(e) Choose the most appropriate alternative for the following MCQs: (10 x 2 = 20 Marks)

(i) When Smt. Sita has undisclosed asset located outside India, what is the time limit within which it is chargeable to tax under Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 (“BM Act")?

(A) Within 16 years from the end of the financial year in which it was originally acquired.

(B) Within 10 years from the end of the financial year in which it was originally acquired.

(C) Within 6 years from the end of the financial year in which it was originally acquired.

(D) No time limit and it would be chargeable to tax when it comes to the notice of the Assessing Officer.
(ii) When Smt. Sita owns an undisclosed asset outside India being immovable property, its value for the purpose of assessment under BM Act, would be

(A) Fair market value as on 01.04.1981
(B) Fair market value as on 01.04.2001.
(C) Higher of cost of acquisition or open market value on the valuation date as per valuation report from a valuer recognised by the foreign country.
(D) Lower of cost of acquisition or open market value on the valuation date as per valuation report from a valuer recognised by the foreign country.

(iii) When Smt. Sita owned a property/asset outside India but has not disclosed the same for income-tax purpose, she can be prosecuted under the BM Act for -

(A) 3 months
(B) Not less than 6 months but which may extend to 7 years
(C) Not less than 3 months but which may extend to 3 years
(D) None of the above

(iv) The time limit for completion of assessment of Smt. Sita under the BM Act, is_______.

(A) 1 year from the end of the financial year i.e. 31.03.20191.
(B) 2 years from the end of the financial year i.e. 31.03.2020
(C) 1 year from the end of the impugned month i.e. 30.06.2018.
(D) None of the above

(v) When Smt. Sita files appeal before the Appellate Tribunal under the BM Act, the appeal fee payable by her is -

(A) ₹5,000
(B) ₹10,000
(C) ₹25,000
(D) ₹50,000

(vi) The time limit for filing appeal before the CIT (Appeals) under BM Act, is_________ from the date of service of the notice of demand.

(A) 30 days
(B) 21 days
(C) 15 days

1 printed as 2009 in the question paper
(vii) The four tie-breaker tests to be applied to determine the residence for Smt. Sita are (a) habitual abode; (b) national; (c) permanent home; and (d) centre of vital interests. The correct sequence of tests is -

(A) (d), (c), (a), (b)
(B) (c), (a), (d), (b)
(C) (a), (c), (b), (d)
(D) (c), (d), (a), (b)

(viii) In case Birta Inc. is an international group having Indian parent, the threshold limit of group revenue in order to be liable for Country by Country (CbC) reporting is ₹

(A) 1,000 crores
(B) 2,000 crores
(C) 5,500 crores
(D) 5,000 crores

(ix) Tatle Inc., Singapore is the holding company of Birta Inc., A foreign company having following income is chargeable to tax in India even in the absence of PE:

(A) Interest
(B) Dividend
(C) Royalty
(D) All the above

(x) The tax deducted on salary paid to Ms. Karuna Kapoor which was remitted in May 2018 is eligible for -

(A) 100% disallowance U/s. 40(a)(i)
(B) 30% disallowance U/s. 40 (a)(ia)
(C) Fully allowable
(D) 50% disallowance U/s. 40(a)(ii)

Solution to Case Study 2

(a) (i) Mr. Ram is a non-resident in India during the P.Y. 2018-19 since he is residing in United States since 1990 and does not fulfil either of the basic conditions for being a resident.

In case of a non-resident, only the following incomes are chargeable to tax:

(i) Income received or deemed to be received in India; and
(ii) Income accruing or arising or deemed to accrue or arise in India.

**Computation of total income and tax liability of Mr. Ram for A.Y.2018-19**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount in ₹</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Income from house property</strong></td>
<td></td>
</tr>
<tr>
<td>Residential house at Mumbai [Annual Value would be Nil, assuming that the property is unoccupied and no other benefit is derived from such property]</td>
<td>Nil</td>
</tr>
<tr>
<td>Commercial apartment in Singapore and residential property at Malaysia [Annual value of house properties outside India is not subject to tax in India, since Mr. Ram is a non-resident]</td>
<td>Nil</td>
</tr>
<tr>
<td><strong>Capital Gains</strong></td>
<td></td>
</tr>
<tr>
<td>Long term capital gains on sale of shares of listed companies</td>
<td></td>
</tr>
<tr>
<td>[As per section 64(1)(iv), income arising to Smt. Sita from transfer of listed shares is includible in the hands of her husband, Mr. Ram, since there has been a transfer of money to a joint account without any consideration, out which Smt. Sita has purchased listed shares in her own name. However, since long-term capital gains of ₹ 44,667 [See Working Note] on transfer of STT paid listed shares arising to Smt. Sita is exempt under section 10(38), there is no income includible in the hands of Mr. Ram.](See Working Note)</td>
<td></td>
</tr>
<tr>
<td>Long term capital gain on sale of vacant site at Chennai (long term, since it is held for more than 24 months)</td>
<td></td>
</tr>
<tr>
<td>Full value of consideration</td>
<td>40,00,000</td>
</tr>
<tr>
<td>As per section 50C, the full value of consideration would be higher of actual consideration of ₹ 35,00,000 and stamp duty value of ₹ 40,00,000</td>
<td></td>
</tr>
<tr>
<td>Less: Indexed cost of acquisition (₹ 7,40,000 x 272/148)</td>
<td>13,60,000</td>
</tr>
<tr>
<td>Less: Exemption under section 54F [Not available since investment in residential house in India is only eligible for exemption]</td>
<td>26,40,000</td>
</tr>
</tbody>
</table>
Gross Total income/Total Income

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount in ₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax on total income</td>
<td></td>
</tr>
<tr>
<td>Tax@20% on long-term capital gains of ₹ 26,40,000</td>
<td>5,28,000</td>
</tr>
<tr>
<td>Add: Education cess @2%</td>
<td>10,560</td>
</tr>
<tr>
<td>Secondary and higher education cess@1%</td>
<td>5,280</td>
</tr>
<tr>
<td>Tax liability</td>
<td>5,43,840</td>
</tr>
</tbody>
</table>

Working Note:

Computation of long-term capital gains on transfer of shares of listed companies in the hands of Smt. Sita

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount in ₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Long term capital gain on transfer of shares purchased on 14.4.2012, since held for more than 12 months</td>
<td></td>
</tr>
<tr>
<td>Sale Consideration</td>
<td>14,00,000</td>
</tr>
<tr>
<td>Less: Indexed Cost of acquisition (₹ 12,00,000 x 272/200)</td>
<td>16,32,000</td>
</tr>
<tr>
<td>Long term capital gain</td>
<td>(2,32,000)</td>
</tr>
<tr>
<td>Long term capital gain on transfer of shares purchased on 25.3.2015, since held for more than 12 months</td>
<td></td>
</tr>
<tr>
<td>Sale Consideration</td>
<td>17,50,000</td>
</tr>
<tr>
<td>Less: Cost of acquisition (₹ 13,00,000 x 272/240)</td>
<td>14,73,333</td>
</tr>
<tr>
<td>Long term capital gain</td>
<td>2,76,667</td>
</tr>
<tr>
<td>Long term capital gain exempt under section 10(38) [₹ 2,76,667 - ₹ 2,32,000]</td>
<td>44,667</td>
</tr>
</tbody>
</table>

Note – Since long-term capital gains on transfer of listed shares has to be computed first in the hands of Smt. Sita who is a resident, the benefit of conversion into foreign currency will not be available. However, benefit of indexation would be available. In any case, such long-term capital gains on sale of listed shares, on which STT is paid at the time of acquisition and sale, is exempt under section 10(38) for A.Y.2018-19.

(ii) Requirement of tax deduction at source on payment made by Mr. Laxman to Mr. Ram

As per section 195, any person responsible for paying interest (other than interest referred to in section 194LB or section 194LC or section 194LD) or any other sum chargeable to tax (other than salaries) to a non-corporate non-resident is liable to deduct tax at source at the rates prescribed by the relevant Finance Act.
Hence, since Mr. Ram is a non-resident, Mr. Laxman is required to deduct tax at source at the rates in force i.e., 20% (plus cess@3%) in this case, under section 195, in relation to consideration for transfer of vacant site at Chennai.

Since, in this case, the whole of the sale consideration payable to Mr. Ram is not chargeable to tax, Mr. Laxman has to make an application to the Assessing Officer for determining the appropriate proportion of such sum so chargeable; accordingly, tax has to be deducted at the rate of 20.6% only on that proportion of the sum which is so chargeable.

**Tax implication of purchase of land in the hands of Mr. Laxman**

In case immovable property is received for inadequate consideration, the difference between the stamp duty value and actual consideration would be taxable under section 56(2)(x) in the hands of the recipient, if such difference exceeds ₹ 50,000. However, if immovable property is received from a relative, section 56(2)(x) would not be attracted. Brother falls within the definition of “relative”. Hence, the difference of ₹ 5 lakhs [₹ 40 lakhs – ₹ 35 lakhs] would not be taxable in Mr. Laxman’s hands.

(b) (i) Mr. Lava is a non-resident in India during the P.Y. 2017-18 since he left India permanently in May, 2012. He does not fulfil either of the basic conditions for being a resident for the P.Y.2017-18.

In case of a non-resident, only the following incomes are chargeable to tax:

(i) Income received or deemed to be received in India; and

(ii) Income accruing or arising or deemed to accrue or arise in India.

**Computation of Total income of Mr. Lava for A.Y. 2018-19 under normal provisions**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income from Other Sources</td>
<td></td>
</tr>
<tr>
<td>Interest on debentures in a listed company in India [50,000x100x8%]</td>
<td>4,00,000</td>
</tr>
<tr>
<td>Dividend from listed domestic companies [Exempt u/s 10(34)]</td>
<td>-</td>
</tr>
<tr>
<td><strong>Gross Total Income</strong></td>
<td>4,00,000</td>
</tr>
<tr>
<td>Less: Deduction under section 80C in respect of LIC premium (since premium does not exceed 20% of actual capital sum assured)</td>
<td>1,00,000</td>
</tr>
<tr>
<td><strong>Total Income</strong></td>
<td>3,00,000</td>
</tr>
</tbody>
</table>

**Income under Chapter XII-A**

As per the provisions of Chapter XII-A, investment income i.e., any income derived (other than dividends referred to in section 115-O) from any specified asset in
foreign currency, shall be charged to tax at a flat rate of 20%. Debentures of listed company in India fall under the category of “specified assets”.

In computing the investment income of non-resident Indian, no deduction is to be allowed under any provision of the Act in respect of any expenditure or allowance in relation thereto. Accordingly, no deduction under Chapter VI-A shall be allowed, where the gross total income consists only of investment income.

In this case, total income of Mr. Lava would be ₹ 4,00,000 and it would be charged to tax at a flat rate of 20%.

Accordingly, it is more beneficial to Mr. Lava to be governed by the regular provisions of the Act, as per which he would be able to claim deduction of ₹ 1 lakh in respect of LIC premium paid under section 80C. Further, he can avail the benefit of basic exemption limit of ₹ 2,50,000. Therefore, only ₹ 50,000 would be subject to tax@5%.

(ii) Income chargeable to tax shall be deemed to have escaped assessment for the purpose of section 147, where a person is found to have any asset (including financial interest in any entity) located outside India.

Further, section 149 prescribes an extended time limit of 16 years for issue of notice under section 148, in case income in relation to such assets located outside India has escaped assessment.

In this case, since Mr. Kushwah has a joint bank account in the United States along with Mr. Ram, income is deemed to have escaped assessment for A.Y.2010-11. Notice under section 148 issued to Mr. Kushwah on 20th March 2018 in respect of A.Y.2010-11 is valid, since the extended time limit of 16 years from the end of the relevant assessment year has not expired.

(c) (i) For determining the POEM of a company, the important criteria is whether the company is engaged in active business outside India or not.

A company shall be engaged in “Active Business Outside India” (ABOI) for POEM, if:
- the passive income is not more than 50% of its total income; and
- less than 50% of its total assets are situated in India; and
- less than 50% of total number of employees are situated in India or are resident in India; and
- the payroll expenses incurred on such employees is less than 50% of its total payroll expenditure.

Birta Inc. shall be regarded as a company engaged in active business outside India for P.Y. 2017-18 for POEM purpose only if it satisfies all the four conditions cumulatively.
Condition 1: The passive income of Birta Inc. should not be more than 50% of its total income

Total income of Birta Inc. during the P.Y. 2017-18 is ₹180 crores

Passive income is the aggregate of, -

(i) income from the transactions where both the purchase and sale of goods is from/to its associated enterprises; and

(ii) income by way of royalty, dividend, capital gains, interest or rental income;

Passive Income of Birta Inc. is ₹100 crores, being dividend income

Percentage of passive income to total income = ₹100 crore/ ₹180 crore x 100 = 55.56%

Since passive income of Birta Inc. i.e., 55.56% is more than 50% of its total income, the first condition is not satisfied.

Note — Since only purchases are from an associated enterprise i.e., Tata Inc., Singapore, and the sales are to unrelated parties (so assumed in the absence of specific information), no passive income arises from such transactions.

Condition 2: Birta Inc. should have less than 50% of its total assets situated in India

Value of total assets of Birta Inc. during the P.Y. 2017-18 is ₹500 crores.

Value of total assets of Birta Inc. in India during the P.Y. 2017-18 is ₹300 crores

Percentage of assets situated in India to total assets = ₹300 crores/₹500 crores x 100 = 60%

Since the value of assets of Birta Inc. situated in India is not less than 50% of its total assets, the second condition for ABOI test is not satisfied.

Condition 3: Less than 50% of the total number of employees of Birta Inc. should be situated in India or should be resident in India

Number of employees situated in India or are resident in India is 1,500

Total number of employees of Birta Inc. is 2,200.

Percentage of employees situated in India or are resident in India to total number of employees is 1,500/2,200 x 100 = 68.18%

Since employees situated in India or are residents in India of Birta Inc. are not less than 50% of its total employees, the third condition for ABOI test is not satisfied.

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2 It is assumed that “1,500” average number of employees in India includes “1,300” average number of resident employees in India.
Condition 4: The payroll expenses incurred on employees situated in India or residents in India should be less than 50% of its total payroll expenditure

Payroll expenditure on employees situated in India or are residents in India is ₹110 crores.

Total payroll expenditure of Birta Inc. is ₹200 crores.

Percentage of payroll expenditure on employees situated in India or are resident in India to total payroll expenditure is ₹110 crores/₹200 crores x 100 = 55%

Since payroll expenditure on employees situated in India or are residents in India of Birta Inc. is not less than 50% of its total payroll expenditure, the fourth condition for ABOI test is not satisfied.

Since Birta Inc. does not satisfy all the above four conditions cumulatively, Birta Inc. has not passed the Active Business Outside India (ABOI) test.

**Note:** This conclusion can be arrived at on non-satisfaction of any one of the four conditions. There is no need to check satisfaction of other conditions, since even if one condition is not satisfied, the company would not pass the active business outside India (ABOI) test.

Determination of POEM

There are two-stage process for determination of POEM in case of companies not engaged in active business outside India are:

**First stage:** Identifying the person(s) who actually make the key management and commercial decisions for the conduct of the company as a whole.

**Second stage:** Determining the place where these decisions are, in fact, being made.

If the persons who actually make the key management and commercial decisions for the conduct of the company as a whole and the place where these decisions are, in fact, being made is in India, POEM of the foreign company would be considered to be in India. In this case, assuming that such decision making power has been delegated by the Board of Directors to Ms. Karuna Kapoor, who is the CEO of Birta Inc. in India, and she actually makes such key management and commercial decisions in the P.Y.2017-18, then the POEM of Birta Inc. would be in India during that year. Otherwise, the POEM of Birta Inc. would be considered to be outside India.

Consequences

As per section 6(3), a foreign company would be resident in India in any previous year, if its POEM, in that year, is in India.
If the POEM of Birta Inc. is in India in the P.Y.2017-18, Birta Inc. would be resident in India for A.Y. 2018-19 and its global income would be taxable in India. However, the applicable rate of tax would be that rate of tax applicable to a foreign company.

If the POEM of Birta Inc. is not in India in the P.Y.2017-18, Birta Inc. would be non-resident in India for A.Y. 2018-19 and only the income attributable to its permanent establishment (PE) would be taxable in India.

(ii) The Assessing Officer has to seek the prior approval of the Principal Commissioner or the Commissioner before initiating any proceedings for holding a company incorporated outside India, i.e., Birta Inc., in this case, as being resident in India on the basis of its POEM.

Further, in case the Assessing Officer proposes to hold a company incorporated outside India, on the basis of its POEM, as being resident in India, then, any such finding shall be given by the Assessing Officer after seeking prior approval of the collegium of three members consisting of the Principal Commissioners or the Commissioners, as the case may be, to be constituted by the Principal Chief Commissioner of the region concerned. The collegium so constituted shall provide an opportunity of being heard to the company before issuing any directions in the matter.

(iii) As per section 92F, “Permanent establishment” includes a fixed place of business through the business of the enterprise is wholly or partly carried on. A branch in India would, therefore, constitute a PE.

Since Birta Inc. is a foreign company having a PE in India i.e., branch, it is liable for book profit tax under section 115JB for the A.Y. 2018-19

Explanation 4 to section 115JB provides that the provisions of MAT under section 115JB would not be applicable to a foreign company, in the following cases:

(i) Where the foreign company is a resident of a country or a specified territory with which India has a DTAA under section 90(1) or the Central Government has adopted any agreement between specified associations for double taxation relief under section 90A(1), if such country does not have a permanent establishment in India in accordance with the provisions of DTAA.

(ii) Where the foreign company is a resident of a country with which India does not have an agreement of the nature referred to in clause (i) above, it should not be required to seek registration under any law for the time being in force relating to companies.

(d) An individual is said to be resident in India in any previous year, if she satisfies any one of the following conditions:

(i) She has been in India during the previous year for a total period of 182 days or more, or
(ii) She has been in India during the 4 years immediately preceding the previous year for a total period of 365 days or more and has been in India for at least 60 days in the previous year.

If she satisfies any one of the conditions mentioned above, she would be a resident. If both the above conditions are not satisfied, she would be a non-resident.

In the present case, Ms. Karuna Kapoor joins duty on 1.9.2017 in India. Her stay in India during the P.Y. 2017-18 is 212 days (i.e., 30+31+30+31+28+31 days). Since her stay in India during the previous year 2017-18 is 182 days or more, her residential status for A.Y.2018-19 is Resident.

An individual is said to be a resident but not ordinarily resident if she satisfies any of the following conditions

(i) If such individual has been non-resident in India in any 9 out of the 10 previous years preceding the relevant previous year, or
(ii) If such individual has during the 7 previous years preceding the relevant previous year been in India for a period of 729 days or less.

If the individual satisfies neither of the conditions mentioned above, she is a resident and ordinarily resident.

Since Ms. Karuna Kapoor was born and brought up in the USA and has never visited India previously, she satisfies both the additional conditions for being a resident but not ordinarily resident. Hence, Ms. Karuna Kapoor is resident but not ordinarily resident in India for the A.Y. 2018-19

(e)

<table>
<thead>
<tr>
<th>Q. No.</th>
<th>Answer</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i)</td>
<td>(D)</td>
</tr>
<tr>
<td>(ii)</td>
<td>(C)</td>
</tr>
<tr>
<td>(iii)</td>
<td>(B)</td>
</tr>
<tr>
<td>(iv)</td>
<td>(B)</td>
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<tr>
<td>(v)</td>
<td>(C)</td>
</tr>
<tr>
<td>(vi)</td>
<td>(A)</td>
</tr>
<tr>
<td>(vii)</td>
<td>(D)</td>
</tr>
<tr>
<td>(viii)</td>
<td>(C)</td>
</tr>
<tr>
<td>(ix)</td>
<td>(D)</td>
</tr>
<tr>
<td>(x)</td>
<td>(C)</td>
</tr>
</tbody>
</table>
ABC LLP is a firm of Chartered Accountants providing services for diversified activities in the fields of Audit, Accounts and Taxation. The International Taxation division of the firm is known for having the expertise in issues and matters relating to International Taxation and Transfer Pricing. The firm has been contacted for seeking their expert opinion on the issues and matters relating to International Taxation and on Transfer Pricing by various constituents/entities and the professional Chartered Accountants. Some of the matters/issues referred by different entities/constituents/professionals for obtaining their expert opinion are:-

A. Matters referred by a small firm of Chartered Accountants

The partners of the firm have sought opinion in respect of the matters of their clients for giving reply to the tax authorities relating to the show cause notice issued to tax the income earned by each of the following clients and opinion on other matters so raised by them under the provisions of the Income-tax Act, 1961:-

(i) Techno Engineering, GMBH, a German foreign company entered into an agreement for the execution of electrical work in India for Super Thermal Power Ltd. Separate payments were made towards drawings and designs by Super Thermal Power Ltd. to the German Company which were termed as “Engineering Fee”.

The German Company is not having any permanent establishment (PE) in India for doing the business and operates from Germany only.

(ii) Engineers and Engineers Pvt. Ltd. (EEPL) of the UK, a non-resident foreign company, entered into a collaboration agreement on 25.06.2017 with TMT (India) Ltd., an Indian Company. The UK Company was issued debentures by TMT (India) Ltd. for ₹ 120 lacs on 1.07.2017 bearing interest @ 10% p.a. in consideration for providing the technical know-how to TMT (India) Ltd. by the UK Company.

TMT (India) Ltd. also paid the interest on the debentures to EEPL which was due for the relevant period ended on 31.03.18.

(iii) XYZ Ltd. is an Indian Company located in Special Economic Zone (SEZ) in which Qilla Inc., a US company is holding 32% shares and voting power. Following transactions were effected between these two companies during the year 2017-18:-

(a) XYZ Ltd. sold 1,50,000 pieces of T-shirts at $ 3 per T-shirt to Qilla Inc. The identical T-shirts were sold by XYZ Ltd. to an unrelated party, namely, Konny Inc. at $ 4 per T-shirt.

(b) XYZ Ltd. borrowed loan of $ 5,00,000 from a foreign lender on the strength of guarantee given by Qilla Inc. and for the purpose of giving guarantee, XYZ Ltd. paid $ 20,000 as guarantee fee to Qilla Inc. However, for the same amount of loan taken by an unrelated party, Qilla Inc. had charged guarantee fees of $ 15,000.
(c) XYZ Ltd. paid $ 20,000 to Qilla Inc. for getting the details of various potential customers to improve its business outside India in global market. Qilla Inc. provided the same services and details to an unrelated party for $ 15,000.

(iv) During the previous year 2017-18, Mohammed Suleman (MS) was treated as resident in India and also in ‘X’, a foreign county, with which India had entered into Double Taxation Avoidance Agreement (DTAA). The particulars of assets and income of MS for the year ended 31.3.18 are:-

(a) He owns immovable properties (including residential house) in both India and country ‘X’.

(b) He earned business income of ₹ 50 lacs from rubber estates in the foreign country ‘X’ during the financial year 2017-18. No business income was earned in India.

(c) He sold a house property situated in foreign country ‘X’ which had resulted in short-term capital gain of ₹ 20 lacs during the year to him and was subject to tax in ‘X’ country.

(d) He has derived rental income of ₹ 6 lacs from the property located in India which was let-out during the year.

(e) He was also having a residential house at Lucknow besides the let out property in India which was used by him for his stay when he was visiting India.

MS had not carried out any business in India and was also not having any permanent establishment in India during the year.

Article 4 of the Double Taxation Avoidance Agreement between India and the foreign country ‘X’ where also MS in a resident, provides:

“Where an individual is a resident of both the Contracting States, then, he shall be deemed to be resident of the Contracting State in which he has permanent home available to him. If he has permanent home in both the Contracting States, he shall be deemed to be a resident of the Contracting State with which his personal and economic relations are closer (centre of vital interests)”.

B. Matter referred by a Company

Central India Offshore Pvt. Ltd. (CIOP) is registered under the Companies Act, 2013 and having its registered office located at Hyderabad, provided the following information:

- The company CIOP is a wholly owned subsidiary (WOS) of CCPI, a company incorporated in UK which was having two other subsidiaries in the US and Canada (collectively referred to as “overseas entities”). The two subsidiaries of US and Canada were engaged in the business of supplying gas and electricity to consumers across US and Canada.

- Overseas entities had outsourced their back office support functions such as consumers billings/ debt collections/monthly job reporting to third party service providers (vendors) in India [Central India Offshore Pvt. Ltd. (CIOP)].
CIOP entered into a Service Agreement with the overseas entities to provide locally based interface between the overseas entities and the vendors in India, and was required to (a) ensure that the vendors complied with the requisite quality guidelines; (b) provide management assistance, including advice on expanding the scope of potential service in India. CIOP was compensated for all such activities on cost plus a fixed mark-up basis.

CIOP and the overseas entities entered into a Secondment Agreement under which the overseas entities seconded some of their employees (assignees) with the requisite knowledge and experience to work with CIOP in India.

The key terms of the Secondment Agreement are as under:-

1. Overseas entities would second the assignees to CIOP at their request as and when being made.
2. The assignees will integrate into CIOP’s organisation.
3. Rules of service of CIOP will be applicable to the assignees.
4. The assignees would work under the direct control and supervision of CIOP.
5. The overseas entities would not be responsible for any error or omission on the part of the assignees.
6. CIOP would bear the risks and rewards of the work of assignees.
7. CIOP was empowered to specify the scope and nature of the assignees’ work and the requisite results to be achieved by them.
8. Assignees to retain their entitlement to participate in CCPI retirement/social security plans and other benefits in accordance with the policies of CCPI and the regulations of the Country.
9. CIOP would bear the monthly costs of employment of assignees, including their basic salary, cost of participation in retirement/social security plans, other compensation and benefits as applicable and any other costs as agreed between CIOP and the overseas entities.
10. CIOP could terminate the Secondment Agreement after a notice.
11. Each assignee would enter into an individual agreement with CIOP which would provide for specific terms of work in India.
12. The salary of all the assignees will be disbursed overseas by the overseas entities and all such amounts to be recovered from CIOP on actual basis.

REQUIRED

In the backdrop of the aforesaid matters referred to ABC LLP which are being entrusted by them to you, provide your expert opinion/views in the context of provisions contained under Income-tax Act, 1961 supported with workings to the following questions on the matters so referred by the firm of Chartered Accountants and by the Company:-
(a) (i) Will the payment made towards drawings and designs by Super Thermal Power Ltd. to Techno Engineering be subject to tax in India, and if so, why? (4 Marks)

(ii) What treatment shall be given to the debentures of ₹ 120 lacs issued by TMT (India) Ltd. to Engineers and Engineers Pvt. Ltd. of UK on 1.7.2017? Will the interest earned on such debentures be taxed in India in A.Y. 2018-19 and if so, on what amount, the tax shall be charged? Answer to be based only on statutory provisions and ignoring the provisions of Double Taxation Avoidance Agreement (DTAA) between India and UK. (4 Marks)

(iii) Explain the relationship of the companies XYZ Ltd. and Qilla Inc. of US and the nature of various transactions entered into between them during the year 2017-18. Compute the adjustments, if required to be made to the total income of XYZ Ltd. under transfer pricing provisions. Take the value of one US dollar as ₹ 70. (7 Marks)

(iv) Examine with reasons and provide detailed opinion as to whether the business income arising in foreign country 'X' from the rubber estate and the capital gains in respect of sale of the property situated in that foreign country can be taxed in India in the hands of MS during the A.Y. 2018-19. State further as to taxability of the income derived by him in India of the let out and other house property. (7 Marks)

(b) (i) Who will be considered as the employer of the employees (assignees) seconded by the overseas group entities to Central India Offshore Pvt. Ltd. (CIOP) in India and who shall be responsible for making payment of salary to these seconded employees for working with CIOP in India? What will be the nature of payment made by CIOP for the assignees in the hands of overseas entities under the Act and whether such payments made by CIOP on cost plus mark-up basis shall be subject to provisions of TDS? (4 Marks)

(ii) In the context of provisions contained under the Income-tax Act, 1961, and by analysing the terms and conditions as specified in the secondment agreement so entered into amongst the overseas entities and CIOP, examine whether there exists any permanent establishment (PE) in India of the overseas entities and if so, what will be its nature? (4 Marks)

(c) Choose the most appropriate alternative for the following MCQs: (10 x 2 = 20 Marks)

(i) Mr. A holds 40% of shareholding in XYZ Ltd., and 55% in ABC Ltd. However, XYZ Ltd. and ABC Ltd., do not have any shareholding in each other. Select which shall be treated as an associate enterprise or deemed associate enterprises, with reference to specified international transactions with Mr. A:

(A) ABC Ltd.

(B) XYZ Ltd.

(C) Both ABC Ltd and XYZ Ltd.

(D) None of the above

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(ii) The excess money determined because of primary adjustments is required to be repatriated within the stipulated time and if not done so, then, the same is treated as an advance subject to charge of interest; where the international transaction is denominated in foreign currency the rate of interest to be charged on such advance amount shall be at LIBOR as on 30th September of the relevant previous year plus:

(A) 3.25%
(B) 3%
(C) 2.75%
(D) 2%

(iii) In respect of transactions/arrangement between XYZ Ltd. and Quilla Inc., if the Department wants to apply GAAR, the tax benefit arising to ______ must be seen, the threshold limit being ₹______

(A) XYZ Ltd. only, 3 crore
(B) Both XYZ Ltd. and Quilla Inc., 2 crore
(C) Quilla Inc. only, 2 crore
(D) Both XYZ Ltd. and Quilla Inc., 3 crore

(iv) XYZ Ltd., had acquired an office building in Spain on 22-4-2015 for a consideration (as stated in INR) of ₹360 lakhs. Of this, ₹90 lakhs was from sources on which taxes had been properly paid. This asset comes to the knowledge of the Assessing Officer on 14-7-2017. The FMV of the house as on 1-4-2017 is ₹500 lakhs and as on 14-7-2017 is ₹600 lakhs. As per the provisions of Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 [BM Act], the FMV to be adopted is the one prevailing as on

(A) 22-4-2015
(B) 1-4-2017
(C) 14-7-2017
(D) None of the above

(v) Continuing the earlier problem/MCQ, the quantum of tax payable under the BM Act will be ₹

(A) 108 lakhs
(B) 81 lakhs
(C) 112.5 lakhs
(D) None of the above
(vi) The factor/factors to be considered in taking the decision or deciding whether a country is being tax haven or not is/are:

(i) Nil rate of tax
(ii) Lack of transparency
(iii) Limited regulatory supervision
(iv) Exchange of information

(A) (i), (ii) & (iii)
(B) (i), (ii) & (iv)
(C) (ii) & (iv)
(D) (i), (ii), (iii) & (iv)

(vii) EEPL has sought to obtain an advance ruling from the Authority for Advance Ruling. Such ruling is

(A) Applicant specific
(B) Transaction specific
(C) Both (A) and (B)
(D) Neither (A) nor (B)

(viii) Assuming (only for this MCO) that EEPL, for receiving trade inquiries from customers has set up a liaison office in India. Work of the liaison office is to forward the trade inquiries to them as well as to negotiate and enter into contracts on behalf of ABC LLC with customers. The existence of liaison office for the purpose of taxability of income of ABC LLC is having:

(A) Neither existence of business connection nor of PE
(B) Liaison office is having independent status
(C) Existence of business connection
(D) Services of a dependent agent

(ix) The following BEPS Action Plan seeks to neutralize the effects of hybrid mismatch arrangements:

(A) Action Plan 2
(B) Action Plan 4
(C) Action Plan 5
(D) None of the above

(x) The residential status of an individual who is treated as resident in India as well as in the foreign country with which India had entered into Double Taxation Avoidance
Agreement (DTAA) is to be determined as per Article contained in the DTAA between both the contracting States. The rule applied to judge the individual’s closer personal economic relations is known as:

(A) Tax benefit rule
(B) Rule of examination of vital interest
(C) Rule under OECD Model
(D) None of the above

Solution to Case Study 3

(a) (i) Separate payments made towards drawings and designs (described as “engineering fee”) are in the nature of fees for technical services. Fees for technical services payable by a resident (Super Thermal Power Ltd., an Indian company, in this case) would be deemed to accrue or arise in India under section 9(1)(vii) in the hands of the non-resident recipient (Techno Engineering GMBH, the German company).

The payment made is not in respect of services utilized for a business or profession outside India or for the purpose of making or earning income from any source outside India and, therefore, is deemed to accrue or arise in India as per section 9(1).

Further, as per Explanation to section 9, where income is deemed to accrue or arise in India under section 9(1)(vii), such income shall be included in the total income of the non-resident German company, regardless of whether it has a residence or place of business or business connection in India, and even if such services are rendered from outside India.

Accordingly, in this case, payments towards drawings and designs would taxable in India in the hands of Techno Engineering GMBH, the German company.

(ii) ₹ 120 lakhs, being the value of debentures issued by an Indian company, TMT (India) Ltd., in consideration of providing technical know-how, is in the nature of fee for technical services, deemed to accrue or arise in India to Engineers and Engineers Pvt. Ltd., a foreign company, under section 9(1)(vii). Hence, it is taxable in India.

Further, as per section 9(1)(v), income by way of interest payable by a person who is a resident in India is deemed to accrue or arise in India except if the debt incurred is used for its business purposes outside India or for making or earning any income from any source outside India.

Therefore, in this case, interest income from debentures of TMT (India) Ltd., an Indian company, is deemed to accrue or arise in India in the hands of Engineers.

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3 It was so held in Aeg Aktiengesellschaft v. CIT (2004) 267 ITR 209 (Kar.)
and Engineers Pvt. Ltd. by virtue of section 9(1)(v), since the debt incurred is not used for a business outside India or for earning income from a source outside India. Hence, interest for 9 months ₹120 lacs of ₹9 lacs shall be taxable in AY.2018-19.

(iii) XYZ Ltd, the Indian company and Qilla Inc., the US company are deemed to be associated enterprises as per section 92A(2)(a), since Qilla Inc. holds shares carrying 32% of voting power (which is not less than 26% of the voting power) in XYZ Ltd.

As per *Explanation* to section 92B, the transactions entered into between these two companies for sale of product, lending or guarantee and provision of services relating to market research are included within the meaning of “international transaction”.

Accordingly, transfer pricing provisions would be attracted and the income arising from such international transactions have to be computed having regard to the arm’s length price.

In this case, from the information given, the arm’s length price has to be determined taking the comparable uncontrolled price (CUP) method to be the most appropriate method.

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹ l in lakhs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amount by which total income of XYZ Ltd. is enhanced on account of adjustment in the value of international transactions:</td>
<td></td>
</tr>
<tr>
<td>(i) Difference in price of T-Shirt @ $1 each for 1,50,000 pieces sold to Qilla Inc. [($1 ($4 - $3) x 1,50,000 x ₹70)]</td>
<td>105.00</td>
</tr>
<tr>
<td>(ii) Difference for excess payment of guarantee fee to Qilla Inc. for loan borrowed from foreign lender [5,000 ($20,000 - $15,000) x ₹70]</td>
<td>3.50</td>
</tr>
<tr>
<td>(iii) Difference for excess payment for services to Qilla Inc. [5,000($20,000 - $15,000) x ₹70]</td>
<td>3.50</td>
</tr>
<tr>
<td></td>
<td>112.00</td>
</tr>
</tbody>
</table>

XYZ Ltd. cannot claim deduction under section 10AA in respect of ₹112 lakhs, being the amount of income by which the total income is enhanced by virtue of the first proviso to section 92C(4), assuming that the above adjustments are made by the Assessing Officer to determine the arm’s length price.

(iv) Section 90(2) provides that where the Central Government has entered into an agreement with the Government of any other country for granting relief of tax or for avoidance of double taxation, then, in relation to the assessee to whom such agreement applies, the provisions of the Income-tax Act, 1961 shall apply to the
extent they are more beneficial to that assessee. In effect, the provisions of the Income-tax Act, 1961 or the DTAA, whichever is more beneficial, would be applicable.

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

MS has residential houses both in India and in Country X. Thus, he has a permanent home in both the countries. Mohd. Suleman (MS) owns rubber estates in Country X from which he derives business income. However, MS has no permanent establishment of his business in India. Therefore, his personal and economic relations with Country X are closer, since Country X is the place where –

(a) the property is located and
(b) the business of rubber estates is being carried on.

Therefore, he shall be deemed to be resident of Country X for A.Y. 2018-19.

The fact of the case and issues arising there from are similar to that of CIT vs. P.V.A.L. Kulandagan Chettiar (2004) 267 ITR 654, where the Supreme Court held that if an assessee is deemed to be a resident of a Contracting State where his personal and economic relations are closer, then, in such a case, the fact that he is a resident in India to be taxed in terms of sections 4 and 5 of the Income-tax Act, 1961 would become irrelevant, since the DTAA prevails over sections 4 and 5.

However, as per section 90(4), in order to claim relief under the agreement, MS has to obtain a certificate [Tax Residency Certificate (TRC)] declaring that he is a resident of Country X from the Government of Country X. Further, he also has to provide such other documents and information, as may be prescribed.

Therefore, in this case, MS would not be liable to income-tax in India for assessment year 2018-19 in respect of business income and capital gains arising in Country X provided he furnishes the Tax Residency Certificate and provides such other documents and information as may be prescribed.

Rental income of ₹ 6 lacs from let-out property located in India would be taxable in India in the hands of MS, since it has accrued and arisen to him in India. Deduction of 30% of Net Annual Value would be allowable under section 24 in computing income from house property.

The Annual Value of residential house at Lucknow, which he uses for his stay while in India, would be Nil, assuming that the house is not let out for the rest of the year and no other benefit is derived therefrom by him.
(b) (i) As per the secondment agreement, the seconded employees retain their entitlement to participate in the overseas holding company's (CCPI) retirement and social security plans and other benefits in terms of their applicable policies, and the salary is payable to them by the overseas entities, which later on claims the money from the Indian entity, CIOP.

Though the Indian entity, CIOP has the right to terminate the Secondment Agreement, the services of the assignee vis-à-vis the overseas entities could not be terminated. Thus, CIOP does not have the right to terminate, or even modify, the employment relationship between the assignee and the overseas entities. Accordingly, the real employer of the seconded employees continued to be the overseas entities. The overseas entities, being the real employer, would be ultimately responsible for making payment of salary to the seconded employees working in India.

The overseas entities have, through their employees, provided technical services to the Indian entity, CIOP. The seconded employees with requisite knowledge and work were provided by the overseas entities to assist CIOP in conducting the business of quality control and management. The services provided by the overseas entities were, thus, provision of technical services through the assignees i.e., seconded employees. Therefore, payment made by CIOP on cost plus mark up basis would be subject to TDS at the rates in force under section 195.

(ii) Section 92F(iii) of the Income-tax Act, 1961 defines permanent establishment to include a fixed place of business through which the business of the enterprise is wholly or partly carried on.

In this case, on perusal of the key terms of the Secondment Agreement, it is evident that there is neither any business conducted by the overseas entities in India through the seconded employees nor any income is derived by them through the activities of such employees. Consequently, there is no fixed place permanent establishment constituted by the overseas entities through the seconded employees.

Note – The above answer is framed solely on the basis of the provisions of the Income-tax Act, 1961 as per the requirement of the question.

If the India-US DTAA and India-Canada DTAA are considered, the definition of PE would include service PE as well, where the employees of one Contracting State stay for more than 90 days in the other Contracting State to render services, other than included services. If fees for technical services is not considered as included service, then, the concept of service PE may apply in the above case, consequent

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4It was so held by the Delhi High Court in Centrica India Offshore Private Limited v. CIT and Others (2014) 364 ITR 336.
to which the overseas entities may be subject to tax in respect of income attributable to the PE.

(c)

<table>
<thead>
<tr>
<th>Q. No.</th>
<th>Answer</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i)</td>
<td>C</td>
</tr>
<tr>
<td>(ii)</td>
<td>B</td>
</tr>
<tr>
<td>(iii)</td>
<td>D</td>
</tr>
<tr>
<td>(iv)</td>
<td>B</td>
</tr>
<tr>
<td>(v)</td>
<td>C</td>
</tr>
<tr>
<td>(vi)</td>
<td>A or D</td>
</tr>
<tr>
<td>(vii)</td>
<td>C</td>
</tr>
<tr>
<td>(viii)</td>
<td>C</td>
</tr>
<tr>
<td>(ix)</td>
<td>A</td>
</tr>
<tr>
<td>(x)</td>
<td>B</td>
</tr>
</tbody>
</table>

Note – In Q. No. (vi), option (iv) is Exchange of Information. The first three options are Nil Rate of tax, Lack of transparency, Limited regulatory supervision. Since option (iv) alone is worded positively, it is possible to take a view that if there is exchange of information, the country cannot be a tax haven, in which case the answer would be “(A) (i), (ii) & (iii)”. However, the question requires the factors to be considered in taking the decision of whether a country is a tax haven. Exchange of information is also a factor along with the other three factors. Hence, on the basis of this rationale, the correct answer is “(D) (i), (ii), (iii) & (iv)”. In view of the language of the question, the correct answer may be either (A) or (D).
CASE STUDY 1

Introduction:

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

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

Meeting of the Board of Directors

An important Board meeting is scheduled on 25th May, 2019. The current date is 20th May, 2019. In this meeting, some important decisions are proposed to be taken, some of them having repercussions associated with Indian and international taxation.

Background of the business activities

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

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

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

Royalty receipts

D Inc., is currently paying a royalty of 2 millions USD per annum (year ended 31-3-2019) to TCL for supply of know-how. For similar supply of know how to Epsilon LLC., a wholly owned Government Company in Japan, TCL receives annual royalty of USD 3 millions. (1 USD = Rs. 70)

Export sales data

Export sales are made from the SEZ unit of TCL.

Manager of Exports Division has furnished the following data pertaining to export sales of identical goods made during the year ended 31-3-2019:

<table>
<thead>
<tr>
<th>Name of the party</th>
<th>Qty in MT</th>
<th>CIF Rate per MT (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>SL</td>
<td>8,00,000</td>
<td>11,800</td>
</tr>
<tr>
<td>GSL</td>
<td>5,00,000</td>
<td>12,000</td>
</tr>
<tr>
<td>XY Inc.</td>
<td>3,00,000</td>
<td>11,900</td>
</tr>
<tr>
<td>AB LLC.</td>
<td>2,00,000</td>
<td>11,700</td>
</tr>
</tbody>
</table>

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

External borrowings

TCL has borrowed a sum of equivalent of Rs.200 crores from Danubes Inc., Dubai on 12-4-2018. On this date, the assets position of TCL was as under:
Danubes Inc., has charged interest at 8% and TCL has paid interest of Rs.16 crores for the year ended 31-3-2019. Though the normal lending rate of Danubes Inc. was 7% per annum to other parties, in view of the urgent requirement of funds and pressing financial commitments, TCL decided to borrow this amount then.

I. 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. Assume that TCL has entered into an Advance Pricing Agreement (APA) on 2nd Jan., 2019, covering transactions for the period starting from 1st April, 2017. This was submitted to the Department on 19th Jan., 2019. The Annual Compliance Report for the assessment year 2018-19 shall be furnished within:
   (a) 60 days from 19th Jan., 2019
   (b) 90 days from 19th Jan., 2019
   (c) 90 days from 2nd Jan., 2019
   (d) 30 days from 30th Nov., 2018

2. Associated enterprise refers to an enterprise which participates, directly or indirectly, or through one or more intermediaries, in, or if one or more persons participates, directly or indirectly, or through one or more intermediaries in certain areas/spheres. Following is not a connected area or sphere:
   (a) Management of the two different enterprises.
   (b) Control of two different enterprises.
   (c) Capital of two different enterprises.
   (d) Dividend distribution policy of the two different enterprises.

3. Assume that TCL has entered into an agreement for sale of a product to Mr. Kashyap on 21-1-2019, who has an agreement with Deep Inc., of Singapore, in which TCL holds 40% of the share capital. The transaction between TCL and Mr. Kashyap will be deemed to be international transaction for transfer pricing purposes (if the other parameters are met),
   (a) Whether Kashyap is a resident or non-resident;
   (b) If Kashyap is a non-resident;
   (c) If Kashyap is a resident;
   (d) Will not be deemed to be international transaction at all.

4. Which of the following is not a transfer pricing method specified u/s 92C for computation of the ALP?
   (a) Resale price method
   (b) Uncontrolled profit method
   (c) Cost plus method
   (d) Profit split method

5. Variation permitted between the actual price charged by an assessee, being a manufacturer, to an associated enterprise in a Notified Jurisdictional Area (NJA) and the Arm's Length Price (ALP) is
   (a) 3%
6. The applicant desiring roll back of the APA may furnish the request for rollback provision in Form No. _______ with proof of payment of an additional fee of ______________.

(a) 3CEDA; Rs.1 lakh
(b) 3CEDA; Rs.5 lakh
(c) 3CED; Rs.2 lakh
(d) 3CED; Rs.3 lakh

7. In the context of transfer pricing provisions entered into by TCL, international transaction should be in the nature of

(i) Purchase, sale or lease of tangible or intangible property
(ii) Provision of service
(iii) Lending or borrowing money

(a) Transaction specified in (i) or (ii) above with an associated enterprise whether resident or non-resident
(b) Transaction specified in (i) or (ii) above with a non-resident associated enterprise
(c) Transaction specified in (i) or (ii) or (iii) above with an associated enterprise whether resident or non-resident
(d) Transaction specified in (i) or (ii) or (iii) above with a non-resident associated enterprise

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

(a) Minimises double taxation;
(b) Real taxable profits can be determined;
(c) Artificial price distortion is reduced;
(d) All the three above.

9. Which of the following transactions fall within the meaning of specified domestic transaction under section 92BA?

(i) any transaction referred to in section 80-A
(ii) any transfer of goods and services between eligible business u/s 80-IA and any other business at a price not corresponding to the market value
(iii) any expenditure in respect of which payment is made to a related person referred to in section 40A(2)(b)

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

10. Where TCL has maintained proper records and documents, and the TPO has made some adjustments to the ALP, thereby increasing the total income by Rs.1 crore, the penalty leviable u/s 270A will be _______

(a) Nil
(b) 50% of amount of tax payable on under-reported income
(c) 200% of amount of tax payable on under-reported income
(d) amount equal to tax payable on under-reported income

II. DESCRIPTIVE QUESTIONS

1. State with reasons the correctness or otherwise of following statements.
   (i) An Advance Pricing Agreement (APA) entered into by the assessee cannot be revised by the CBDT suo moto, but only upon an application made by the assessee for such revision. (2 Marks)
   (ii) Under Rule 10MA(2)(ii), there is a condition that the return of income for the relevant roll back year has been or is furnished by the applicant before the due date specified in Explanation 2 to section 139(1). Hence the applicants who have filed returns under section 139(4) or 139(5) of the Act would not be eligible for roll back of the APA. (4 Marks)
   (iii) Where the total income of TCL is computed by the Assessing Officer applying the provisions of section 115JB, then adjustments made on account of transfer pricing provisions will not have any impact while computing the book profits under section 115JB. Assume that TCL is a company which is not required to comply with the Indian Accounting Standards. Would your answer change if TCL is required to comply with Ind AS? (4 Marks)

2. The Board of Directors want to know the income likely to be computed by the Assessing Officer, taking note of the adjustments under transfer pricing provisions. The profits of TCL computed without taking note of said adjustments, as per the provisions of Chapter IV -D of the Act is Rs.32.2 crores. Assume that there is no Advance Pricing Agreement and TCL has opted not to be subjected to Safe Harbour Rules. You are required to examine the various transactions entered into by TCL and determine the applicability of transfer pricing provisions for each transaction. (18 Marks)

3. State with reason, whether TCL can claim deduction under section 10AA in respect of the transfer pricing adjustment made in respect of the export sales, if such adjustments to transfer pricing are made by the Assessing Officer. (2 Marks)

CASE STUDY 2

Introduction

Akash bricks Ltd. ("ABL") is a leading Indian company, having number of divisions and is engaged in manufacturing, as well as trading activities. It has global presence. It has few foreign subsidiaries also. For this case study, S Inc. (located in Singapore), N Inc (formed in New York, USA) and A LLC. (In Perth, Australia) are relevant.

A LLC., ("AL"), incorporated on 1-11-2018, is engaged in various types of e-commerce activities. It has a website present in Indian soil also.

N Inc., ("NI") provides technical know-how to an Indian company DC and is in receipt of royalty, as per an agreement for provision of know-how. The agreement is within the Industrial Policy conditions laid down by the Central Government.

S Inc., ("SI") is engaged in various types of trading activities. It has presence in India also, operating a branch at Delhi.

The company owns a ship and an aeroplane, which operate from Indian ports to various ports across the world. ABL is planning to file an application with the AAR for seeking advance ruling on certain issues.

Advertisement campaign

ABL decided to expand its overseas markets and in this context, it has engaged the services of two foreign companies PST and DLM. PST is a London-based company and has a branch office in India. DLM is incorporated in Colombo and does not have a PE in India.
During the year, ABL has spent Rs.2.10 crores on digital online advertisements. It has paid Rs.1.20 crores to PST and Rs.90 lakhs to DLM.

**Net results of SI for the year ended 31-3-2019**

For the branch of SI in India, the net results for the year ended 31-3-2019 were as under:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs. in lakhs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net profit prior to adjustment below</td>
<td>20</td>
</tr>
<tr>
<td>Share of HO expenses</td>
<td>45</td>
</tr>
<tr>
<td>Net loss (adjusted loss)</td>
<td>25</td>
</tr>
</tbody>
</table>

**Royalty receipts of NI**

NI has received royalty of Rs.30 lakhs from DC during the F.Y. 2018-19. It has incurred an expenditure of Rs.3 lakhs in India for earning the same.

**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. NI has assets in India as well as outside India. The assets include building, machinery and land. As regards the assets test (for the POEM purposes), to be considered as a company having active business outside India (ABOI), one has to consider whether:
   (a) 50% or more of the total book value of assets are located outside India.
   (b) 50% or more of the total market value of land and book value of building and machinery are located outside India.
   (c) 50% or more of the average value of assets for tax purposes in USA at the beginning and end of the P.Y. is located outside India.
   (d) 50% or more of the average value of building and machinery for tax purposes in USA at the beginning and end of the P.Y. and value of land as per books of account is located outside India.

2. Assume that the income of SI is as under (Rs. in crores):

<table>
<thead>
<tr>
<th>Place of earning income</th>
<th>Total Income</th>
<th>Income from transactions where</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Only purchase of goods is from associated enterprises (I)</td>
</tr>
<tr>
<td>Earned in India</td>
<td>75</td>
<td>10</td>
</tr>
<tr>
<td>Outside India</td>
<td>25</td>
<td>6</td>
</tr>
</tbody>
</table>

Which of the following statements is true?

(a) SI can be said to be engaged in ABOI, since its royalty/ dividend/ interest income is not more than 50% of its total income
(b) SI is engaged in ABOI, since its income referred to in (III) & (IV) is not more than 50% of its total income
(c) SI is not engaged in ABOI, since its income referred to in (I), (II), (III) & (IV) earned in India exceeds 50% of its total income earned in India
(d) SI is not engaged in ABOI, since its income referred to in (I), (II), (III) & (IV) earned in and outside India exceeds 50% of its total income earned in India and outside India

3. An Indian branch of a foreign bank has paid interest of Rs.2 crores to its head office and Rs.1 crore to the Colombo branch. Tax has to be deducted at source to the tune of
   (a) Nil
   (b) Rs.10,40,000
   (c) Rs.31,20,000
   (d) None of the above

4. The AAR will not allow an application made by a PSU if the question raised in the application
   (i) is pending before any income tax authority or ITAT
   (ii) involves determination of fair market value of any property
   (iii) is designed prima facie for avoidance of tax
Which of the following option is correct?
   (a) Only (ii)
   (b) (i) and (ii)
   (c) (i) and (iii)
   (d) (i), (ii) and (iii)

5. ABL is desirous of obtaining an advance ruling in respect of a transaction of Rs.100 crore proposed to be undertaken by it. It has to pay a fee of _____ while making an application for advance ruling.
   (a) Rs.2 lakh
   (b) Rs.10 lakh
   (c) Rs.5 lakh
   (d) Rs.10,000

6. ABL has paid purchase commission of Rs.7 lakhs to Mr. Guru, a resident. Tax to be deducted at source is
   (a) Nil
   (b) Rs.70,000
   (c) Rs.36,400
   (d) Rs.35,000

7. ABL has paid a sum of Rs.12 lakhs during the year ended 31-3-2019, to the Airports Authority of India, towards landing charges (for using the ground when the aircraft is stationary before and after landing or take off). The amount of tax to be deducted at source by ABL in this regard is
   (a) Nil
   (b) Rs.24,000
   (c) Rs.1,20,000
   (d) Rs.24,960

8. The following residents can be an applicant for seeking advance ruling:
   I. Public Sector Undertaking
   II. Resident entering into a transaction with a non-resident in relation to the tax liability of non-resident
III. Resident in relation to his tax liability arising out of one or more transactions valuing Rs.100 crore in total

IV. Resident in relation to his tax liability arising out of one or more transactions valuing Rs.1 crore in total
   (a) (II) & (III)
   (b) (II) & (IV)
   (c) (I), (II) & (III)
   (d) (I), (II) & (IV)

9. ABL made an application seeking advance ruling on 2-1-2019. ABL wanted to withdraw the said application. Under normal circumstances, he may do so within
   (a) 1.2.2019
   (b) 2.2.2019
   (c) 28.2.2019
   (d) 1.3.2019

10. The following persons are involved in an advance ruling.
   (i) Applicant who sought the ruling
   (ii) Commissioner
   (iii) Jurisdictional income tax authorities subordinate to the Commissioner
   (iv) Jurisdictional Principal Chief Commissioner of Income-tax to whom the Commissioner is subordinate

   The advance ruling pronounced by the AAR is binding on
   (a) Only (i) above
   (b) Only (i) and (ii) above
   (c) (i), (ii) and (iii) above
   (d) All four above

II. DESCRIPTIVE QUESTIONS

1. The Board of directors wish to know whether the existence of a website on Indian Soil constitutes a permanent establishment. You are required to give your expert opinion on the same. (5 Marks)

2. Briefly sketch the tax implications and the TDS implications (including consequence of non-deduction of TDS) in respect of the advertisement charges paid by the assessee ABL to PST and DLM. Brief note on the provisions involved is also required. (8 Marks)

3. Continuing 2 above, if the payment made is "net of tax", can the assessee claim that since it has borne the tax burden, it will not issue any tax deduction certificate to the payee? Advise the Board of Directors suitably. (3 Marks)

4. The Board of Directors desires to know the total income of Sl in India for income-tax purposes. You are required to compute the same, and give a brief note on the applicable provisions. (4 Marks)

5. In the under-mentioned situations, what will be the tax liability (including TDS obligation) of NI and DC:
   (i) The agreement having been entered into before 1st June, 2002; the tax payable by NI is paid to the Indian income-tax authorities by DC;
   (ii) There is no clause in the agreement that DC has to undertake the tax liability; the royalty payable is decided to be Rs.30 Lakhs (net of taxes). (6 Marks)
6. Assuming that another foreign company FC has entered into an identical technical know-how agreement with another Indian company and has obtained an advance ruling from the AAR, can NI make use of the said ruling for its tax purposes for the A.Y. 2019-20?  

(4 Marks)

CASE STUDY 3

Mr. Abhinav, a citizen of India, aged 48 years, for the first time, moved for employment purpose to Country “X”, a country outside India, on 1st September, 2014. He was employed with a consulting firm in Country “X”. Since then, he has visited India during the P.Y.2014-15, 2015-16, 2016-17, 2017-18, 2018-19 for 30 days, 50 days, 170 days and 150 days, respectively, for both personal and professional purposes. His family comprises of himself, his spouse Mrs. Archana (aged 45 years); his mother, Mrs. Kamala (aged 81 years); and his two sons, Rohan and Kapil, aged 19 years and 15 years, respectively. In addition, Mr. Abhinav’s unmarried sister Ms. Geetha, aged 42 years, is living with his family in Country “X” since September, 2014. Ms. Geetha and Mrs. Kamala have been visiting India during the P.Y.2014-15, 2015-16, 2016-17, 2017-18, 2018-19 for 50 days, 50 days, 120 days, 150 days and 150 days, respectively.

In the year 2017-18, Mr. Abhinav resigned from his job and started his own consultancy in Country “X” for providing technical services. He entered into an agreement with ABC Ltd, an Indian company, on 01.06.2017 and pursuant to the agreement, Fees for Technical Services (FTS) of INR 10,00,000, is payable to Mr. Abhinav every year for a period of five years. The agreement is approved by the Central Government. Mr. Abhinav also entered into an agreement with the Government of Country “Y” for provision of technical services for a period of three years. The FTS payable to Mr. Abhinav every year for a period of three years under this agreement in foreign currency is equivalent to INR 15,00,000.

During the previous year 2017-18, Mr. Abhinav became partner in a partnership firm M/s Lotus & Co., India and contributed INR 50 lakhs towards capital. He was paid interest @10% as interest on capital and profit share of INR 4 lakhs every year by the firm.

His friend Mr. George, a citizen and resident of Country “X”, borrowed money from Mr. Abhinav and invested the same in bonds issued by MNO Ltd., an Indian Company in April, 2018. Mr. George visited India during the P.Y.2018-19 for the period from 10th April, 2018 to 15th May, 2018. During the previous year 2018-19, interest on borrowings in foreign currency equivalent to INR 1,95,000 was paid by Mr. George to Mr. Abhinav in his bank account in Country “X”.

Mr. Abhinav also earned income of foreign currency equivalent to INR 3,00,000 from his house property in Country ‘X’ deposited in an Indian Bank at Country ‘X’ and subsequently brought to India. Also, he had paid property tax of foreign currency equivalent to INR 3,000 on the said property. During the previous year 2018-19, the rental income earned was invested in deposits in India in the ratio of 30:20:50 in NRO savings account, 5 year fixed deposits and NRE savings account. Interest earned on such deposits is INR 4,000, 5,000 and 9,000, respectively.

On 30.06.2018, he sold shares of Prime Pvt. Ltd., India for INR 12,00,000 and of Hello Pvt. Ltd., India for INR 9,30,000 net of transfer expenses. These shares were purchased by him in convertible foreign currency on 01.12.2015 at a cost of INR 6,20,000 and on 01.01.2018 at a cost of INR 7,50,000 respectively. On 31.10.2018, he invested the sale proceeds of INR 10,50,000 in purchase of shares of Cheers Pvt. Ltd., India.

Further, on 01.12.2018, Mr. Abhinav sold 2000 shares of PQR Pvt. Ltd., India, for INR 15 each. 1500 of such shares were acquired on 01.10.2016 @ INR 10 each and 500 shares were acquired on 31.10.2017 @INR 12 each.

In April, 2018, he had taken a loan of INR 50 lakhs @10% from SBI for construction of residential house in Pune. The construction is completed in May, 2019. He prepaid INR 3 lakhs in March, 2019 to the bank.

He had also purchased the following capital assets in April, 2018 and he transferred the same outside India to Mr. Thomas, a resident of Country “X”, in March, 2019 –

- Rupee Denominated Bonds of INR 1,00,000 of LMN Ltd., an Indian Company, issued outside India, for INR 2,00,000.

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- Government Securities of INR 1,00,000 through an intermediary dealing in settlement of securities, for INR 1,50,000

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

Mrs. Archana, a painter by profession, earned income of INR 3,00,000 from exhibition conducted in Mumbai. Rohan and Kapil are pursuing education in Country ‘X’. Mr. Abhinav paid foreign currency equivalent to INR 60,000 to Catheral School, Country ‘X,’ towards their annual tuition fees. Kapil won an excellence award of INR 25,000 at the Science Olympiad held in Mumbai in February, 2019.

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

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 above facts, Mr. Abhinav’s residential status in India for P.Y.2018-19 and P.Y.2014-15 is -
   (a) Non-resident for both the years
   (b) Non-resident for P.Y.2018-19 and Resident but not ordinarily resident for P.Y.2014-15
   (c) Resident but not ordinarily resident for P.Y.2018-19 and Resident for P.Y.2014-15

(Note – Assume that the rules for determining residential status for A.Y.2015-16 were the same as it is for A.Y.2019-20)

2. Which of the following benefits are not allowable to Ms. Geetha, while computing her total income and tax liability for A.Y.2019-20 under the Income-tax Act, 1961?
   (a) Deduction of 30% of gross annual value while computing her income from house property in Bangalore, India
   (b) Tax rebate of INR 2,500 from tax payable on her total income of INR 3,40,000
   (c) Deduction for donation made by her to Prime Minister’s National Relief Fund
   (d) Deduction for interest earned by her on NRO savings account.

3. Unexhausted basic exemption limit, if any, of Mr. Thomas, for A.Y.2019-20 can be adjusted against –
   (a) Only LTCG taxable@20%
   (b) Only STCG taxable@15%
   (c) Both (a) and (b)
   (d) Neither (a) nor (b)

4. Had Ms. Geetha been seconded on employment outside India by the Indian Government, which of the following emoluments paid to her by the Indian Government shall be taxable under the Income-tax Act, 1961:
   (a) Basic Salary paid outside India
   (b) Allowances and Perquisites paid outside India
   (c) Both (a) and (b), since emoluments are paid to her by the Indian Government
   (d) Neither (a) nor (b), since she has rendered services outside India
5. Ms. Geetha is an enthusiastic sports person and is keen on contributing an article on a game of Soccer in a leading newspaper in India. She approaches you to enquire on taxability of such income for A.Y.2019-20. As per the provisions of Income-tax Act, 1961, such income shall be taxable in her hands at:
   (a) 5%
   (b) 10%
   (c) 20%
   (d) Normal tax slab rates

(Note – The above tax rates are excluding cess and surcharge, if any)

6. Ms. Geetha shall be mandatorily required to file return of income in India for A.Y.2019-20, -
   (a) if she holds assets outside India even though she does not have taxable income in India
   (b) if she has income exceeding the basic exemption limit but after taking into account deduction under Chapter VI-A, her income falls below the basic exemption limit
   (c) if she has income, without giving effect to deduction under Chapter VI-A, below the basic exemption limit and tax credit appearing in Form 26AS, in respect of which she does not wish to claim the refund
   (d) in all the above situations

7. In December, 2015, Ms. Geetha bought, in foreign currency, 500 Global Depository Receipts of PQR Ltd, an Indian Company, which were issued in accordance with the notified scheme of the Central Government. In January, 2019, she sold 300 GDRs outside India to Mr. Frank, a citizen and resident of Country ‘X’ and 200 GDRs to Mr. Kamal, a Resident but not ordinarily resident in India. Comment on the tax consequences of such sale transaction under the Income-tax Act, 1961 -
   (a) Capital gains arising on sale of 500 GDRs shall be subject to tax @20% with indexation benefit in India
   (b) No capital gains would arise on sale of 500 GDRs in India, since the GDRs are purchased in foreign currency
   (c) No capital gains would arise on sale of 300 GDRs, but capital gains arising on sale of 200 GDRs shall be taxed in India @10% without indexation benefit
   (d) No capital gains would arise on sale of 300 GDRs, but capital gains arising on sale of 200 GDRs shall be taxed @20% with indexation benefit in India

8. Benefit of presumptive taxation under the Income-tax Act, 1961 would not be available to Mr. George for A.Y.2019-20, in respect of the related Indian income, if he is engaged in the business of -
   (a) Operation of Ships
   (b) Operation of Aircrafts
   (c) Civil Construction in connection with an approved turnkey power project
   (d) Plying, hiring or leasing of goods carriages.

9. Interest income earned by Mr. George during the P.Y.2018-19 on bonds, issued by MNO Ltd., an Indian company, under a scheme notified by the Central Government, which were purchased by him in convertible foreign currency, is -
   (a) taxable@10%
   (b) taxable@15%
(c) taxable@20%
(d) not taxable

(Note – The above tax rates are excluding cess and surcharge, if any)

10. An agent, in relation to income which is deemed to accrue or arise in India to a non-resident, is considered as a representative assessee. However, an agent, in relation to a non-resident person does not include-

(a) An employee in India of the non-resident
(b) A trustee in India of the non-resident
(c) A broker in India dealing with the non-resident person only through a non-resident broker, where both non-residents carry on transactions in the ordinary course of business
(d) A person in India having business connection with the non-resident

II. DESCRIPTIVE QUESTIONS

1. (i) Examine the tax consequence of fees for technical services (FTS) received by Mr. Abhinav, a resident of Country ‘X’, from ABC Ltd. for Assessment Year 2019-20, if -
   India has no Double Tax Avoidance Agreement (DTAA) with Country “X”
   India has a DTAA with Country “X”, which provides for taxation of such FTS @5%.
   India has a DTAA with Country “X”, which provides for taxation of such FTS @15%.
   (3 Marks)

(ii) In case Mr. Abhinav fails to furnish the PAN details to ABC Ltd., at what rate should ABC Ltd. deduct tax at source, considering that Mr. Abhinav is a resident of a Country ‘X’, with which India has no DTAA?
   (4 Marks)

(iii) If Mr. Abhinav has a fixed place of profession in India and the contract in respect of FTS with ABC Ltd. is effectively connected with such fixed place of profession in India, how would the FTS be computed in such a case and what are the related requirements under the Income-tax Act, 1961?
   (3 Marks)

2. (i) Chapter XVII-B requires tax deduction at source by a resident making payment to either a resident or a non-resident. It does not require tax deduction at source by non-residents, who do not have any place of business or business connection in India. Examine the correctness or otherwise of this statement.
   (3 Marks)

(ii) As a tax consultant for M/s Lotus & Co., India, you need to advise the firm regarding tax deduction at source on the payments (i.e. interest on capital and share of profit) made to Mr. Abhinav during the previous year 2018-19, considering that Mr. Abhinav is a resident of Country ‘X’, with which India has no DTAA. In case tax is not deductible at source, is there any other related requirement to be complied with by the firm?
   (4 Marks)

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

3. Using the information given in the facts of the case, compute Mr. Abhinav’s total income and tax liability for the Assessment Year 2019-20, assuming that he is a resident of Country X, with which India has no DTAA and he opts for computing his income in accordance with the provisions of Chapter XII-A of the Income-tax Act, 1961. You may ignore the amount of advance tax and TDS credit appearing in Form 26AS. Also, ignore the effect of first proviso to section 48, wherever applicable.
   (10 Marks)
<table>
<thead>
<tr>
<th>Financial Year</th>
<th>Cost Inflation Index</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001-02</td>
<td>100</td>
</tr>
<tr>
<td>2002-03</td>
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<tr>
<td>2017-18</td>
<td>272</td>
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<tr>
<td>2018-19</td>
<td>280</td>
</tr>
</tbody>
</table>
I. ANSWERS TO MCQs (Most appropriate answers)

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

II. ANSWERS TO DESCRIPTIVE QUESTIONS

Answer to Q.1:

(i) The statement is incorrect

An agreement, after being entered, may be revised by the Board either suo moto or on request of the assessee or the competent authority in India or the Director General of Income-tax (International Taxation), in appropriate situations, as per Rule 10Q.

(ii) The statement is partly correct

If the return of income filed u/s 139(1) is revised, then the return of income filed under section 139(5) of the Act replaces the original return of income filed under section 139(1). Hence, if there is a return which is filed under section 139(5) to revise the original return filed before the due date specified in Explanation 2 to section 139(1), the applicant would be entitled for rollback on this revised return of income.

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

Further, if a return filed u/s 139(4) is revised u/s 139(5), then, the revised return replaces the belated return filed u/s 139(4) in which case, the applicant would not be entitled for rollback.

(iii) The statement is correct

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

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

No, the answer will not change even if TCL is required to comply with Ind AS. Even then the adjustment in 115JB(2A) need to be made, but not TP adjustment.
Answer to Q.2:

Any income arising from an international transaction, where two or more "associated enterprises" enter into a mutual agreement or arrangement, shall be computed having regard to arm's length price as per the provisions of Chapter X of the Act.

The items that are to be considered for transfer pricing adjustments are as under:

(a) Sales to SL, XY Inc and AB LLC;
(b) Royalty payments received from D Inc., and
(c) Interest on borrowings from Danubes Inc., Dubai.

Export sales to foreign companies

Sales to SL

Section 92A defines an "associated enterprise" and sub-section (2) of this section speaks of the situations when the two enterprises shall be deemed to be associated enterprises.

In SL, TCL holds 14/50 i.e. 28% of the voting power.
Since TCL holds more than 26% of the voting power in SL, TCL and SL are deemed to be associated enterprises.

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

Sales to GSL

In GSL, TCL holds 18/80 i.e. 22.5% of the voting power.
Since TCL holds less than 26% of the voting power, GSL is not an associated enterprise.

Sales to XY Inc and AB LLC

Both these companies are located in notified jurisdictional areas (NJA).

As per section 94A, following are the consequences:

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

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

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

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

<table>
<thead>
<tr>
<th>Name of the party</th>
<th>Qty in MT</th>
<th>Rate per MT (Rs.)</th>
<th>ALP</th>
<th>Difference per MT</th>
<th>Total amount (Rs. In lakhs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>SL</td>
<td>8,00,000</td>
<td>11,800</td>
<td>12,000</td>
<td>200</td>
<td>1600</td>
</tr>
<tr>
<td>XY Inc.</td>
<td>3,00,000</td>
<td>11,900</td>
<td>12,000</td>
<td>100</td>
<td>300</td>
</tr>
<tr>
<td>AB LLC.</td>
<td>2,00,000</td>
<td>11,700</td>
<td>12,000</td>
<td>300</td>
<td>600</td>
</tr>
<tr>
<td><strong>Total adjustment to ALP</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td><strong>2,500</strong></td>
</tr>
</tbody>
</table>

Royalty receipts

D Inc., is a wholly owned subsidiary of TCL and is a non-resident company. Hence it is an associated enterprise.
Royalty falls within the meaning of international transaction, since it is payment for supply of know-how, being an intangible property.

D Inc., is currently paying a royalty of 2 million USD per annum (year ended 31-3-2019) to TCL for supply of know-how. For similar supply of know how to Epsilon LLC., a wholly owned Government Company in Japan, TCL receives annual royalty of 3 million.

Under CUP Method, ALP has to be taken as 3 million USD

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

**Borrowings**

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

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

Hence Danubes Inc., is deemed to be an associated enterprise of TCL.

Interest payments are also covered by the term "international transaction".

Danubes Inc., has charged interest at 8% and TCL has paid interest of Rs.16 crores for the year ended 31-3-2019.

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

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

**Total income of TCL**

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

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount (Rs. in cr)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net profit as given prior to TP adjustments</td>
<td>32.2</td>
</tr>
<tr>
<td><strong>Add:</strong> Difference on account of value in international transactions</td>
<td></td>
</tr>
<tr>
<td>(i) Export sales</td>
<td>25.0</td>
</tr>
<tr>
<td>(ii) Royalty receipts</td>
<td>7.0</td>
</tr>
<tr>
<td>(iii) Interest payment</td>
<td>2.0</td>
</tr>
<tr>
<td><strong>Total Income</strong></td>
<td><strong>66.2</strong></td>
</tr>
</tbody>
</table>

**Answer to Q.3:**

As per the first proviso to section 92CA(4), TCL cannot claimed deduction u/s 10AA in respect of the income enhanced (Rs.25 crores) by applying the transfer pricing adjustments, where such adjustments are made by the Assessing Officer to determine the ALP.

---

**SOLUTION TO CASE STUDY 2**

1. **ANSWERS TO MCQs (Most appropriate answers)**
   1. (d)
   2. (b)
   3. (d)
   4. (a)
   5. (a)
II. ANSWERS TO DESCRIPTIVE QUESTIONS

Answer to Q.1:

Website on Indian soil, whether is PE

The term "permanent establishment" has not been defined in section 2 of the Income-tax Act, 1961. As per section 92F(iiiA), "permanent establishment" includes a fixed place of business through which the business of the enterprise is wholly or partly carried on.

The term "permanent establishment" includes (a) a place of management (b) a branch, (c) an office, (d) a factory, (e) a workshop, (f) mines, (g) warehouse, etc. In most of the DTAs, an exhaustive definition of the term "permanent establishment" is given, wherein several more items are enumerated.

A website is a set of web documents belonging to a particular organization. It consists of data and programs in digital form, from which it is stored in a server which is accessible through internet.

A website does not normally imply "a fixed place of business", even though in the case of some entities, some business could be transacted through a website. Thus, the mere presence of a website in Indian soil, without anything more, will not amount to a permanent establishment.

If the website contains merely information about the concern, the website cannot be regarded as a permanent establishment. Where the website is being used as a virtual office for transacting orders of purchases or sales or for rendering services on a more than casual basis, then it could be regarded as a permanent establishment, if the server supporting the website is located in India.

Answer to Q.2:

An equalisation levy of 6% is attracted in respect of the amount of consideration for specified services received or receivable by a non-resident not having permanent establishment in India, from a resident in India who carries out business or profession, or from a non-resident having permanent establishment in India.

"Specified Service" means

(a) online advertisement;
(b) any provision for digital advertising surface or any other facility or service for the purpose of online advertisement and
(c) any other service as may be notified by the Central Government.

However, equalisation levy shall not be levied-
- where the non-resident providing the specified services has a permanent establishment in India
- the aggregate amount of consideration for specified service received or receivable during the previous year does not exceed Rs.1 lakh.
- where the payment for specified service is not for the purposes of carrying out business or profession

Where DLM has no PE in India

In the present case, the assessee is required to deduct equalisation levy of Rs.5,40,000 i.e., @6% of Rs.90 lakhs, being the amount paid towards online advertisement services provided by DLM, a non-resident having no permanent establishment in India.

Non-deduction of equalisation levy would attract disallowance under section 40(a)(ib) of 100% of the
amount paid while computing business income.

**Payment made to PST having PE in India**

Equalisation levy would not be attracted where the non-resident service provider PST Inc., in this case, has a permanent establishment in India. Therefore, the ABL is not required to deduct equalisation levy on Rs.1.2 crores, being the amount paid towards online advertisement services to PST.

However, tax has to be deducted by the assessee at the rates in force under section 195 in respect of such payment to PST.

Non-deduction of tax at source under section 195 would attract disallowance under section 40(a)(i) of 100% of the amount paid while computing business income.

**Answer to Q.3:**

Section 195A enjoins that where under an agreement, the tax chargeable on any income is to be borne by the person by whom the income is payable (payment is made net of tax), then for the purpose of deduction of tax at source, such income shall increase to such amount as would, after deduction of tax thereon, be equal to the net amount payable under the agreement.

As per section 203, every person deducting tax shall furnish to the deductee, certificate of deduction of tax in the prescribed form. No exception has been provided in this regard.

The CBDT has, vide Circular No.785 dated 24.11.99, clarified that even in those cases where the tax has been borne by the payer of income under an agreement, the payer is under a legal obligation to furnish a TDS Certificate as per the provisions of section 203 of the Income-tax Act, 1961.

Therefore, the view of ABL that the payee PST is not entitled for TDS certificate, is incorrect.

As regards payment to DLM, there is no provision in law for issuance of TDS certificate in respect of equalisation levy deducted.

**Answer to Q.4:**

Section 44C restricts the allowability of the head office expenses to the extent of lower of an amount equal to 5% of the adjusted total income or the amount actually incurred as is attributable to the business of the assessee in India.

For the purpose of computing the adjusted total income, the head office expenses of Rs.45 Lacs charged to the profit and loss account have to be added back. In other words, the income before charging such HO expenditure has to be considered.

The amount of income to be declared by the assessee for A.Y. 2019-20 will be as under:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs. in Lakhs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net profit before charging HO expenditure</td>
<td>20.00</td>
</tr>
<tr>
<td>Less: Share of HO expenditure</td>
<td></td>
</tr>
<tr>
<td>- 5% of Rs.20 lakhs i.e. Rs.1 lakh</td>
<td>1.00</td>
</tr>
<tr>
<td>- Actual 45 lakhs</td>
<td></td>
</tr>
<tr>
<td>Total income of SI for the A.Y. 2019-20</td>
<td>19.00</td>
</tr>
</tbody>
</table>

**Answer to Q.5:**

(i) As per section 10(6A), in the case of a foreign company deriving income by way of royalty or fees for technical services from the Government or an Indian concern under the terms of an agreement entered into before 1.6.2002 relating to a matter included in the industrial policy of the Central Government, the tax paid by the Government or an Indian concern on such income would not be included in the total income of the foreign company. Hence, such tax paid would be exempt in the hands of e foreign company.
company.
Therefore, in the impugned situation, the tax paid by DC will be exempt from tax in the hands of NI. In this case, section 195A is not applicable and consequently, the royalty of Rs.30 lacs should not be grossed up.

The rate of tax is 10% as per section 115A(1)(b)(A), if the royalty is received in pursuance of an agreement made after 31.3.1976.

Therefore, DC is required to pay tax of Rs.3.12 lakhs i.e., @ 10.4% on Rs.30 lakhs. No deduction is allowable in respect of any expenditure incurred to earn such income.

(ii) Since there is no clause in the agreement that DC has to bear the tax liability, the benefit under section 10(6A) is not available.

DC has to deduct tax at source on royalty payment to NI, a foreign company, as per section 195.
Since in this case, DC has to pay the royalty of Rs.30 lacs ‘net to taxes” to NI, the royalty has to be grossed up.

The tax liability of NI has to be computed as under:

<table>
<thead>
<tr>
<th>Description</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net royalty income</td>
<td>30,00,000</td>
</tr>
<tr>
<td>Gross royalty income (30,00,000 x 100/89.6)</td>
<td>33,48,214</td>
</tr>
<tr>
<td>Tax on royalty of @10.40%</td>
<td>3,48,214</td>
</tr>
<tr>
<td>DC has to deduct tax of Rs.3,48,214 at source under section 195</td>
<td></td>
</tr>
</tbody>
</table>

Answer to Q.6:
As per section 245S(1), the advance ruling pronounced under section 245R by the Authority for Advance Rulings shall be binding only on the applicant who had sought it and in respect of the specific transaction in relation to which advance ruling was sought. It shall also be binding on the Principal Commissioner/Commissioner and the income-tax authorities subordinate to him, in respect of the concerned applicant and the specific transaction.

Consequently, NI cannot use the advance ruling, obtained on an identical issue by another foreign company, FC, for its tax purposes for the assessment year 2019-20.

However, though the advance ruling pronounced does not become a precedent, it has persuasive value where the facts warrant such reference to the rulings of AAR. There is no legitimate bar for relying or forming an opinion in consonance with the reasoning of the AAR. It was so held by the Madras High Court in CIT v. P Sekar Trust (2010) 321 ITR 305.

SOLUTION TO CASE STUDY 3
I. ANSWERS TO MCQs (Most appropriate answers)
1. (d)
2. (b)
3. (d)
4. (a)
5. (d)
6. (b)
7. (c)
8. (c)
II. ANSWERS TO DESCRIPTIVE QUESTIONS

Answer to Q.1:

1. (i) In accordance with the provisions of section 115A, where the total income of a non-corporate non-resident includes any income by way of royalty or fees for technical services other than the income referred to in section 44DA(1), received from an Indian concern in pursuance of an agreement made by him with the Indian concern and the agreement is approved by the Central Government, then, the special rate of tax at 10% of such fees for technical services is applicable. No deduction would be allowable under sections 28 to 44C while computing such income.

Section 90(2) makes it clear that where the Central Government has entered into a DTAA with a country outside India, then, in respect of an assessee to whom such agreement applies, the provisions of the Act shall apply to the extent they are more beneficial to the assessee. Therefore, if the DTAA provides for a rate lower than 10%, then, the provisions of DTAA would apply.

(a) In this case, since India does not have a DTAA with Country ‘X’, of which the Abhinav is a resident, the fees for technical services (FTS) of INR 10,00,000 from ABC Ltd. would be taxable @10%, by virtue of section 115A.

(b) In this case, the FTS from ABC Ltd. would be taxable @5%, being the rate specified in the DTAA, even though section 115A provides for a higher rate of tax, since the tax rates specified in the DTAA are more beneficial. However, since Abhinav is a non-resident, he has to furnish a tax residency certificate from the Government of Country X for claiming such benefit. Also, he has to furnish other information, namely, his nationality, his tax identification number in Country X and his address in Country X.

(c) In this case, the FTS from ABC Ltd. would be taxable @10% as per section 115A, even though DTAA provides for a higher rate of tax, since the provisions of the Act (i.e. section 115A in this case) are more beneficial.

(ii) Under section 206AA, any person who is entitled to receive any sum or income or amount on which tax is deductible under Chapter XVII-B has to furnish his Permanent Account Number (PAN) to the person responsible for deducting such tax, failing which tax shall be deducted at

- the rate mentioned in the relevant provisions of the Act or
- the rate or rates in force or
- the rate of 20%
whichever is higher.

For the purpose of reducing the compliance burden of non-corporate non-residents or foreign company, section 206AA(7) provides for non-applicability of the requirements contained in section 206AA to a non-corporate non-resident or foreign company, in respect of interest on long-term bonds as referred to in section 194LC and any other payment subject to prescribed conditions.

As per Rule 37BC, the provisions of section 206AA shall not apply to a non-corporate non-resident or foreign company not having PAN in respect of payments in the nature of interest, royalty, fees for technical services and payments on transfer of any capital asset, if the deductee furnishes the following details and documents to the deductor:

- Name, e-mail id, contact number;
- address in the country or specified territory outside India of which the deductee is a resident;
- a certificate of his being resident in any country outside India from the Government of that country, if the law of that country provides for issuance of such certificate;

- Tax Identification Number of the deductee in the country of his residence. In case no such number is available, then a unique number on the basis of which the deductee is identified by the Government of that country or the specified territory of which he claims to be a resident.

Hence, if Mr. Abhinav fails to furnish the PAN details to ABC Ltd., then the company can obtain the above information from him and deduct TDS @10% in accordance with provisions of section 115A. If he is not able to furnish the requisite details, tax has to be deducted @20% under section 206AA, being the highest of the following rates –

- rate under section 115A i.e., 10%,
- rates in force i.e., 10%,
- 20%.

(iii) By virtue of section 44DA, the income by way of fees for technical services received by Mr. Abhinav from ABC Ltd., India, would be computed under the head "Profits and gains of business or profession" in accordance with the provisions of Income-tax Act, 1961, since technical services are provided from a fixed place of profession situated in India and fees for technical services is received from an Indian concern in pursuance of an agreement by Mr. Abhinav with ABC Ltd., an Indian company, and is effectively connected with such fixed place of profession. No deduction would, however, be allowed in respect of any expenditure or allowance which is not wholly and exclusively incurred for the fixed place of profession in India.

Mr. Abhinav is required to keep and maintain books of account and other documents in accordance with the provisions contained in section 44AA and get his accounts audited by an accountant and furnish the report of such audit in the prescribed form duly signed and verified by such accountant along with the return of income.

2. (i) The statement is incorrect, since as per section 195(1), the obligation to deduct tax at source from interest and other payment to non-resident which are chargeable to tax in India, is on "any person responsible for paying to a non-resident or to a foreign company". The words “any person” used in section is intended to include both residents and non-residents. Therefore, if the income of payee non-resident is chargeable to tax, then tax has to be deducted at source, whether the payment is made by a resident or non-resident.

Further, Explanation 2 to section 195(1) also clarifies that the obligation to comply with section 195(1) and to make deduction thereunder applies and shall be deemed to have always applied and extends to all persons, resident or non-resident, whether or not the non-resident has:

(a) a residence or place of business or business connection in India; or

(b) any other presence in any manner whatsoever in India.

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

As per section 10(2A), share of profit received by partner from the total income of firm is exempt from tax. Therefore, the share of profit paid to non-resident Indian is not liable for tax deduction at source.
However, section 195(6) provides that the person responsible for paying any sum, whether or not chargeable to tax, to a non-corporate non-resident or to a foreign company shall be required to furnish the information relating to payment of such sum in the prescribed form and manner.

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

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

3. **Computation of Total Income of Mr. Abhinav for A.Y. 2019-20**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>INR</th>
<th>INR</th>
<th>INR</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Profits &amp; Gains of Business &amp; Profession</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income from partnership firm M/s Lotus &amp; Co., India</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Interest on Capital [See Note (iii)]</td>
<td>5,00,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Share of Profit</td>
<td>4,00,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Less: Exempt under section 10(2A)</td>
<td>(4,00,000)</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>Fees for technical services received from ABC Ltd., India</td>
<td>10,00,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fees for technical services received from Government of Country “Y” [See Note (iii)]</td>
<td>-</td>
<td>15,00,000</td>
<td></td>
</tr>
</tbody>
</table>

**Capital Gains [See Working Note]**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>INR</th>
<th>INR</th>
<th>INR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Short-term capital gain on sale of shares of</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- PQR Pvt. Ltd.</td>
<td>1,500</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Hello Pvt. Ltd</td>
<td>1,80,000</td>
<td>1,81,500</td>
<td></td>
</tr>
<tr>
<td>Long-term capital gain on sale of shares of</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- PQR Pvt. Ltd.</td>
<td>Nil</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Prime Pvt. Ltd.</td>
<td>72,500</td>
<td>72,500</td>
<td>2,54,000</td>
</tr>
</tbody>
</table>

**Income from Other Sources**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>INR</th>
<th>INR</th>
<th>INR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest earned on deposits:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Interest earned on NRO saving deposits</td>
<td>4,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Interest earned on fixed deposits</td>
<td>5,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Interest on NRE savings account [Exempt u/s 10(4)(ii)] [See Note (v)]</td>
<td>-</td>
<td>9,000</td>
<td></td>
</tr>
</tbody>
</table>

**Gross Total Income**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>INR</th>
<th>INR</th>
<th>INR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Life insurance premium for self and his spouse</td>
<td>50,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Term deposit [Five year term deposit]</td>
<td>60,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Repayment of housing loan borrowed for construction of residential house</td>
<td>-</td>
<td>1,10,000</td>
<td></td>
</tr>
</tbody>
</table>

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**Deduction under section 80D [See Note (ix)]**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amounts</th>
</tr>
</thead>
<tbody>
<tr>
<td>Health insurance of self and spouse</td>
<td>20,000</td>
</tr>
<tr>
<td>Health insurance of mother</td>
<td>25,000</td>
</tr>
<tr>
<td>Health insurance of mother</td>
<td>45,000</td>
</tr>
</tbody>
</table>

**Deduction u/s 80TTA [See Note (x)]**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amounts</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>4,000</td>
</tr>
<tr>
<td></td>
<td>1,59,000</td>
</tr>
</tbody>
</table>

**Total Income**

| Total Income | 16,04,000 |

---

**Computation of Tax Liability of Mr. Abhinav for A.Y. 2019-20**

**Particulars** | **INR** | **INR** |
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax@10% on fee for technical services under section 115A</td>
<td>1,00,000</td>
<td></td>
</tr>
<tr>
<td>Tax@10% on long-term capital gain on sale of foreign exchange assets under section 115E</td>
<td>7,250</td>
<td></td>
</tr>
<tr>
<td>Tax on balance income of INR 5,31,500 (i.e., INR 6,90,500 - INR 1,59,000)</td>
<td>18,800</td>
<td></td>
</tr>
<tr>
<td>Add: Health and education cess @4%</td>
<td>5,042</td>
<td></td>
</tr>
<tr>
<td>Tax liability</td>
<td>1,31,092</td>
<td></td>
</tr>
<tr>
<td>Tax liability (rounded off)</td>
<td>1,31,090</td>
<td></td>
</tr>
</tbody>
</table>

**Woking Note:**

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

**Particulars** | **INR** |
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>LTCG on sale of shares of Prime Pvt. Ltd., since held for more than 24 months</td>
<td>12,00,000</td>
</tr>
<tr>
<td>Sale Consideration</td>
<td>12,00,000</td>
</tr>
<tr>
<td>Less: Cost of Acquisition</td>
<td>(6,20,000)</td>
</tr>
<tr>
<td>Long term capital gain</td>
<td>5,80,000</td>
</tr>
<tr>
<td>Less: Exemption under section 115F</td>
<td>(5,07,500)</td>
</tr>
<tr>
<td>Long-term capital gain as per Chapter XII-A</td>
<td>72,500</td>
</tr>
<tr>
<td>STCG on sale of shares of Hello Pvt. Ltd., since held for less than 24 months</td>
<td>9,30,000</td>
</tr>
<tr>
<td>Sale Consideration</td>
<td>9,30,000</td>
</tr>
</tbody>
</table>

---

1 Since the question specifies that the Abhinav has opted for Chapter XII-A, the resultant long-term capital gains would be taxable @10%, after providing for proportional exemption under section 115F, which is available in respect of investment of net consideration in another specified asset, shares of a private company in this case. It would have been more beneficial for Abhinav to have not opted for Chapter XII-A, as he could have claimed exemption of the entire capital gain of INR 5,80,000 under section 54F, since the amount invested in construction of house at Pune exceeds the net sale consideration of INR 12 lakhs on sale of shares of Prime Pvt Ltd.

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Less: Cost of Acquisition

<table>
<thead>
<tr>
<th>Short term Capital Gain</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Provisions of Chapter XII-A are only applicable in respect of long term capital gain from transfer of foreign exchange assets.)</td>
</tr>
</tbody>
</table>

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

<table>
<thead>
<tr>
<th>Particulars</th>
<th>INR</th>
</tr>
</thead>
<tbody>
<tr>
<td>LTCG on sale of 1500 shares acquired on October 1, 2016</td>
<td></td>
</tr>
<tr>
<td>(As per section 2(42A), share of an unlisted company, if sold after period of 24 months from the acquisition date will be considered as long-term capital asset)</td>
<td></td>
</tr>
<tr>
<td>Sale Consideration [1,500 x INR 15]</td>
<td>22,500</td>
</tr>
<tr>
<td>Less: Cost of Acquisition [1,500 x INR 10]</td>
<td>(15,000)</td>
</tr>
<tr>
<td>Long term Capital Gain</td>
<td>7,500</td>
</tr>
<tr>
<td>Less: Exemption u/s 54F [since the amount invested in construction of house at Pune exceeds the net sale consideration of INR 22,500 on sale of shares, the entire capital gain would be exempt. The construction of the house in Pune was completed within the prescribed time i.e., within three years after the date of transfer]</td>
<td>7,500</td>
</tr>
<tr>
<td>STCG on sale of 500 shares acquired on October 31, 2017</td>
<td></td>
</tr>
<tr>
<td>Sale Consideration [500 x INR 15]</td>
<td>7,500</td>
</tr>
<tr>
<td>Less: Cost of Acquisition [500 x INR 12]</td>
<td>(6,000)</td>
</tr>
<tr>
<td>Short term Capital Gain</td>
<td>1,500</td>
</tr>
</tbody>
</table>

Notes:

(i) Mr. Abhinav is a person who, staying outside India, comes on a visit to India every year. Hence, the minimum period of stay in India for Mr. Abhinav to be treated as a resident is 182 days in any previous year. For A.Y.2019-20, Mr. Abhinav is a non-resident since his stay in India in the P.Y.2018-19 is less than 182 days. In case of a non-resident, only income which accrues or arises or is deemed to accrue or arise in India or is received or is deemed to be received in India is taxable in India. Income which accrues or arises outside India is not taxable in India. Rental income from property in Country ‘X’ received there and subsequently brought to India is not taxable in India in the hands of Mr. Abhinav, since it neither accrues to him in India nor is it received by him in India.

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

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

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

(iv) As per section 9(1)(v)(c), interest payable by a non-resident would be deemed to accrue or arise in India, where the interest is payable on any debt incurred, or money borrowed and used, for the...
purpose of a business or profession carried on by such non-resident in India. In the present case, Mr. George, a non-resident had purchased bonds of MNO Ltd., an Indian company out of the money borrowed. Consequently, the interest received by Mr. Abhinav in foreign currency equivalent to INR 1,95,000 will not be taxable in India, since such interest is neither received nor is it deemed to accrue or arise in India. Mr. George is a non-resident in India for A.Y.2019-20 since his stay in India during the P.Y.2018-19 is only 36 days.

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

(vi) Transfer outside India of Rupee denominated bonds of an Indian company issued outside India and Government Securities through an intermediary dealing settlement of securities by Mr. Abhinav, a non-resident, to Mr. Thomas, another non-resident, would not be regarded as a transfer under section 47 for levy of capital gains tax. Thomas is a non-resident since he has stayed in India only for 100 days in the P.Y.2018-19. Being a citizen of India residing in Country “X”, he has to come and stay in India for atleast 182 days in a year to be treated as a resident.

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

(viii) Under section 80C, deduction is allowed for life insurance premium paid for self or spouse or any child, even though such premium is paid outside India. It is assumed that the annual premium is not more than 10% of actual capital sum assured. However, deduction in respect of tuition fees paid by individual to any university, college, school or other educational institution for full time education of his two children would be allowed only if, such institution is situated in India. Thus, payment for life insurance premium paid by Mr. Abhinav is fully allowable as deduction but no deduction would be allowed for annual tuition fees, since it is for education abroad. Further, no deduction is allowable under section 80C for A.Y.2019-20 in respect of repayment of housing loan, since the property in Pune is under-construction and no amount is chargeable to tax as income from house property, during the previous year 2018-19.

(ix) Mr. Abhinav is eligible for deduction of INR 20,000 in respect of health insurance premium of self and spouse, since the same is less than INR 25,000. He is also eligible for deduction in respect of premium paid for insuring the health of his mother, subject to a maximum of INR 25,000. However, he would not be eligible for claiming higher deduction of upto INR 50,000 under section 80D, as applicable to senior citizen, for the insurance on the health of his mother, since she is non-resident. Further, he is not eligible for any deduction in respect of the premium paid to insure the health of his sister, Ms. Geetha, since sister is not included within the definition of “family”.

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

Therefore, interest earned on fixed deposits by Mr. Abhinav shall not be eligible for deduction under section 80TTA.
‘A’ Ltd., an Indian company, was incorporated in the year 2008. 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 2017-18, 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 2017-18 is ₹ 100 crores. The details of the transactions entered into by A Ltd. during F.Y.2017-18 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>80</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>
<tr>
<td>4</td>
<td>Interest-free loan obtained</td>
<td>A Pty, Singapore</td>
<td>50</td>
</tr>
</tbody>
</table>

Prior to F.Y.2017-18, A Ltd. had obtained loan of ₹ 200 crores @8% from A LLC, Cyprus in April, 2016.

The following additional information pertaining to loans obtained by A Ltd. is provided for the previous year 2017-18:

- Interest of ₹ 16 crores paid to A LLC, Cyprus on the loan of ₹ 200 crores, which constituted 52% of the total assets of A Ltd.

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

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

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

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

- A Ltd. obtained interest-free loan of ₹ 50 crores from A Pty, Singapore. 40% of the directors of A Pty., Singapore is appointed by A Ltd.

- A Ltd. obtained foreign currency loan of $ 10 million from Wells Cargo Bank of USA, in USA, based on a back to back deposit made by A Inc. USA to the tune of $ 5 million in the bank. Interest of ₹ 6 crores is paid on such loan.

- A Ltd. obtained foreign currency loan of $ 20 million from Bank of USA, in USA, based on a back to back deposit made by A Inc., USA to the tune of $ 20 million in the bank. Interest works out to ₹ 12 crores.

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

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

I. OBJECTIVE TYPE QUESTIONS

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

1. The provisions relating to limitation of interest deduction in respect of debt issued by a non-resident associated enterprise are not applicable to an Indian company engaged in the business of:

(a) Information Technology

(b) Banking and Insurance

(c) Bio-technology

(d) Aviation

2. The provisions relating to limitation of interest deduction in respect of debt issued by a non-resident associated enterprise would not apply where the expenditure by way of interest or similar nature is -
3. 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.

4. In respect of any payment made to a person located in a Notified Jurisdictional Area (NJA), tax is deductible at higher of the rate specified in the Income-tax Act 1961 or rates in force or -

(a) 10%
(b) 15%
(c) 20%
(d) 30%

5. 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.2017-18, if the guarantee fee declared is -

(a) ₹ 47.50 lakhs
(b) ₹ 90 lakhs
(c) ₹ 95 lakhs
(d) Either (a) or (b)
6. If A Ltd. does not furnish transfer pricing report for F.Y.2017-18, 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

7. Interest paid to non-resident associated enterprise disallowed under the relevant provision of the Income-tax Act, 1961, during the A.Y.2018-19 can be carried forward upto-

(a) A.Y.2022-23

(b) A.Y.2023-24

(c) A.Y.2026-27

(d) Indefinitely

8. 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

9. If the excess money is not repatriated, A Ltd. has to make secondary adjustment in A.Y.2018-19, 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.2017-18 and the amount of primary adjustment is ₹ 1 crore

(c) A.Y.2017-18 and the amount of primary adjustment is ₹ 1.05 crore
10. Which of the following approaches does India follow in relation to secondary adjustments?
(a) Deemed equity approach
(b) Deemed dividend approach
(c) Deemed loan approach
(d) Either (a) or (c)

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.2018-19 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”. (10 Marks)

2. (a) (i) Examine how thin capitalization is an anti-avoidance measure (2 Marks)
(ii) Which Action Plan of BEPS is based on thin capitalization? Mention the provision incorporated in the Income-tax Act, 1961 in line with this Action Plan. (2 Marks)
(iii) 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)

(b) The Assessing Officer has, while carrying out the transfer pricing assessment for Assessment Year 2017-18, arrived at an arm’s length rate interest of 4% on the loan obtained from A LLC Cyprus (Interest paid ₹ 16 crores). Accordingly, he has made a primary adjustment to the tune of ₹ 8 crores for A.Y. 2017-18. In this regard,
(i) You are required to examine whether any secondary adjustment is to made under the relevant provision of the Income-tax Act, 1961 in the A.Y.2018-19, where –
(1) A Ltd has not gone on an appeal on the said matter.

(2) A Ltd. has opted to file an appeal before the CIT (Appeals)

(ii) What would be the consequence if the CIT (Appeals) reduces the primary adjustment to the transfer price made by the Assessing Officer to ₹ 6 crores, by considering the arm’s length interest rate@5% instead of 4%, and the same is accepted by A Ltd.? (4 Marks)

3. (a) On the facts provided, A Ltd makes interest payment to A LLC, Cyprus. While making the interest payment to A LLC, Cyprus, A Ltd had withheld taxes at 10% based on Article 11 of India-Cyprus double taxation avoidance agreement. The Assessing Officer has issued a show cause notice contending that the assessee has deducted tax at a lower rate, based on the view that A LLC, Cyprus is a notified jurisdiction area. You are required to reply to the show cause notice of the Assessing Officer, giving your views. (4 Marks)

| Extract of ARTICLE 11 of DTAA between India and Cyprus |
| INTEREST |
| 1. Interest arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State. |
| 2. However, such interest may also be taxed in the Contracting State in which it arises, and according to the laws of that State, but if the beneficial owner of the interest is a resident of the other Contracting State, the tax so charged shall not exceed 10 percent of the gross amount of the interest. |
| 3. Notwithstanding the provisions of paragraph 2, interest arising in a Contracting State shall be exempt from tax in that State, provided that it is derived and beneficially owned by: |
| (a) the Government, a political sub-division or a local authority of the other Contracting State; or |
| (b) in the case of India, the Reserve Bank of India, the Export-Import bank of India, the National Housing bank; and |
| (c) any other institution as may be agreed upon from time to time between the Competent authorities of the Contracting States through exchange of letters |
| 4. The term “interest” as used in this Article means income from debt claims of every kind, whether or not secured by mortgage and whether or not carrying a right to participate in the debtor’s profits, and in particular, income from government securities and income from bonds or debentures, including premiums and prizes attaching to such securities, bonds or debentures. Penalty charges for late payment shall not be regarded as interest for the purpose of this Article. |
| 5. The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the interest, being a resident of a Contracting State, carries on business in the other |
Contracting State in which the interest arises, through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the debt claim in respect of which the interest is paid is effectively connected with such permanent establishment or fixed base. In such case the provisions of Article 7 or Article 14, as the case may be, shall apply.

6. Interest shall be deemed to arise in a Contracting State when the payer is a resident of that State. Where, however, the person paying the interest, whether he is a resident of a Contracting State or not, has in a Contracting State a permanent establishment or a fixed base in connection with which the indebtedness on which the interest is paid was incurred, and such interest is borne by such permanent establishment or fixed base, then such interest shall be deemed to arise in the State in which the permanent establishment or fixed base is situated.

7. Where, by reason of a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the interest, having regard to the debt claim for which it is paid, exceeds the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship, the provisions of this Article shall apply only to the last mentioned amount. In such case, the excess part of the payments shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of this Agreement.

(b) A Ltd wants to understand whether it can opt for safe harbour rules in order to avoid litigation on transfer pricing related matters, for the intra-group loans that it has taken from its Associated Enterprises. If the answer is in the affirmative, what are the conditions to be satisfied? (3 Marks)

(c) 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)
Mr. Abhinav, a citizen of India, aged 48 years, for the first time, moved for employment purpose to Country “X”, a country outside India, on 1st September, 2013. He was employed with a consulting firm in Country “X”. Since then, he has visited India during the P.Y.2013-14, 2014-15, 2015-16, 2016-17, 2017-18 for 30 days, 50 days, 50 days, 170 days and 150 days, respectively, for both personal and professional purposes. His family comprises of himself, his spouse Mrs. Archana (aged 45 years); his mother, Mrs. Kamala (aged 81 years); and his two sons, Rohan and Kapil, aged 19 years and 15 years, respectively. In addition, Mr. Abhinav’s unmarried sister Ms. Geetha, aged 42 years, is living with his family in Country “X” since September, 2013. Ms. Geetha and Mrs. Kamala have been visiting India during the P.Y.2013-14, 2014-15, 2015-16, 2016-17, 2017-18 for 50 days, 50 days, 120 days, 150 days and 150 days, respectively.

In the year 2016-17, Mr. Abhinav resigned from his job and started his own consultancy in Country “X” for providing technical services. He entered into an agreement with ABC Ltd, an Indian company, on 01.06.2016 and pursuant to the agreement, Fees for Technical Services (FTS) of INR 10,00,000, is payable to Mr. Abhinav every year for a period of five years. The agreement is approved by the Central Government. Mr. Abhinav also entered into an agreement with the Government of Country “Y” for provision of technical services for a period of three years. The FTS payable to Mr. Abhinav every year for a period of three years under this agreement in foreign currency is equivalent to INR 15,00,000.

During the previous year 2016-17, Mr. Abhinav became partner in a partnership firm M/s Lotus & Co., India and contributed INR 50 lakhs towards capital. He was paid interest @10% as interest on capital and profit share of INR 4 lakhs every year by the firm.

His friend Mr. George, a citizen and resident of Country “X”, borrowed money from Mr. Abhinav and invested the same in bonds issued by MNO Ltd., an Indian Company in April, 2017. Mr. George visited India during the P.Y.2017-18 for the period from 10th April, 2017 to 15th May, 2017. During the previous year 2017-18, interest on borrowings in foreign currency equivalent to INR 1,95,000 was paid by Mr. George to Mr. Abhinav in his bank account in Country “X”.

Mr. Abhinav also earned income of foreign currency equivalent to INR 3,00,000 from his house property in Country ‘X’ deposited in an Indian Bank at Country ‘X’ and subsequently brought to India. Also, he had paid property tax of foreign currency equivalent to INR 3,000 on the said property. During the previous year 2017-18, the rental income earned was invested in deposits in India in the ratio of 30:20:50 in NRO savings
account, 5 year fixed deposits and NRE savings account. Interest earned on such deposits is INR 4,000, 5,000 and 9,000, respectively.

On 30.06.2017, he sold shares of Prime Pvt. Ltd., India for INR 12,00,000 and of Hello Pvt. Ltd., India for INR 9,30,000 net of transfer expenses. These shares were purchased by him in convertible foreign currency on 01.12.2014 at a cost of INR 6,20,000 and on 01.01.2017 at a cost of INR 7,50,000 respectively. On 31.10.2017, he invested the sale proceeds of INR 10,50,000 in purchase of shares of Cheers Pvt. Ltd., India.

Further, on 01.12.2017, Mr. Abhinav sold 2000 shares of PQR Pvt. Ltd., India, for INR 15 each. 1500 of such shares were acquired on 01.10.2015 @ INR 10 each and 500 shares were acquired on 31.10.2016 @INR 12 each.

In April, 2017, he had taken a loan of INR 50 lakhs @10% from SBI for construction of residential house in Pune. The construction is completed in May, 2018. He prepaid INR 3 lakhs in March, 2018 to the bank.

He had also purchased the following capital assets in April, 2017 and he transferred the same outside India to Mr. Thomas, a resident of Country “X”, in March, 2018 –

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

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

Mrs. Archana, a painter by profession, earned income of INR 3,00,000 from exhibition conducted in Mumbai. Rohan and Kapil are pursuing education in Country ‘X’. Mr. Abhinav paid foreign currency equivalent to INR 60,000 to Catheral School, Country ‘X,’ towards their annual tuition fees. Kapil won an excellence award of INR 25,000 at the Science Olympiad held in Mumbai in February, 2018.

Mr. Abhinav paid foreign currency equivalent to INR 50,000 to an Insurance Company in Country ‘X’ towards life insurance premium to insure his life and life of Mrs. Archana. Mr. Abhinav has also paid INR 20,000 to New India Assurance Company, India, for health insurance of himself and Mrs. Archana, INR 35,000 to insure health of Mrs. Kamala and INR 25,000 to insure the health of Ms. Geetha.
Based on the above facts, you are required to answer the following questions.

**OBJECTIVE TYPE QUESTIONS**

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

1. Based on the above facts, Mr. Abhinav’s residential status in India for P.Y.2017-18 and P.Y.2013-14 is -
   (a) Non-resident for both the years
   (b) Non-resident for P.Y.2017-18 and Resident but not ordinarily resident for P.Y.2013-14
   (c) Resident but not ordinarily resident for P.Y.2017-18 and Resident for P.Y.2013-14
   (d) Non-resident for P.Y.2017-18 and Resident and ordinarily resident for P.Y.2013-14.

   *(Note – Assume that the rules for determining residential status for A.Y.2014-15 were the same as it is for A.Y.2018-19)*

2. Which of the following benefits are not allowable to Ms. Geetha, while computing her total income and tax liability for A.Y.2018-19 under the Income-tax Act, 1961?
   (a) Deduction of 30% of gross annual value while computing her income from house property in Bangalore, India
   (b) Tax rebate of INR 2,500 from tax payable on her total income of INR 3,40,000
   (c) Deduction for donation made by her to Prime Minister’s National Relief Fund
   (d) Deduction for interest earned by her on NRO savings account.

3. Unexhausted basic exemption limit, if any, of Mr. Thomas, for A.Y.2018-19 can be adjusted against –
   (a) Only LTCG taxable@20%
   (b) Only STCG taxable@15%
   (c) Both (a) and (b)
   (d) Neither (a) nor (b)

4. Had Ms. Geetha been seconded on employment outside India by the Indian Government, which of the following emoluments paid to her by the Indian Government shall be taxable under the Income-tax Act, 1961?
   (a) Basic Salary paid outside India

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(b) Allowances and Perquisites paid outside India

(c) Both (a) and (b), since emoluments are paid to her by the Indian Government

(d) Neither (a) nor (b), since she has rendered services outside India

5. Ms. Geetha is an enthusiastic sports person and is keen on contributing an article on a game of Soccer in a leading newspaper in India. She approaches you to enquire on taxability of such income for A.Y.2018-19. As per the provisions of Income-tax Act, 1961, such income shall be taxable in her hands at -

(a) 5%

(b) 10%

(c) 20%

(d) Normal tax slab rates

(Note – The above tax rates are excluding cess and surcharge, if any)

6. Ms. Geetha shall be mandatorily required to file return of income in India for A.Y.2018-19, -

(a) if she holds assets outside India even though she does not have taxable income in India

(b) if she has income exceeding the basic exemption limit but after taking into account deduction under Chapter VI-A, her income falls below the basic exemption limit

(c) if she has income, without giving effect to deduction under Chapter VI-A, below the basic exemption limit and tax credit appearing in Form 26AS, in respect of which she does not wish to claim the refund

(d) in all the above situations

7. In December, 2014, Ms. Geetha bought, in foreign currency, 500 Global Depository Receipts of PQR Ltd, an Indian Company, which were issued in accordance with the notified scheme of the Central Government. In January, 2018, she sold 300 GDRs outside India to Mr. Frank, a citizen and resident of Country ‘X’ and 200 GDRs to Mr. Kamal, a Resident but not ordinarily resident in India. Comment on the tax consequences of such sale transaction under the Income-tax Act, 1961 -

(a) Capital gains arising on sale of 500 GDRs shall be subject to tax @20% with indexation benefit in India

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(b) No capital gains would arise on sale of 500 GDRs in India, since the GDRs are purchased in foreign currency

(c) No capital gains would arise on sale of 300 GDRs, but capital gains arising on sale of 200 GDRs shall be taxed in India @10% without indexation benefit

(d) No capital gains would arise on sale of 300 GDRs, but capital gains arising on sale of 200 GDRs shall be taxed @20% with indexation benefit in India

8. Benefit of presumptive taxation under the Income-tax Act, 1961 would not be available to Mr. George for A.Y.2018-19, in respect of the related Indian income, if he is engaged in the business of -

(a) Operation of Ships

(b) Operation of Aircrafts

(c) Civil Construction in connection with an approved turnkey project

(d) Plying, hiring or leasing of goods carriages.

9. Interest income earned by Mr. George during the P.Y.2017-18 on bonds, issued by MNO Ltd., an Indian company, under a scheme notified by the Central Government, which were purchased by him in convertible foreign currency, is -

(a) taxable@10%

(b) taxable@15%

(c) taxable@20%

(d) not taxable

(Note – The above tax rates are excluding cess and surcharge, if any)

10. An agent, in relation to income which is deemed to accrue or arise in India to a non-resident, is considered as a representative assessee. However, an agent, in relation to a non-resident person does not include -

(a) An employee in India of the non-resident

(b) A trustee in India of the non-resident

(c) A broker in India dealing with the non-resident person only through a non-resident broker, where both non-residents carry on transactions in the ordinary course of business

(d) A person in India having business connection with the non-resident

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DESCRIPTIVE QUESTIONS

1. (i) Examine the tax consequence of fees for technical services (FTS) received by Mr. Abhinav, a resident of Country “X”, from ABC Ltd. for Assessment Year 2018-19, if -
   (a) India has no Double Tax Avoidance Agreement (DTAA) with Country “X”
   (b) India has a DTAA with Country “X”, which provides for taxation of such FTS @5%.
   (c) India has a DTAA with Country “X”, which provides for taxation of such FTS @15%.
   (3 Marks)

(ii) In case Mr. Abhinav fails to furnish the PAN details to ABC Ltd., at what rate should ABC Ltd. deduct tax at source, considering that Mr. Abhinav is a resident of a Country ‘X’, with which India has no DTAA?
   (4 Marks)

(iii) If Mr. Abhinav has a fixed place of profession in India and the contract in respect of FTS with ABC Ltd. is effectively connected with such fixed pace of profession in India, how would the FTS be computed in such a case and what are the related requirements under the Income-tax Act, 1961?
   (3 Marks)

2. (i) Chapter XVII-B requires tax deduction at source by a resident making payment to either a resident or a non-resident. It does not require tax deduction at source by non-residents, who do not have any place of business or business connection in India. Examine the correctness or otherwise of this statement.
   (3 Marks)

(ii) As a tax consultant for M/s Lotus & Co., India, you need to advise the firm regarding tax deduction at source on the payments (i.e. interest on capital and share of profit) made to Mr. Abhinav during the previous year 2017-18, considering that Mr. Abhinav is a resident of Country ‘X’, with which India has no DTAA. In case tax is not deductible at source, is there any other related requirement to be complied with by the firm?
   (4 Marks)

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

3. Using the information given in the facts of the case, compute Mr. Abhinav’s total income and tax liability for the Assessment Year 2018-19, assuming that he is a resident of Country X, with which India has no DTAA and he opts for computing his income in accordance with the provisions of Chapter XII-A of the Income-tax Act, 1961. You may ignore the amount of advance tax and TDS credit appearing in Form 26AS. Also, ignore the effect of first proviso to section 48, wherever applicable.
   (10 Marks)
EXHIBIT I

COST INFLATION INDICES

<table>
<thead>
<tr>
<th>Financial Year</th>
<th>Cost Inflation Index</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001-02</td>
<td>100</td>
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<tr>
<td>2002-03</td>
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<td>2015-16</td>
<td>254</td>
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<tr>
<td>2016-17</td>
<td>264</td>
</tr>
<tr>
<td>2017-18</td>
<td>272</td>
</tr>
</tbody>
</table>

EXHIBIT - II

PART II OF THE FIRST SCHEDULE TO THE FINANCE ACT, 2017

RATES FOR DEDUCTION OF TAX AT SOURCE IN CERTAIN CASES
In every case in which under the provisions of sections 193, 194, 194A, 194B, 194BB, 194D, 194LBA, 194LBB, 194LBC and 195 of the Income-tax Act, tax is to be deducted at the rates in force, deduction shall be made from the income subject to the deduction at the following rates:—
### I. In the case of a person other than a company—

**Rate of income-tax**

<table>
<thead>
<tr>
<th>Description</th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) where the person is resident in India—</td>
<td></td>
</tr>
<tr>
<td>(i) on income by way of interest other than &quot;Interest on securities&quot;</td>
<td>10 per cent;</td>
</tr>
<tr>
<td>(ii) on income by way of winnings from lotteries, crossword puzzles, card games and other games of any sort</td>
<td>30 per cent;</td>
</tr>
<tr>
<td>(iii) on income by way of winnings from horse races</td>
<td>30 per cent;</td>
</tr>
<tr>
<td>(iv) on income by way of insurance commission</td>
<td>5 per cent;</td>
</tr>
<tr>
<td>(v) on income by way of interest payable on—</td>
<td></td>
</tr>
<tr>
<td>(A) any debentures or securities for money issued by or on behalf of any local authority or a corporation established by a Central, State or Provincial Act;</td>
<td></td>
</tr>
<tr>
<td>(B) any debentures issued by a company where such debentures are listed on a recognised stock exchange in India in accordance with the Securities Contracts (Regulation) Act, 1956 (42 of 1956) and any rules made thereunder;</td>
<td></td>
</tr>
<tr>
<td>(C) any security of the Central or State Government;</td>
<td></td>
</tr>
<tr>
<td>(vi) on any other income</td>
<td>10 per cent;</td>
</tr>
<tr>
<td>(b) where the person is not resident in India—</td>
<td></td>
</tr>
<tr>
<td>(i) in the case of a non-resident Indian—</td>
<td></td>
</tr>
<tr>
<td>(A) on any investment income</td>
<td>20 per cent;</td>
</tr>
<tr>
<td>(B) on income by way of long-term capital gains referred to in section 115E or sub-clause (iii) of clause (c) of sub-section (1) of section 112</td>
<td>10 per cent;</td>
</tr>
<tr>
<td>(C) on income by way of short-term capital gains referred to in section 111A</td>
<td>15 per cent;</td>
</tr>
<tr>
<td>(D) on other income by way of long-term capital gains [not being long-term capital gains referred to in clauses (33), (36) and (38) of section 10]</td>
<td>20 per cent;</td>
</tr>
<tr>
<td>(E) on income by way of interest payable by Government or an Indian concern on moneys borrowed or debt incurred by Government or the Indian concern in foreign currency (not being income by way of interest referred to in section 194LB or section 194LC)</td>
<td>20 per cent;</td>
</tr>
<tr>
<td>(F) on income by way of royalty payable by Government or an Indian concern in pursuance of an agreement made by it with the Government or the Indian concern where such royalty is in consideration for the transfer of all or any rights (including the granting of a licence) in respect of copyright in any book on a subject referred to in the first proviso to sub-section (1A) of section 115A of the Income-tax Act, to the Indian concern, or in respect of any computer software referred to in the second proviso to sub-section (1A) of section 115A of the Income-tax Act, to a person resident in India</td>
<td>10 per cent;</td>
</tr>
<tr>
<td>(G) on income by way of royalty [not being royalty of the nature of individual's personal services]</td>
<td>10 per cent;</td>
</tr>
</tbody>
</table>
referred to in sub-item (b)(i)(F)] payable by Government or an Indian concern in pursuance of an agreement made by it with the Government or the Indian concern and where such agreement is with an Indian concern, the agreement is approved by the Central Government or where it relates to a matter included in the industrial policy, for the time being in force, of the Government of India, the agreement is in accordance with that policy

(H) on income by way of fees for technical services payable by Government or an Indian concern in pursuance of an agreement made by it with the Government or the Indian concern and where such agreement is with an Indian concern, the agreement is approved by the Central Government or where it relates to a matter included in the industrial policy, for the time being in force, of the Government of India, the agreement is in accordance with that policy 10 per cent;

(I) on income by way of winnings from lotteries, crossword puzzles, card games and other games of any sort 30 per cent;

(J) on income by way of winnings from horse races 30 per cent;

(K) on the whole of the other income 30 per cent;

(ii) in the case of any other person—

(A) on income by way of interest payable by Government or an Indian concern on moneys borrowed or debt incurred by Government or the Indian concern in foreign currency (not being income by way of interest referred to in section 194LB or section 194LC) 20 per cent;

(B) on income by way of royalty payable by Government or an Indian concern in pursuance of an agreement made by it with the Government or the Indian concern where such royalty is in consideration for the transfer of all or any rights (including the granting of a licence) in respect of copyright in any book on a subject referred to in the first proviso to sub-section (1A) of section 115A of the Income-tax Act, to the Indian concern, or in respect of any computer software referred to in the second proviso to sub-section (1A) of section 115A of the Income-tax Act, to a person resident in India 10 per cent;

(C) on income by way of royalty [not being royalty of the nature referred to in sub-item (b)(ii)(B)] payable by Government or an Indian concern in pursuance of an agreement made by it with the Government or the Indian concern and where such agreement is with an Indian concern, the agreement is approved by the Central Government or where it relates to a matter included in the industrial policy, for the time being in force, of the Government of India, the agreement is in accordance with that policy 10 per cent;

(D) on income by way of fees for technical services payable by Government or an Indian concern in pursuance of an agreement made by it with the Government or the Indian concern and where such agreement is with an Indian concern, the agreement is approved by the Central Government or where it relates to a
matter included in the industrial policy, for the time being in force, of the Government of India, the agreement is in accordance with that policy

(E) on income by way of winnings from lotteries, crossword puzzles, card games and other games of any sort 30 per cent;

(F) on income by way of winnings from horse races 30 per cent;

(G) on income by way of short-term capital gains referred to in section 111A 15 per cent;

(H) on income by way of long-term capital gains referred to in sub-clause (iii) of clause (c) of sub-section (1) of section 112 10 per cent;

(I) on income by way of other long-term capital gains [not being long-term capital gains referred to in clauses (33), (36) and (38) of section 10] 20 per cent;

(J) on the whole of the other income 30 per cent;

2. In the case of a company—

(a) where the company is a domestic company—

(i) on income by way of interest other than "Interest on securities" 10 per cent;

(ii) on income by way of winnings from lotteries, crossword puzzles, card games and other games of any sort 30 per cent;

(iii) on income by way of winnings from horse races 30 per cent;

(iv) on any other income 10 per cent;

(b) where the company is not a domestic company—

(i) on income by way of winnings from lotteries, crossword puzzles, card games and other games of any sort 30 per cent;

(ii) on income by way of winnings from horse races 30 per cent;

(iii) on income by way of interest payable by Government or an Indian concern on moneys borrowed or debt incurred by Government or the Indian concern in foreign currency (not being income by way of interest referred to in section 194LB or section 194LC) 20 per cent;

(iv) on income by way of royalty payable by Government or an Indian concern in pursuance of an agreement made by it with the Government or the Indian concern after the 31st day of March, 1976 where such royalty is in consideration for the transfer of all or any rights (including the granting of a licence) in respect of copyright in any book on a subject referred to in the first proviso to sub-section (1A) of section 115A of the Income-tax Act, to the Indian concern, or in respect of any computer software referred to in the second proviso to sub-section (1A) of section 115A of the Income-tax Act, to a person resident in India 10 per cent;

(v) on income by way of royalty [not being royalty of the nature referred to in sub-item (b)(iv)] payable by Government or an Indian concern in pursuance of an agreement made by it with the Government or the Indian concern and where such agreement is with an Indian concern, the agreement is approved by the Central Government or where it relates to a matter
included in the industrial policy, for the time being in force, of the Government of India, the agreement is in accordance with that policy—

(A) where the agreement is made after the 31st day of March, 1961 but before the 1st day of April, 1976 50 per cent;

(B) where the agreement is made after the 31st day of March, 1976 10 per cent;

(vi) on income by way of fees for technical services payable by Government or an Indian concern in pursuance of an agreement made by it with the Government or the Indian concern and where such agreement is with an Indian concern, the agreement is approved by the Central Government or where it relates to a matter included in the industrial policy, for the time being in force, of the Government of India, the agreement is in accordance with that policy—

(A) where the agreement is made after the 29th day of February, 1964 but before the 1st day of April, 1976 50 per cent;

(B) where the agreement is made after the 31st day of March, 1976 10 per cent;

(vii) on income by way of short-term capital gains referred to in section 111A 15 per cent;

(viii) on income by way of long-term capital gains referred to in sub-clause (iii) of clause (c) of sub-section (1) of section 112 10 per cent;

(ix) on income by way of other long-term capital gains [not being long-term capital gains referred to in clauses (33), (36) and (38) of section 10] 20 per cent;

(x) on any other income 40 per cent

Explanation.—For the purposes of item 1(b)(i) of this Part, "investment income" and "non-resident Indian" shall have the meanings assigned to them in Chapter XII-A of the Income-tax Act.

Surcharge on income-tax

The amount of income-tax deducted in accordance with the provisions of—

(i) item 1 of this Part, shall be increased by a surcharge, for the purposes of the Union,—

(a) in the case of every individual or Hindu undivided family or association of persons or body of individuals, whether incorporated or not, or every artificial juridical person referred to in sub-clause (vii) of clause (31) of section 2 of the Income-tax Act, being a non-resident, calculated,—

I. at the rate of ten per cent of such tax, where the income or the aggregate of such incomes paid or likely to be paid and subject to the deduction exceeds fifty lakh rupees but does not exceed one crore rupees;

II. at the rate of fifteen per cent of such tax, where the income or the aggregate of such incomes paid or likely to be paid and subject to the deduction exceeds one crore rupees; and

(b) in the case of every co-operative society or firm, being a non-resident, calculated at the rate of twelve per cent, where the income or the aggregate of such incomes paid or likely to be paid and subject to the deduction exceeds one crore rupees;

(ii) item 2 of this Part shall be increased by a surcharge, for purposes of the Union, in the case of every company other than a domestic company, calculated,—

(a) at the rate of two per cent of such income-tax where the income or the aggregate of such incomes paid or likely to be paid and subject to the deduction exceeds one crore rupees but does not exceed ten crore rupees; and

(b) at the rate of five per cent of such income-tax where the income or the aggregate of such incomes paid or likely to be paid and subject to the deduction exceeds ten crore rupees.
CASE STUDY - 3

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, 2018 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 5\textsuperscript{th} February, 2018 and left on 30\textsuperscript{th} March, 2018 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 31.3.2018. 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, 2018. 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 2017-18 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.2018-19.

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 2017-18 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.2018-19 and the rate at which such income would be subject to tax.

Assignment 4 [Client – PQR Bank Ltd.]

PQR Bank Ltd. carrying on banking business is incorporated in Country Z. It has branches in different countries including India. During the financial year 2017-18, the Indian branch of the bank paid interest of Rs. 35 lakhs and Rs. 17 lakhs, respectively, to its head office in Country Z and to the branch office in Country N. It wants to know whether interest so paid shall be liable to tax in India in the hands of head office and Country N branch.

Assignment 5 [Client – Mahesh Sharma]

Mahesh Sharma, a citizen of India, is a musician deriving income of Rs. 12,00,000 from concerts performed in Country P. Tax of Rs. 3,36,000 was deducted at source in Country P. His income in India amounted to Rs. 45,00,000. He has deposited Rs. 75,000 in Public Provident Fund and paid medical insurance premium in respect of his father, aged 65 years, Rs. 32,000. He spent Rs. 50,000 on medical treatment of his handicapped sister, dependent on him. His father has not travelled outside India for the last 3 years. Mahesh Sharma visited Country P from 19th February, 2018 to 13th March, 2018 for giving concerts. He also visited Country S on a vacation from 2nd January, 2018 to 21st January, 2018. For the rest of the year he stays in India. He wants to know his tax liability for A.Y.2018-19.

Note - India does not have any double tax avoidance agreement with Countries L, N, P, X, Y & Z.

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. In respect of income earned by Mr. Harry Smith in India –
   (a) Tax is deductible at source at the rates in force under section 195
   (b) Tax is deductible at source @30% plus cess on income from horse races and at the rates in force under section 195 on other income.
   (c) Tax is deductible at source @30% plus cess on income from horse races and @20% plus cess on other income
   (d) Tax is deductible at source @30% plus cess on income from horse races and income from advertisement of a product on TV, 20% plus cess on income from participation in international swimming competition in India and no tax is deductible at source on income from contribution of articles relating to swimming in India.

2. 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.2018-19?
   (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

3. If Harry Smith had been a match referee instead of a swimmer, then, in respect of income earned by him in India (assuming the other facts remain the same) –
   (a) Tax is deductible at source at the rates in force under section 195
   (b) Tax is deductible at source @30% plus cess on income from horse races and at the rates in force under section 195 on other income.
   (c) Tax is deductible at source @30% plus cess on income from horse races and @20% plus cess on other income
   (d) Tax is deductible at source @30% plus cess on income from horse races and advertisement of a product on TV, 20% plus cess on income from participation in
4. 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.

5. The effective rate of income-tax applicable on total income of M/s. Pacific Airlines is –
   (a) 42.024%
   (b) 44.084%
   (c) 43.26%
   (d) 46.144%

6. 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

7. If Country L is a notified jurisdictional area (NJA), then, the rate at which interest receivable from India Infradebt Ltd. is taxable in the hands of Mr. Vallish and the rate at which tax has to be deducted at source on such income are –

<table>
<thead>
<tr>
<th></th>
<th>Tax rate</th>
<th>TDS rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a)</td>
<td>5%</td>
<td>30%</td>
</tr>
<tr>
<td>(b)</td>
<td>5%</td>
<td>5%</td>
</tr>
<tr>
<td>(c)</td>
<td>30%</td>
<td>30%</td>
</tr>
<tr>
<td>(d)</td>
<td>30%</td>
<td>5%</td>
</tr>
</tbody>
</table>

Note – The above rates are exclusive of cess.

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8. 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, 2017. 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.2017-18 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.

9. On the subject of principles of interpretation of tax treaties, match the principles given in Column A with the description/examples given in Column B and choose the correct option:

<table>
<thead>
<tr>
<th>Column A</th>
<th>Column B</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) Subjective Interpretation</td>
<td>(I) Such interpretation should not be done if it defeats the primary objective of the tax treaty as far as the particular item under consideration is concerned.</td>
</tr>
<tr>
<td>(ii) Purposive Interpretation</td>
<td>(II) Article 32 of Vienna Convention embodies this principle</td>
</tr>
<tr>
<td>(iii) Contemporanea Expositio</td>
<td>(III) Speeches of Finance Ministers of India can be relied upon to find out the common intent at the time of signing the treaties</td>
</tr>
<tr>
<td>(iv) Liberal Construction</td>
<td>(IV) The fact that treaties are entered into for promoting mutual trade and investment needs to be kept in mind while interpreting a treaty</td>
</tr>
<tr>
<td></td>
<td>(V) Any term used in the treaty has to be interpreted according to their plain and natural meaning</td>
</tr>
<tr>
<td></td>
<td>(VI) A treaty should be interpreted in a manner to have effect rather than to make it ineffective.</td>
</tr>
</tbody>
</table>
10. On the subject of BEPS Action Plans, match the BEPS Action Plans given in Column A with the description/examples given in Column B and choose the correct option:

<table>
<thead>
<tr>
<th>Column A</th>
<th>Column B</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) Action Plan 5</td>
<td>(I) Controlled Foreign Corporation Rules not incorporated in the Income-tax law</td>
</tr>
<tr>
<td>(iii) Action Plan 13</td>
<td>(III) Special tax regime incorporated in the Income-tax Act, 1961 for taxation of royalty income from patents developed and registered in India</td>
</tr>
<tr>
<td>(v)</td>
<td>(V) CBC Reporting requirement incorporated in the Income-tax Act, 1961</td>
</tr>
<tr>
<td>(VI)</td>
<td>(VI) Limitation of Benefits Clause incorporated in select tax treaties for taxing capital gains on transfer of shares of an Indian company</td>
</tr>
<tr>
<td>(VII)</td>
<td>(VII) Equalisation Levy introduced in Indian tax regime.</td>
</tr>
<tr>
<td>(VIII)</td>
<td>(VIII) Incorporation of secondary adjustment in transfer pricing regime</td>
</tr>
</tbody>
</table>

(a) (i)→(VIII) (ii)→(V) (iii)→(IV) (iv)→(II)  
(b) (i)→(III) (ii)→(I) (iii)→(V) (iv)→(II)  
(c) (i)→(III) (ii)→(I) (iii)→(VIII) (iv)→(II)  
(d) (i)→(III) (ii)→(V) (iii)→(VIII) (iv)→(II)
DESCRIPTIVE QUESTIONS

1. (a) Compute the income-tax liability of Mr. Harry Smith and Ms. Rita Smith for A.Y.2018-19.  
(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)

(c) Examine whether the interest paid by Indian branch of PQR Bank to its head office in Country Z and branch office is Country N is liable to tax in India in the hands of the head office and Country N branch.  
(3 Marks)

3. (a) Determine the tax liability of Mr. Mahesh Sharma for A.Y.2018-19.  
(6 Marks)

(b) Mr. Vallish is in receipt of income of Rs.2,45,000 being income distributed by a REIT. The components of income are as follows:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) Rental Income from real estate property owned by REIT</td>
<td>1,25,000</td>
</tr>
<tr>
<td>(ii) Interest Income of REIT from A Ltd.</td>
<td>62,000</td>
</tr>
<tr>
<td>(iii) Dividend Income of REIT from A Ltd.</td>
<td>58,000</td>
</tr>
</tbody>
</table>

A Ltd. is an Indian company in which the REIT holds controlling interest. The REIT holds 100% of shareholding of A Ltd.

Examine whether the above components of the income distributed by REIT would be chargeable to tax in the hands of Mr. Vallish. Also, examine whether the REIT is required to deduct tax at source on such income distributed to Mr. Vallish.  
(6 Marks)
M/s. Vaish & Co., an Indian firm, is a leading Delhi-based international tax consultant, specializing in transfer pricing assignments. The following are the details pertaining to some of its assignments:

(1) ABC Ltd., an Indian Company, supplied steel manufactured by it to ABC Inc., Country A during the previous year 2017-18. ABC Limited also supplied the same product to another Country A based company, PQR Inc. The transactions with ABC Inc. are priced at Euro 800 per MT (FOB), whereas the transactions with PQR Inc. are priced at Euro 1200 per MT (CIF). Insurance and Freight amounts to Euro 400 per MT. ABC Ltd. wants to know if transfer pricing provisions would be attracted in such a case.

(2) Sigma Ltd., operating in India, is one of the dealers for the goods manufactured by Epsilon Ltd., Country B. During the course of assessment, the Assessing Officer, after verification of transactions between Sigma Ltd. and Epsilon Ltd., opined that transfer pricing provisions would become applicable in this case. The Assessing Officer adjusted the total income of Sigma Ltd. by making an addition of Rs.2 crore to the declared income of Rs.6 crore for A.Y.2018-19. It also issued show cause notice asking the company to explain why penalty should not be levied for failure to report such transactions and maintain the requisite records. Sigma Ltd is of the opinion that transfer pricing provisions would not be applicable in its case and hence, there is no question of levy of such penalty. Sigma Ltd. wants to know the lines in which reply needs to be given to the show cause notice.

(3) XYZ Motors Ltd., an Indian company declared business income of Rs.585 crores computed in accordance with Chapter IV-D of the Income-tax Act, 1961 but before making transfer pricing adjustments in respect of the following transactions for the year ended on 31.3.2018:

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

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

(iii) Royalty of $ 80,00,000 was paid to RST Ltd., Country C, for use of technical know-how in the manufacturing of van. However, RST Ltd. had provided the same know-how to Birla Motors Ltd. for $ 60,00,000.
(iv) Loan of Euro 74 crores carrying interest @8% p.a. advanced by HIT Ltd., a Country D company, was outstanding on 31.3.2018. The said Country D company had also advanced a loan of similar amount to Aravalli Ltd. @7% p.a. Total interest paid for the year was EURO 5.92 crores.

XYZ Motors Ltd. wants to know the provisions of the Income-tax Act, 1961 affecting all these transactions. It also wants to know its business income chargeable to tax for A.Y.2018-19.

(4) OMR Limited, an Indian company, is engaged in manufacturing electronic components. OMR Limited has borrowed Country L $ equivalent to Rs.200 lakhs from Omega Inc., a Country L based company at LIBOR plus 200 points. The LIBOR prevalent at the time of borrowing is 5% for Country L $. The borrowings allowed under the External Commercial Borrowings guidelines issued under Foreign Exchange Management Act are LIBOR plus 300 basis points. OMR Limited wants to know whether transfer pricing provisions are attracted in respect of this transaction.

(5) 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.2017-18 is Rs.87 crore. The operating expenses incurred are Rs.68 crore. It has declared operating profit of Rs.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.2017-18 is Rs.25 crore. The operating expenses incurred are Rs.18 crores. It has declared operating profit of Rs.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.2017-18 is Rs.192 crore. The operating expenses incurred are Rs.160 crores. It has declared operating profit of Rs.32 crore.

Based on the facts given above and the exhibits 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 1000 units of non-core auto components to Mr. Rajiv, an unrelated party, on 13.7.2017, and Mr. Rajiv had entered into an agreement for sale of such components with Gigo Inc. on 8.7.2017, 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.2016-17. The company decides to make an application for roll back of the said APA. However, rollback provision shall not be available in respect of the said transaction for a rollback year, if–

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

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

(iii) determination of the arm’s length price of the said transactions for the said year has been the subject matter of appeal before the Appellate Tribunal and the Appellate Tribunal has passed an order disposing of such appeal at any time before signing of the agreement
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.2018-19 has increased by Rs.2 crores due to application of arm’s length price by the Assessing Officer, and the same has been accepted by Fulcrum Ltd., then, -

(a) business loss of A.Y.2017-18 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.2012-13 cannot be set-off against the enhanced income
(d) business loss referred to in (a) above, deductions referred to in (b) above and unabsorbed depreciation referred to in (c) above cannot be set-off against the enhanced income.

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

(a) is not required to be repatriated if the said increase is as per the safe harbor rules
(b) is not required to be repatriated if the said increase is determined by an advance pricing agreement
(c) need not be repatriated in both cases (a) and (b) mentioned above. However, had the increase been made by the Assessing Officer during the course of assessment, the same has to be repatriated failing which it would be treated as a deemed advance.
(d) has to be repatriated in both cases (a) and (b) mentioned above, failing which the same would be treated as a deemed advance.

6 Which of the following pairs of companies are Associated Enterprises/deemed to be associated enterprises?

(i) ABC Ltd. & ABC Inc.
(ii) Satpura Ltd. & Sigma Ltd.
(iii) XYZ Motors Ltd. & RST Ltd.
(iv) XYZ Motors Ltd. & HIT Ltd.

The correct answer is -

(a) Only (i) above
(b) (i) and (ii) above
7 If Himalaya Ltd. has two Units, Unit 1 is engaged in power generation business and Unit 2 is engaged in manufacture of wires. Both the units were set up in Himachal Pradesh in the year 2014. In the year 2017-18, fourteen lakh metres of wire are transferred from Unit 2 to Unit 1 at Rs.150 per metre when the market price per metre was Rs.200. Which of the following statements is correct?

(a) Transfer pricing provisions would be attracted in this case
(b) Transfer pricing provisions would not be attracted in this case, since Unit 1 and Unit 2 belong to the same company and are not associated enterprises.
(c) Transfer pricing provisions would not be attracted in this case as it is not an international transaction as both the Units are in India. For the purpose of Chapter VIA deduction, the profits of power generation business shall, however, be computed as if the transfer has been made at the market value of Rs.200 per MT.
(d) Transfer pricing provisions would not be attracted in this case due to reasons mentioned in both (b) and (c) above.

8 Ram, an individual aged 35 years resident in India, bought 3,000 equity shares of Rs.10 each of ABC Ltd. at Rs.70 per share on 1.6.2017. He sold 1800 equity shares at Rs.50 per share on 3.11.2017 and the remaining 1200 shares at Rs.60 per share on 23.3.2018. ABC Ltd. declared a dividend of 40%, the record date being 14.8.2017. On 15.3.2018, Ram sold a house from which he derived a long-term capital gain of Rs.1,25,000. Assuming Ram’s interest income from bank fixed deposit is Rs.3,00,000, his tax liability (rounded off) for A.Y.2018-19 would be -

(a) 18,440
(b) 18,810
(c) 19,920
(d) 19,410

9 Which of the following is not an eligible international transaction for application of safe harbor rules?

(i) Preparation of user documentation
(ii) Receipt of intra-group loans where the amount of loan is denominated in Indian rupees
(iii) Providing implicit corporate guarantee
(iv) Purchase and export of core auto components
(v) Receipt of intra-group services from group member

(a) Only (ii)
(b) (ii) and (v)
(c) (ii), (iv) and (v)
(d) (ii), (iii), (iv) and (v)
Let us consider two hypothetical cases -

Case 1: Ganga Ltd., Yamuna Ltd. and Saraswati Ltd. amalgamate to form Ganga Ltd.

Case 2: Ganga Ltd., Yamuna Ltd. and Saraswati Ltd. merge to form new company, Triveni Sangam Ltd.

Which companies are eligible to apply for rollback provisions post amalgamation/merger in the above cases, assuming that all other conditions are satisfied?

(a) In Cases 1 & 2: Ganga Ltd., Yamuna Ltd. and Saraswati Ltd.

(b) In Case 1: Ganga Ltd and in Case 2: Ganga Ltd., Yamuna Ltd. and Saraswati Ltd.

(c) In Case 1: Ganga Ltd., Yamuna Ltd. and Saraswati Ltd. and in Case 2, None.

(d) In Case 1: Ganga Ltd. and in Case 2, None.

II. DESCRIPTIVE QUESTIONS

1. (i) Would transfer pricing provisions be attracted in respect of the transaction of supply of steel by ABC Ltd. to ABC Inc.? If so, compute the arm’s length price of such transaction. (4 Marks)

(ii) Examine whether transfer pricing provisions would be attracted in respect of transactions between Sigma Ltd. and Epsilon Ltd. If so, what is the penalty leviable for defaults, if any, by Sigma Ltd. in compliance of the requisite provisions under the Income-tax Act? (6 Marks)

2. (i) Examine whether transfer pricing provisions are attracted in respect of the transactions entered into by XYZ Motors Ltd. Also, compute the total income of XYZ Motors Ltd. chargeable to tax for A.Y.2018-19. (7 Marks)

(ii) Would transfer pricing provisions be attracted in respect of the transaction of borrowal of funds by OMR Ltd. from Omega Inc? Examine. (3 Marks)

3. With respect to the transactions listed in (a) to (c) under para (5) 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: Shareholding pattern of ABC Ltd.

<table>
<thead>
<tr>
<th>Shareholder</th>
<th>Number of equity shares</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ganga Ltd., India</td>
<td>20,000</td>
</tr>
<tr>
<td>Yamuna Ltd., India</td>
<td>10,000</td>
</tr>
<tr>
<td>Saraswati Ltd., India</td>
<td>10,000</td>
</tr>
<tr>
<td>Thames Inc., Country A</td>
<td>30,000</td>
</tr>
<tr>
<td>ABC Inc., Country A</td>
<td>1,20,000</td>
</tr>
<tr>
<td>General public</td>
<td>1,10,000</td>
</tr>
</tbody>
</table>

Exhibit B: Details relating to PQR Inc.

(1) Shareholding pattern of PQR Inc.

<table>
<thead>
<tr>
<th>Shareholder</th>
<th>Number of equity shares</th>
</tr>
</thead>
<tbody>
<tr>
<td>Peru Inc., Country A</td>
<td>30,000</td>
</tr>
<tr>
<td>Andes Inc., Country A</td>
<td>40,000</td>
</tr>
<tr>
<td>Niagra Inc., Country A</td>
<td>25,000</td>
</tr>
<tr>
<td>Atlanta Inc., Country A</td>
<td>15,000</td>
</tr>
<tr>
<td>EFG Ltd., India</td>
<td>50,000</td>
</tr>
<tr>
<td>General Public</td>
<td>80,000</td>
</tr>
</tbody>
</table>

(2) List of Lenders:

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Barclays Bank</td>
</tr>
<tr>
<td>2</td>
<td>Grindlays Bank</td>
</tr>
<tr>
<td>3</td>
<td>Bank of America</td>
</tr>
<tr>
<td>4</td>
<td>American Express Bank</td>
</tr>
</tbody>
</table>
(3) List of Borrowers:

<table>
<thead>
<tr>
<th></th>
<th>Borrower</th>
<th>Country</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Titanic Inc.</td>
<td>Country A</td>
</tr>
<tr>
<td>2</td>
<td>Bolivia Inc.</td>
<td>Country A</td>
</tr>
<tr>
<td>3</td>
<td>Detro Inc.</td>
<td>Country A</td>
</tr>
<tr>
<td>4</td>
<td>Santro Inc.</td>
<td>Country A</td>
</tr>
</tbody>
</table>

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

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

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

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

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

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

(10) List of Debtors for sales:

<table>
<thead>
<tr>
<th></th>
<th>Debtor</th>
<th>Country</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Michigan Inc.</td>
<td>Country A</td>
</tr>
<tr>
<td>2</td>
<td>Celro Inc.</td>
<td>Country A</td>
</tr>
<tr>
<td>3</td>
<td>Dolphin Inc.</td>
<td>Country A</td>
</tr>
<tr>
<td>4</td>
<td>Elephanta Inc.</td>
<td>Country A</td>
</tr>
</tbody>
</table>

Exhibit C: 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>
</tbody>
</table>
Aravalli Ltd., India 25,000
General public 1,50,000

(2) Particulars of turnover of Sigma Ltd.

<table>
<thead>
<tr>
<th>Previous Year</th>
<th>Turnover</th>
</tr>
</thead>
<tbody>
<tr>
<td>2014-15</td>
<td>Rs.35 crores</td>
</tr>
<tr>
<td>2015-16</td>
<td>Rs.55 crores</td>
</tr>
<tr>
<td>2016-17</td>
<td>Rs.82 crores</td>
</tr>
<tr>
<td>2017-18</td>
<td>Rs.117 crores</td>
</tr>
</tbody>
</table>

Exhibit D: Details relating to XYZ Motors Ltd.

(1) Shareholding pattern of XYZ Motors Ltd.

<table>
<thead>
<tr>
<th>Shareholder</th>
<th>Number of equity shares</th>
</tr>
</thead>
<tbody>
<tr>
<td>DEF Ltd., India</td>
<td>6,000</td>
</tr>
<tr>
<td>GHI Inc., Country D</td>
<td>3,000</td>
</tr>
<tr>
<td>LMN Inc., Country A</td>
<td>50,000</td>
</tr>
<tr>
<td>RST Ltd., Country C</td>
<td>10,000</td>
</tr>
<tr>
<td>HIT Ltd., Country D</td>
<td>1,000</td>
</tr>
<tr>
<td>Others</td>
<td>60,000</td>
</tr>
</tbody>
</table>

(2) Total book value of its assets. as on 31.3.2018 : Rs.12,000 crores.

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

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

(5) The value of 1 Country C $ and of 1 EURO was Rs.60 and Rs.81, respectively, throughout the year.
Exhibit E: Details relating to Birla Motors Ltd., India

(1) Shareholding pattern of Birla Motors Ltd.

<table>
<thead>
<tr>
<th>Shareholder</th>
<th>Number of equity shares</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sahara Ltd., India</td>
<td>15,000</td>
</tr>
<tr>
<td>Thar Ltd., India</td>
<td>20,000</td>
</tr>
<tr>
<td>Gobi Ltd., India</td>
<td>7,000</td>
</tr>
<tr>
<td>Sunderbans Ltd., India</td>
<td>8,000</td>
</tr>
<tr>
<td>General Public</td>
<td>1,50,000</td>
</tr>
</tbody>
</table>

(2) List of Lenders:

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

(3) List of Borrowers:

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

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

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

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

(7) Birla Motors Ltd. uses the technical know how provided by a few companies outside India, including RST Ltd.
8) Birla Motors Ltd. is not a shareholder of RST Ltd; It does not appoint any of the directors of RST Ltd.

Exhibit F: Details relating to OMR Ltd.

1) Shareholding pattern of OMR Ltd.

<table>
<thead>
<tr>
<th>Shareholder</th>
<th>Number of equity shares</th>
</tr>
</thead>
<tbody>
<tr>
<td>A Ltd., India</td>
<td>5,000</td>
</tr>
<tr>
<td>B Inc., Country L</td>
<td>7,000</td>
</tr>
<tr>
<td>C Inc., Country L</td>
<td>14,000</td>
</tr>
<tr>
<td>D Ltd., India</td>
<td>12,000</td>
</tr>
<tr>
<td>E Inc., Country L</td>
<td>8,000</td>
</tr>
<tr>
<td>Omega Inc., Country L</td>
<td>10,000</td>
</tr>
<tr>
<td>Others</td>
<td>24,000</td>
</tr>
</tbody>
</table>

2) Total book value of assets of OMR Ltd as on 31.3.2018: Rs.3,000 crores.

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

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

Note: In all the above exhibits, the shareholding pattern is reflective of the voting power, i.e., all shares have equal voting rights.
Athena Ltd. is a company specializing in manufacture of electronic products such as hair straighteners and curlers. Athena Ltd. was incorporated in Country A in September 2011.

Athena Ltd. set up its own manufacturing facility by July 2012 and set up its first retail store in December 2012 in Country A. The retail store displayed and sold the various variants of straighteners and curlers that it had manufactured. The products are sold under Athena’s registered trade mark. The first retail store showed tremendous success and sales. Given the success, between the years 2013 to 2016, Athena grew its network of retail stores in Country A. By the end of 2016 it had set up a total of ten retail stores in Country A.

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

Athena Ltd. seeks to expand its presence to other countries including India in the previous year 2017-18. India is a potential market and seems to be a profitable move for the company.

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

**Stage I:**

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

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

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

Pursuant to the strategy, Mr. Hari, Mr. Rajesh and Mr. Ravi were hired by Athena Ltd. on March 1, 2017. Their monthly remuneration were fixed at Rs.75,000, Rs.82,000 and Rs.80,000 respectively, for the two month period. The report was duly submitted by them to the board of Athena Ltd. on April 30, 2017. The board was happy to receive the report and duly considered the findings submitted.

**Stage II:**

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

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

After a host of interviews, Mr. Shyam was found eligible for the position of the agent. The terms of engagement of Mr. Shyam were fixed for four months. Mr. Shyam acted as an agent from June 2017 to September 2017. He received a remuneration of Rs. 1,50,000 per month for the performance of his functions, as described above.

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

**Stage III:**

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

In order to enable the delivery of the straighteners and curlers to Indian customers, Athena Ltd. identified warehouse(s) where the stock can be maintained and from which the orders of the customers can be satisfactorily met. Athena Ltd. directly supplied the stock from the Country A entity to the local warehouses. The website was functional for the said purpose in October, 2017 and thereafter, online sales were effected through the website at the price decided by Athena Ltd. During October 1, 2017 to December 31, 2017 Athena Ltd. was able to sell 2500 units of hair straighteners and 1500 units of hair curlers to customers based in India. The hair dryer was priced at Rs. 2,500 while the hair curler was priced at Rs. 3,500.

**Stage IV:**

As a fourth step, the board of Athena Ltd. reviewed the strategies adopted. Encouraged by the positive market response in India, the board of Athena Ltd. decided to set up a branch in Mumbai in January, 2018. Mr. Garg and Mr. Patnaik, who are residing in Mumbai, are now entrusted with spearheading the Indian operations and expansion strategy. Sales were effected through the Mumbai branch from January, 2018 itself.
Athena Ltd. is also considering advertising the product on the internet using websites such as Google Inc. The board believes that using digital means of advertising would give the necessary push to sales by educating interested Indian customers of the product range which would contribute to better sales and profits, in turn.

The company enters into talks with Google Inc. for hosting the desired advertisements. It negotiated a sum of Rs.30,00,000, which is paid to Google Inc. in March, 2018 for online advertising services.

Additional facts to be able to answer the questions:

Google Inc does not have a permanent establishment in India.

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

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

I. **MULTIPLE CHOICE QUESTIONS**

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

1. The income earned by Athena Ltd. from sale of hair straighteners and hair curlers in India during the period from June, 2017 to December, 2017 –
   
   (a) Would not be taxable in India, since no business connection is established on account of Mr. Shyam not having authority to conclude contracts on behalf of Athena Ltd.
   
   (b) Would be taxable in India, since business connection would be established on account of Mr. Shyam securing orders in India wholly for Athena Ltd.
   
   (c) Would not be taxable in India, since Athena Ltd. does not have a PE in India
   
   (d) Would be taxable in India, since Athena Ltd. has a PE in India

2. Dividend from an Indian company is exempt in the hands of a non-resident shareholder by virtue of section 10(34). Can such income be subject to tax in his hands in accordance with the provisions of the tax treaty?
   
   (a) Yes, since the provisions of the treaty override the domestic law
   
   (b) No, due to the non-aggravation principle
   
   (c) No, due to the equivalent beneficiary principle
   
   (d) No, due to allocation of taxing rights principle.

3. Which of the following may be viewed by the tax authorities as a tax avoidance measure undertaken by Athena Ltd.?
   
   (a) Choosing Google Inc., a company not having a PE in India, for advertising its products.
   
   (b) Hosting the website on a server based in Cayman islands
   
   (c) Both (a) and (b)
4. In respect of remuneration of Rs.1,50,000 per month paid by Athena Ltd. to Mr. Shyam, which of the following statements is correct, having regard to the provisions of the Income-tax Act, 1961 (provisions of DTAA may be ignored) –

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

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

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

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

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

(a) Only an employee of Athena Ltd.

(b) Only a trustee of Athena Ltd.

(c) Only an agent of Athena Ltd.

(d) All the above

6. As per the DTAA with Country A, which of the following statements is correct? –

(a) The DTAA applies only to taxes on income

(b) The DTAA applies both in respect of taxes on income and capital

(c) The DTAA applies only to persons who are resident of Country A in respect of taxes on income and capital

(d) The DTAA applies only to persons who are resident of India in respect of taxes on income.

7. Which of the following is ordinarily **not** a function served by a tax treaty?

(a) Relieving economic double taxation

(b) Imposing a fresh tax liability

(c) Boosting mutual trade and investment in the two Contracting States

(d) Allocating taxing rights

8. Which of the following statements reflects the **incorrect** position?

(a) Domestic tax laws are irrelevant while considering application of the provisions of a DTAA

(b) Provisions of Income-tax Act, 1961 empower the Union Government to enter into tax treaties for relieving double taxation
(c) Provisions of a DTAA overrides the provisions of domestic laws unless the latter are more beneficial for a taxpayer

(d) In the absence of a DTAA, domestic tax laws provide unilateral relief to tackle double taxation

9. Which of the following is not a principle incorporated in the Vienna Convention on Law of Treaties?

(a) Preparatory work of the treaty can be used as a supplementary means of interpretation

(b) A State which is a third party cannot be bound by the terms of a bilateral tax treaty without its consent

(c) Violation of any term of the tax treaty by one Contracting State entitles the other Contracting State to terminate the treaty

(d) Ordinarily, each authenticated version of a treaty in more than one language carries equal force

10. Which article has been introduced in the India-Mauritius tax treaty to specifically target the practice of treaty shopping?

(a) Elimination of double taxation

(b) Limitation of benefits

(c) Most Favoured Nation clause

(d) Non-discrimination

II. DESCRIPTIVE QUESTIONS

1. In relation to the income earned during previous year 2017-18, does Athena Ltd. have a permanent establishment in India? Answer the question in relation to activities undertaken in each of four stages in the case study. (10 Marks)

2. (a) (i) What may be viewed as a strategy which has been adopted by Athena Ltd. to avoid tax in India in the third stage? Examine. (3 Marks)

(ii) Which action plan of BEPS addresses the tax challenges arising out of the strategy adopted by Athena Ltd. in the third stage? What were the recommendations thereunder to address such challenges? (4 Marks)

(b) From the following hypothetical situation given below, determine whether Athena Ltd satisfies the active business test for determination of place of effective management under the Income-tax Act, 1961:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Country A</th>
<th>Country B</th>
<th>India</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Foreign currency equivalent</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Value of assets</td>
<td>Rs.400 lakhs</td>
<td>Rs.100 lakhs</td>
<td>Rs.210 lakhs</td>
</tr>
<tr>
<td>Number of employees</td>
<td>30</td>
<td>10</td>
<td>20</td>
</tr>
<tr>
<td>Payroll expenses on employees</td>
<td>Rs.160 lakhs</td>
<td>Rs.35 lakhs</td>
<td>Rs.65 lakhs</td>
</tr>
<tr>
<td>Number of Board Meetings</td>
<td>10</td>
<td>2</td>
<td>4</td>
</tr>
<tr>
<td>Particulars</td>
<td>Rs.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>---------------------------------------------------------------------------</td>
<td>---------</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income from transactions where only the purchases of goods are from</td>
<td>25 lakhs</td>
<td></td>
<td></td>
</tr>
<tr>
<td>associated enterprises</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income from transactions where only the sale of goods is to associated</td>
<td>45 lakhs</td>
<td></td>
<td></td>
</tr>
<tr>
<td>enterprises</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income from transactions where both purchases and sales are from/to</td>
<td>110 lakhs</td>
<td></td>
<td></td>
</tr>
<tr>
<td>associated enterprises</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income by way of dividend and interest involving associated enterprises</td>
<td>22 lakhs</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total income by way of dividend and interest</td>
<td>35 lakhs</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total income of Athena Ltd.</td>
<td>250 lakhs</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

(5 Marks)

3.  (a) What are the tax implications under the Indian tax laws, in respect of fees paid for online advertising services?  
(3 Marks)

(b) In respect of the fees referred to in (a) above, examine the requirement, if any, under the Indian tax laws to deduct tax at source and the consequences of non-deduction at source.  
(3 Marks)

(c) Is there any provision incorporated in the Indian tax laws to avoid double taxation of such income [i.e., fees referred to in (a) above] in India? Examine.  
(2 Marks)
Shivam completed his engineering from BITS Country ‘X’ 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 for INR 25,000 per month in 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 performance in music concerts.

Arvind visits Country X 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 X except interest on Fixed Deposits made by him with a bank in that country out of his Indian income.

Sudha and her team is engaged in a project with Cure House Inc., a company based out of Country “Z”, to provide consultancy services in field of medicine to various research institutes in India. The engagement began during May 2017 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 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 2017-18, the company initiated a Global Mobility Program and selected Shivam for secondment to Country “Y” for 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 “Y” in his Country “Y” bank account. As per the terms of global mobility program, Shivam would be entitled to a monthly basic salary of YGD 1400 and cost of living allowance of YGD 1000. Tax at the rate of 15% would be withheld on such salary as per Country “Y” tax laws. Shivam would be staying there in a rent-free accommodation provided by the company.

Shivam left India on September 30, 2017 for his overseas assignment and reached Country “Y” next day. His parents and Sudha stayed in India in the same rented accommodation in Delhi owing to Sudha’s work commitments. Shivam continued to pay rent of INR 25,000 per month in respect of the said accommodation.

On July 31, 2017, the company announced a bonus of INR 3,00,000 for the previous financial year (i.e. F.Y.2016-17). As a retention policy, such bonus was paid after the first half of the financial year i.e. in October 2017. Shivam received the bonus amount in his salary account with the bank in Country Y.

Shivam had invested his overseas salary in purchase of securities of a Country “Y” company which yielded an interest income of YGD 5000 due as on March 31, 2018. Such interest was taxed at 15% of the gross amount as per Country “Y” domestic tax laws.

He has also purchased shares of Country “Y” Company and dividend of YGD 1000 was credited to his bank account on March 31, 2018. Just like Indian tax laws, dividend paid by Country “Y” Company is exempt in the hands of shareholders.
On 31.03.2018, he had earned interest income of YGD 150 from his saving bank account in Country “Y”, which is also exempt as per the domestic tax laws of Country “Y”.

Shivam also owns a residential house property in Mumbai, which was let out for 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 “X” and earned annual interest of INR 30,000 during the previous year. Such interest earned was exempt from tax in Country “X”.

Other points:

As per Country “Y” 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 “Y”, a person shall be regarded as resident if a person stays in Country “Y” for more than 180 days in a financial year.

YGD is the currency abbreviation for the Country “Y” dollar, the currency of Country “Y”.

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

I MULTIPLE CHOICE QUESTIONS

Write the correct 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 sum of INR 10,000 to each musician performing in the concerts organised by it. Shivam, however, refuses to accept this sum. If he requests Delhi Tamil Sangam to pay such sum directly to Help All, an unregistered institution providing relief to the poor and needy in rural India, what would be the tax consequence?
   (a) No amount would be chargeable to tax in the hands of Mr. Shivam since this is a case of diversion of income at source by overriding title.
   (b) The amount payable to Help All would be chargeable to tax only in the hands of Mr. Shivam since it is a case of application of income.
   (c) The amount payable to Help All would be chargeable to tax only in the hands of the institution which has received the amount.
   (d) The amount payable to Help All would be chargeable to tax both in the hands of Mr. Shivam and in the hands of the institution.

2. Mr. Arvind opened a bank A/c in Country X on 1.7.2015. He has made deposits of foreign currency equivalent of INR 5 lakhs on 1.7.2015, INR 7 lakhs on 1.10.2015, INR 12 lakhs on 1.9.2017 and INR 25 lakhs on 1.3.2018, in that bank, out of Indian income which has not been subject to tax in India. The deposit of INR 12 lakhs is made out of the withdrawal of earlier deposits made with the said bank. Further, out of INR 25 lakhs deposited by him on 1.3.2018, Mr. Arvind withdrew INR 2 lakhs on 31.3.2018. The value of an undisclosed asset in form of bank account is:
   (a) INR 49 lakhs
(b) INR 47 lakhs
(c) INR 37 lakhs
(d) INR 35 lakhs

3. Which of the following statements does not hold good in the case of OECD Model Convention?
   (a) OECD Model lays emphasis on the right of the State of Residence to tax income.
   (b) The relevant article of the Convention providing for determination of business profits of a PE, does not deal with/provide for deduction of expenses
   (c) The relevant article relating to PE of the Convention explicitly deals with mechanism of Service PE
   (d) It is essentially a model treaty between two developed nations

4. To address the problem of dual residency, under OECD Model Convention, certain rules are provided. The rules are to be applied:
   (a) At the discretion of competent authority of the respective countries based on permanent home and nationality of the assessee
   (b) Sequentially in order of nationality, permanent home, centre of vital interest and habitual abode
   (c) Sequentially in order of permanent home, centre of vital interest, habitual abode and nationality
   (d) Only if an assessee is not able to produce Tax Residency Certificate from the respective country.

5. 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

6. Which of the following would not be considered as a permanent home in context of tie breaker rule for dual residency?
   (a) Accommodation taken on rent for occupation
   (b) Hotel Accommodation provided for the purpose of prolonged employment
   (c) Self-occupied house co-owned with spouse
   (d) None of the above
7. Form 67 has to be filed mandatorily on or before the due date of filing of return of income -

(i) if the assessee claims foreign tax credit in his return of income for the year in which such corresponding income was offered to tax

(ii) if the assessee owns directly, or as a beneficial owner, any foreign assets

(iii) if there is a carry backward of loss of the current year resulting in refund of foreign tax for which credit has been claimed in an earlier previous year.

(iv) The correct answer is -

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

8. While interpreting the treaty entered into by India with Country X, the Budget Speech 2015-16 of Shri Arun Jaitley was relied upon to understand the intent at the time of signing the treaty. Which law of interpretation has been followed in this case?

(a) Liberal Interpretation
(b) Subjective Interpretation
(c) Purposive Interpretation
(d) Objective Interpretation

9. An application for advance ruling was made on 31.05.2017 in relation to a transaction proposed to be undertaken by Mr. James, a resident of Country X. On 07.07.2017, he decides to withdraw the said application. Such application:

(a) cannot be withdrawn once filed
(b) can be withdrawn on 07.07.2017 only with special permission of Principal Chief Commissioner
(c) cannot be withdrawn since 30 days from date of application have passed
(d) can be withdrawn on 07.07.2017 with permission of the AAR, if the circumstances of the case so justify

10. Ms. Sudha acquired a flat in Country N in the P.Y.2013-14 for INR 50 lakhs. Out of the said sum, INR 20 lakhs was assessed to tax in the total income for the P.Y.2013-14 and earlier years. This asset comes to the notice of the Assessing Officer in the year 2017-18. If the value of the flat in the year 2017-18 is INR 90 lakhs, the amount chargeable to tax would be:

(a) INR 90 lakhs
(b) INR 70 lakhs
(c) INR 54 lakhs
(d) INR 30 lakhs

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II DESCRIPTIVE QUESTIONS

1. (i) With reference to the DTAA between India and Country “Y”, examine whether Shivam is a resident of India or Country “Y” in the year 2017-18. (6 Marks)

(ii) The Competent Authority in India has made a request to the concerned official in Country “Y” to provide certain information in order to prevent tax avoidance in India. The Country “Y” tax officer denied the request stating that they are not obliged to provide such information as Country “Y” will not get any revenue benefit by doing so. Is the officer justified in his denial?

Will your answer change, if the officer denied stating that exchange of such information would be contrary to public policy? (4 Marks)

2. (a) (i) With reference to the DTAA between India and Country “Z”, comment on whether provision of consultancy services through Sudha would lead to creation of PE in India for Cure House Inc., a Country Z company. (3 Marks)

(ii) Can Cure House Inc. approach the Authority of Advance Ruling to determine its tax liability arising from project undertaken in India. Is Sudha eligible to file an application for advance ruling to determine her tax liability arising from the project? (4 Marks)

(b) India has a DTAA with Country Y but does not have a DTAA with Country N. Examine the significance of the concepts of business connection and permanent establishment in bringing to tax business income earned by a resident of Country Y and Country N in India. (4 Marks)

3. Determine the total income and tax liability of Shivam for the previous year 2017-18 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 Y. (10 Marks)

Note: Support your answers with clear assumptions, while answering the above questions.

EXHIBIT I

Telegraphic Transfer Buying Rate

Assume SBI TT buying rate for Country “Y” – 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>30.09.2017</td>
<td>45.95</td>
<td>31.01.2018</td>
<td>47.83</td>
</tr>
<tr>
<td>31.10.2017</td>
<td>46.85</td>
<td>28.02.2018</td>
<td>48.52</td>
</tr>
<tr>
<td>30.11.2017</td>
<td>45.10</td>
<td>31.03.2018</td>
<td>48.61</td>
</tr>
<tr>
<td>31.12.2017</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

(1) "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.

(2) "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.

(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 “Y”

ARTICLE 4

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

2. "Where by reason of the provisions of paragraph 1, an individual is a resident of both Contracting States, then his status shall be determined as follows:
(a) he shall be deemed to be a resident of the State in which he has a permanent home available to him; if he has a permanent home available to him in both States, he shall be deemed to be a resident of the State with which his personal and economic relations are closer (centre of vital interests);

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

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

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

ARTICLE 25

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 “Y”, India shall allow as a deduction from the tax on the income of that resident an amount equal to the Country “Y” tax paid, whether directly or by deduction. Where the income is a dividend paid by a company which is a resident of Country “Y” 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 “Y” 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 “Y”.

ARTICLE 28

EXCHANGE OF INFORMATION

1. The competent authorities of the Contracting States shall exchange such information as is foreseeably relevant for carrying out the provisions of this Agreement or to the administration or enforcement of the domestic laws concerning taxes of every kind and description imposed on behalf of the Contracting States, or of their political sub-divisions or local authorities, insofar as the taxation thereunder is not contrary to the Agreement. The exchange of information is not restricted by Articles 1 and 2.

2. Any information received under paragraph 1 by a Contracting State shall be treated as secret in the same manner as information obtained under the domestic laws of that State and shall be disclosed only to persons or authorities (including courts and administrative bodies) concerned with the assessment or collection of the enforcement or prosecution in respect of, the determination of appeals in relation to the taxes referred to in paragraph 1, or the oversight of the above. Such persons or authorities shall use the information only for such purposes. They may disclose the information in public court proceedings or in judicial decisions.

3. In no case shall the provisions of paragraphs 1 and 2 be construed so as to impose on a Contracting State the obligation:
(a) to carry out administrative measures at variance with the laws and administrative practice of that or of the other Contracting State;

(b) to supply information which is not obtainable under the laws or in the normal course of the administration of that or of the other Contracting State;

(c) to supply information which would disclose any trade, business, industrial, commercial or professional secret or trade process, or information the disclosure of which would be contrary to public policy.

4. If information is requested by a Contracting State in accordance with this Article, the other Contracting State shall use its information gathering measures to obtain the requested information, even though that other State may not need such information for its own tax purposes. The obligation contained in the preceding sentence is subject to the limitations of paragraph 3 but in no case shall such limitations be construed to permit a Contracting State to decline to supply information solely because it has no domestic interest in such information.

5. In no case shall the provisions of paragraph 3 be construed to permit a Contracting State to decline to supply information solely because the information is held by a bank, other financial institution, nominee or person acting in an agency or a fiduciary capacity or because it relates to ownership interests in a person."

EXHIBIT IV

EXTRACT OF DTAA BETWEEN INDIA AND COUNTRY “Z”

ARTICLE 5(3)

PERMANENT ESTABLISHMENT

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 - 7

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

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

Assignment A

Client Name: Connors & Ann, Country X

Nature of Assignment: Connors & Ann had entered into a joint venture agreement with an Indian party in March, 2017 for construction of a nuclear thermal power plant in Tamil Nadu, India during the financial year 2017-18.

Additional Details:
➢ As per the scope of work, the firm had
  • advised on all aspects of structuring and drafting, negotiation, construction contract and maintenance contracts;
  • advised on procurement structures, multi contract/onshore offshore structures;
  • provided specialised project finance expertise and ensured to reduce the risks associated with operating in foreign jurisdiction;
  • advised on tax and regulatory implications from a Country X law perspective; and
  • attended meetings with project sponsors, negotiated floating rate issues and advisory on any other overseas jurisdiction related regulatory aspects etc.
➢ The execution of work was done partly from India and partly from Country X office.
➢ The firm’s employees and partners were in India for 120 days.
➢ The firm’s billing model for the services rendered were as follows:
  • each partner and employee of the firm who was involved in doing work for the clients was required to maintain detailed time sheets recording the time spent by them on such work; the said time sheets separately showed the time spent on doing such work in India and outside India;
  • the time so spent was multiplied by the hourly billing rates applicable to each respective partner/employee as specified in the terms of appointment between the firm and the client;
  • the bills so raised were paid to the firm by the client outside India.

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Based on the above details, the firm is of the view that the income attributable to the services rendered in India would be taxable in India. The said income would be arrived at based on “estimation of fees with reference to the fees rates at which such services could have been procured from corresponding professionals acting in India”.

The firm intends to claim the following expenditure -

(a) direct costs allocated on the basis of number of hours spent at the pro-rated Country X salary cost; and
(b) general overheads have been allocated @5% of income on an ad-hoc basis.

Assignment B

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

Nature of Assignment: Vidyut India has entered into a contract with an Indian construction company for construction of a pharma research and development unit in India. Vidyut India also has a group entity, Vidyut Z Inc, in Country Z, from whom necessary inputs are obtained for construction of the pharma research and development centre. The construction agreement provided that the law in Country Y will govern the contract. There is currently a dispute in the contract and as per the agreement, the adjudication proceedings were initiated on 30th August 2017. Gryffindors Y is a registered firm in Country Y engaged by Vidyut India to represent it in the adjudication proceedings in India. Further, as part of the adjudication proceedings, site visits are essential in India and Country Z. For the site visit in Country Z, Gryffindors Z, a Country Z registered partnership firm was engaged for which Vidyut India would compensate the Country Z firm separately.

Additional Details:

➢ As per the terms of agreement, the activities are to be carried on in Country Y, Country Z and India.
➢ Except a site visit and an adjudication hearing in Chennai between 21st and 24th September, 2017, no other activity is carried on in India by Gryffindors Y. The total time spent in India was 6 days between 19th September and 24th September, 2017.
➢ Meanwhile, another site visit in Country Z was for 10 days for which partners from Gryffindors Z undertook the visit and provided its report to Gryffindors Y, Country Y. For the time spent by the Country Z firm, it had raised an invoice to Vidyut India.
➢ Apart from the 6 days in India and 10 days in Country Z, major part of the adjudication proceedings were at Country Y.
➢ Gryffindors Y produced a tax residency certificate from Country Y. It is also to be noted that Gryffindors Y is a fiscally transparent entity as per the tax laws of Country Y. Gryffindors Y is only liable for trade tax in Country Y.
➢ Gryffindors Z produced a tax residency certificate from Country Z tax authorities certifying that it is a tax resident of Country Z. It is also to be noted that Gryffindors Z is a fiscally transparent entity as per the Country Z tax laws.

Assignment C

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

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

➢ The scope of work for the firm shall be the following:
  o Phase I: Education & Training
  o Phase II: Acquisition Transaction
  o Phase III: Regulatory approval for the transaction.

➢ As part of the first phase, on education and training, the firm will provide a detailed document to Abhimanyu India on the legal framework on banking and regulatory laws in Country X. Further, apart from the document, the firm will provide presentation and discuss the various legal and regulatory requirements in Country X for setting up a bank branch or acquiring a bank in Country X.

➢ The presentation to be made by the firm will be to the bank officials of Abhimanyu India. The presentation will be made from the law firm’s office in Country X. The purpose of the training is to ensure that if the bank sets up a branch or office in Country X, the said officials will be deputed to the Country X entity.

➢ The work shall be undertaken by the firm from its office in Country X and there will be no visit in India.

➢ As mentioned previously, the firm is a tax resident of Country X and is a fiscally transparent entity for tax purpose in Country X.

➢ Phase II and Phase III are subject to the conditions and legal environment being favourable, and hence, the happening of the same is not certain. However, Phase I: Education is certain and a fee of foreign currency equivalent to Rs.1,50,000 has been agreed upon by the firm to render Phase I services, which would be paid in Country X.

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

I. MULTIPLE CHOICE QUESTIONS

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

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

   (a) Juridical double taxation
   (b) Territorial double taxation
   (c) Economic double taxation
   (d) Municipal double taxation

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

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

(d) The Vienna Convention

3. Can benefit of India-Country X tax treaty be availed by M/s. Gryffinders LLP (“the firm”), Country X in respect of income earned by it in India from Assignment A, which is taxable in both India and Country X, by virtue of the respective domestic tax laws?

(a) Yes, since the income is subject to tax in both countries albeit in the hands of different persons

(b) No, since as per the laws of Country X, the firm is a fiscally transparent entity. Hence, there is no double taxation of income in its hands.

(c) Yes, since the firm’s employees and partners stayed in India for more than 100 days. Hence, the requisite condition for availing treaty benefit under the DTAA is satisfied.

(d) Yes, since the execution of work was done partly from India and partly from Country X. Hence, treaty benefit can be availed.

4. A fiscally transparent entity means –

(a) An entity entitled to concessional rate of tax

(b) An entity enjoying tax pass through status

(c) An entity entitled to benefits of DTAA

(d) An entity which is subject to distribution tax on profits distributed by it.

5. What are the tax implications under the Income-tax Act, 1961 in respect of income earned from assignment A by M/s. Gryffindors LLP, a Country X based partnership firm (You may ignore the provisions of the DTAA for the purpose of answering this question) -

(a) the entire income from the assignment is taxable in India

(b) Only income attributable to the services rendered in India is taxable in India

(c) No part of the income is taxable in India since the firm does not have a permanent establishment in India

(d) No part of the income is taxable in India since the income was received outside India.

6. In order to claim relief under the tax treaty in India, a non-resident -

(a) should have a business presence in India

(b) should produce his Permanent Account Number

(c) should produce Tax Residency Certificate (TRC)

(d) should produce his income-tax return filed in the home country.

7. As per the provisions of the Income-tax Act, 1961, which of the following is not an objective of the Central Government to enter into tax treaty with another Country:
(a) For granting relief in respect of income-tax chargeable to tax in India and the other country
(b) For enabling round tripping of unaccounted money into India
(c) For recovery of income-tax
(d) For exchange or information for prevention of evasion or avoidance of income tax

8. When a term used in a tax treaty is not defined in the tax treaty or in the Act, but the same is defined subsequently through a notification in the Official Gazette by the Central Government, then, in such a case:

(a) The notification shall take effect from the date of its publication in the Official Gazette
(b) The notification shall be deemed to be effective from the date when the tax treaty came into force
(c) The notification shall be deemed to be effective from the date when the tax treaty was last modified
(d) The notification shall take effect from 1st April and be effective from the current assessment year.

9. In order to invoke the tax treaty for a person who is a dual resident i.e. tax resident in both the countries, which rule may be applied under the relevant article of the tax treaties to resolve the issue?

(a) Force of Attraction
(b) Tie-breaker
(c) Equivalent beneficiary
(d) Non-discrimination

10. Under the provisions of the Income-tax Act, 1961, the term “Person” would not include:

(a) A body corporate incorporated in a country outside India
(b) A Limited Liability Partnership (LLP)
(c) Indian branch of a foreign company
(d) A co-operative society

II. DESCRIPTIVE QUESTIONS

1. (i) For making the payment to Gryffindors Y and Gryffindors Z, Vidyut India Limited’s tax advisor has opined that the Country Y firm and the Country Z firm are not eligible to access India-Country Y DTAA and India-Country Z DTAA, respectively, even though TRC has been provided by such firms. The Indian client’s tax advisor has formed this view based on Article 1 read with the relevant articles of the India-Country Y DTAA and India Country Z DTAA coupled with the fact that both the firms are fiscally transparent entities as per the tax laws of the respective countries. Examine the correctness of the view taken by the tax adviser by analysing the relevant Articles of the India-Country Y DTAA and India Country Z DTAA  

(6 Marks)
(ii) Assuming that the tax treaty benefit is available for both the foreign entities, namely, Gryffindors Y and Gryffindors Z your views are solicited as to whether Article 14 of India-Country Y and India-Country Z tax treaty can be invoked. (4 Marks)

(iii) The firms want clarification as to whether surcharge, education cess and secondary and higher education cess need to be separately added to the withholding tax rate specified in the tax treaty while invoking the tax treaty rate. Examine. (5 Marks)

2. (i) What are the tax implications under the Income-tax Act, 1961 in respect of income earned by the firm, M/s. Gryffindors X from the proposed phase I service to be rendered by it in respect of Assignment C? (4 Marks)

(ii) Assuming that the above-referred income is not chargeable to tax in India in the hands of the firm as per the Indian tax laws, is it possible to bring it into tax by invoking the India-Country X DTAA provisions? (4 Marks)

(iii) Assuming that the above-referred income is chargeable to tax in India, how can the tax liability of the firm be mitigated? Your answer should be based on the relevant provision(s) of the Income-tax Act, 1961. (4 Marks)

(iv) Assuming that the tax consequences in the above case are not certain, what is the option available to M/s. Gryffindors X to ensure tax certainty. (3 Marks)

EXHIBIT A

Extract of the relevant Articles of India - Country X DTAA

ARTICLE 1

SCOPE OF THE CONVENTION

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

2. This Convention extends to the territory of each Contracting State, including its territorial sea, and to those areas of the exclusive economic zone or the continental shelf adjacent to the outer limit of the territorial sea of each State over which it has, in accordance with international law, sovereign rights for the purpose of exploration and exploitation of the natural resources of such areas, and references in this Convention to the Contracting State or to either of them shall be construed accordingly.

ARTICLE 2

TAXES COVERED

1. The taxes which are the subject of this Convention are:

   (a) in Country X:

      (i) the income-tax;

      (ii) the corporation tax;

      (iii) the capital gains tax; and

      (iv) the petroleum revenue tax;
(hereinafter referred to as "Country X tax");

(b) in India;

the income-tax including any surcharge thereon;

(herenafter referred to as "Indian tax").

2. This Convention shall also apply to any identical or substantially similar taxes which are imposed by either Contracting State after the date of signature of this Convention in addition to, or in place of, the taxes of that Contracting State referred to in paragraph 1 of this Article. The competent authorities of the Contracting States shall notify each other of any substantial changes which are made in their respective taxation laws.

ARTICLE 3 (EXTRACT)

GENERAL DEFINITIONS

1. In this Convention, unless the context otherwise requires:

(f) the term "person" includes an individual, a company, a body of persons and any other entity which is treated as a taxable unit under the taxation laws in force in the respective Contracting States;

ARTICLE 4

FISCAL DOMICILE

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

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

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

ARTICLE 5

PERMANENT ESTABLISHMENT

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

2. The term "permanent establishment" shall include especially:

(a) a place of management;

(b) a branch;

(c) an office;

(d) a factory;

(e) a workshop;
(f) premises used as a sales outlet or for receiving or soliciting orders;

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

(h) a mine, an oil or gas well, quarry on other place of extraction of natural resources;

(i) an installation or structure used for the exploration or exploitation of natural resources;

(j) a building site or construction, installation or assembly project or supervisory activities in connection therewith, where such site, project or supervisory activity continues for a period of more than six months, or where such project or supervisory activity, being incidental to the sale or machinery or equipment, continues for a period not exceeding six months and the charges payable for the project or supervisory activity exceed 10 per cent of the sale price of the machinery and equipment;

(k) the furnishing of services including managerial services, other than those taxable under Article 13 (Royalties and fees for technical services), within a Contracting State by an enterprise through employees or other personnel, but only if:

   (i) activities of that nature continue within that State for a period or periods aggregating more than 90 days within any twelve month period; or

   (ii) services are performed within that State for an enterprise within the meaning of paragraph 1 of Article 10 (Associated enterprises) and continue for a period or periods aggregating more than 30 days within any twelve-month period:

Provided that for the purposes of this paragraph an enterprise shall be deemed to have a permanent establishment in a Contracting State and to carry on business through that permanent establishment if it provides services or facilities in connection with, or supplies plant and machinery on hire used or to be used in, the prospecting for, or extraction or production of, mineral oils in that State.

**ARTICLE 13**

**ROYALTIES AND FEES FOR TECHNICAL SERVICES**

1. Royalties and fees for technical services arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.

2. However, such royalties and fees for technical services may also be taxed in the Contracting State in which they arise and according to the law of that State; but if the beneficial owner of the royalties or fees for technical services is a resident of the other Contracting State, the tax so charged shall not exceed:

   (a) in the case of royalties within paragraph 3(a) of this Article, and fees for technical services within paragraphs 4(a) and (c) of this Article,—

      (i) during the first five years for which this Convention has effect;

      (aa) 15 per cent of the gross amount of such royalties or fees for technical services when the payer of the royalties or fees for technical services is the Government of the first-mentioned Contracting State or a political sub-division of that State, and

      (bb) 20 per cent of the gross amount of such royalties or fees for technical services in all other cases; and
(ii) during subsequent years, 15 per cent of the gross amount of such royalties or fees for technical services; and

(b) in the case of royalties within paragraph 3(b) of this Article and fees for technical services defined in paragraph 4(b) of this Article, 10 per cent of the gross amount of such royalties and fees for technical services.

3. For the purposes of this Article, the term "royalties" means:

(a) payments of any kind received as a consideration for the use of, or the right to use, any copyright of a literary, artistic or scientific work, including cinematography films or work on films, tape or other means of reproduction for use in connection with radio or television broadcasting, any patent, trade mark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience; and

(b) payments of any kind received as consideration for the use of, or the right to use, any industrial, commercial or scientific equipment, other than income derived by an enterprise of a Contracting State from the operation of ships or aircraft in international traffic.

4. For the purposes of paragraph 2 of this Article, and subject to paragraph 5, of this Article, the term "fees for technical services" means payments of any kind of any person in consideration for the rendering of any technical or consultancy services (including the provision of services of a technical or other personnel) which:

(a) are ancillary and subsidiary to the application or enjoyment of the right, property or information for which a payment described in paragraph 3(a) of this article is received; or

(b) are ancillary and subsidiary to the enjoyment of the property for which a payment described in paragraph 3(b) of this Article is received; or

(c) make available technical knowledge, experience, skill know-how or processes, or consist of the development and transfer of a technical plan or technical design.

5. The definition of fees for technical services in paragraph 4 of this Article shall not include amounts paid:

(a) for services that are ancillary and subsidiary, as well as inextricably and essentially linked, to the sale of property, other than property described in paragraph 3(a) of this Article;

(b) for services that are ancillary and subsidiary to the rental of ships, aircraft, containers or other equipment used in connection with the operation of ships, or aircraft in international traffic;

(c) for teaching in or by educational institutions;

(d) for services for the private use of the individual or individuals making the payment; or

(e) to an employee of the person making the payments or to any individual or partnership for professional services as defined in Article 15 (Independent personal services) of this Convention.

6. The provisions of paragraphs 1 and 2 of this Article shall not apply if the beneficial owner of the royalties or fees for technical services, being a resident of a Contracting State, carries on business in the other Contracting State in which the royalties or fees for technical services arise through a permanent
establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the right, property or contract in respect of which the royalties or fees for technical services are paid is effectively connected with such permanent establishment or fixed base. In such case, the provisions of Article 7 (Business profits) or Article 15 (Independent personal services) of this Convention, as the case may be, shall apply.

7. Royalties and fees for technical services shall be deemed to arise in a Contracting State where the payer is that State itself, a political sub-division, a local authority or a resident of that State. Where, however, the person paying the royalties or fees for technical services, whether he is a resident of a Contracting State or not, has in a Contracting State a permanent establishment or a fixed base in connection with which the obligation to make payments was incurred and the payments are borne by that permanent establishment or fixed base then the royalties or fees for technical services shall be deemed to arise in the Contracting State in which the permanent establishment or fixed base is situated.

8. Where, owing to a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the royalties or fees for technical services paid exceeds for whatever reason the amount which would have been paid in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In that case, the excess part of the payments shall remain taxable according to the law of each Contracting State, due regard being had to the other provisions of this Convention.

9. The provisions of this Article shall not apply if it was the main purposes or one of the main purposes of any person concerned with the creation or assignment of the rights in respect of which the royalties or fees for technical services are paid to take advantage of this Article by means of that creation or assignment.

EXHIBIT B

Extract of the relevant Articles of India - Country Y DTAA

ARTICLE 1
PERSONAL SCOPE
This Agreement shall apply to persons who are residents of one or both of the Contracting States.

ARTICLE 2
TAXES COVERED
1 This Agreement shall apply to taxes on income and on capital imposed on behalf of a Contracting State, of a land or a political sub-division or local authority thereof, irrespective of the procedure in which they are levied.

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

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

(a) in the Federal Republic of Country Y:

income-tax.
(a) corporation-tax, capital tax, and trade tax (hereinafter referred to as "Country Y tax");
(b) in the Republic of India, the income-tax including any surcharge tax thereon, and the wealth-tax (hereinafter referred to as "Indian tax").

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

ARTICLE 3 (EXTRACT)

GENERAL DEFINITIONS

1. For the purposes of this Agreement, unless the context otherwise requires, -

(d) the term "person" includes an individual, a company and any other entity which is treated as a taxable unit under the taxation laws in force in the respective Contracting States;

ARTICLE 4 (EXTRACT)

RESIDENT

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

ARTICLE 14

INDEPENDENT PERSONAL SERVICES

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

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

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

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

Extract of the relevant Articles of India – Country Z DTAA

ARTICLE 1
PERSONAL SCOPE
This Agreement shall apply to persons who are residents of one or both of the Contracting States.

ARTICLE 2
TAXES COVERED
1. The taxes to which this Agreement shall apply are:
   (a) in the case of India:
       the Income-tax including any surcharge thereon; and
   (b) in the case of Country Z:
       the federal, cantonal and communal taxes on income (total income, earned income, income from
capital, industrial and commercial profits, capital gains, and other items of income).

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

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

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

ARTICLE 3 (EXTRACT)
GENERAL DEFINITIONS
1. In this Agreement, unless the context otherwise requires:
   (d) the term "person" includes an individual, a company, a body of persons, or any other entity which is
       taxable under the laws in force in either Contracting State;

ARTICLE 4
FISCAL DOMICILE
1. For the purposes of this Convention, the term "resident of a Contracting State" means any person who,
   under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of
   management, place of incorporation, or any other criterion of a similar nature, provided, however, that:
(a) this term does not include any person who is liable to tax in that State in respect only of income from sources in that State; and

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

ARTICLE 14

INDEPENDENT PERSONAL SERVICES

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

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

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

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

1. (b) Banking and Insurance business
2. (d) ₹ 1 Crore
3. (c) A Inc., USA; A LLC, Cyprus; and AA Ltd., China.
4. (d) 30%
5. (c) ₹ 95 lakhs
6. (d) ₹ 1 lakh – fixed penalty
7. (c) A.Y.2026-27
8. (d) 90 days from 30th November of the assessment year
9. (c) A.Y.2017-18 and the amount of primary adjustment is ₹1.05 crore
10. (c) Deemed loan approach

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 associated 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 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>16.00</td>
</tr>
<tr>
<td>Interest paid to Bank of Chennai based on guarantee issued 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><strong>37.50</strong></td>
</tr>
<tr>
<td><strong>EBIDTA</strong></td>
<td><strong>100.00</strong></td>
</tr>
</tbody>
</table>

**Excess Interest:**

<table>
<thead>
<tr>
<th>Interest paid or payable to non-resident AE in excess of lower of the following would be disallowed</th>
<th>7.50</th>
</tr>
</thead>
<tbody>
<tr>
<td>- 30% of EBIDTA</td>
<td>₹ 30.00 crores</td>
</tr>
<tr>
<td>- Interest paid or payable to non-resident AE</td>
<td>₹ 37.50 crores</td>
</tr>
<tr>
<td>Therefore, interest allowable as deduction under the head “Profits and Gains of business or Profession”</td>
<td>30.00</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 an AE.

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

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

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

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

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

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

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

1 CIT v. Vijay Ship Breaking Corporation decision of Supreme Court [2008] 175 Taxman 77 (SC)
Further, since 90% of raw materials required by A Ltd. is supplied by AA Ltd., China, this company is deemed to be an AE of A Ltd. Thus, the amount of interest paid towards delayed payment has to be considered for the purpose of limitation of interest deduction under section 94B.

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 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 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 amount of interest paid or payable by A Ltd to non-resident AE allowable as deduction under the head “Profits and gains of business or profession” would be –

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</tr>
<tr>
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<td>4.00</td>
</tr>
<tr>
<td>Interest paid to Union City Bank, India</td>
<td>3.00</td>
</tr>
<tr>
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</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>Total interest paid or payable by A Ltd.</td>
<td>53.75</td>
</tr>
<tr>
<td>Interest paid or payable to non-resident AE (computed above)</td>
<td>37.50</td>
</tr>
</tbody>
</table>

EBIDTA |
100.00

Excess Interest:

Total interest paid or payable in excess of lower of the following would be disallowed [i.e., ₹ 53.75 crores – ₹ 30.00 crores]

- 30% of EBIDTA ₹ 30.00 crores
- Interest paid or payable to non-resident AE ₹ 37.50 crores
Therefore, interest paid or payable to non-resident AE allowable as deduction under the head “Profits and gains of business or profession” [₹ 37.50 crores – ₹ 23.75 crores]

2. (a) (i) A company is typically financed or capitalized through a mixture of debt and equity. The manner in which company raises capital has a significant impact on the amount of profit it reports for tax purposes. This is due to the reason that tax legislations of countries typically allow a deduction for interest paid or payable in arriving at the profit for tax purposes while the dividend paid on equity contribution is not deductible. Therefore, the higher the level of debt in a company, and thus, the amount of interest it pays, the lower will be its taxable profit. For this reason, debt is often a more tax efficient method of finance than equity. Since in such a structure, equity financing is less, it is referred to as Thin Capitalization. Thin capitalization, thus, refers to the process of funding an entity by debt instead of equity with a view to take advantage of interest deduction benefits.

(ii) 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, new 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.
(iii) 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.

(b) (i) Section 92CE, provides that where a primary adjustment for an amount exceeding ₹1 crore has been made by the Assessing Officer in respect of A.Y.2017-18 or thereafter, which has been accepted by the assessee, a secondary adjustment shall be made. In the first scenario, where the assessee has not gone on an appeal against the order passed by the Assessing Officer, it may be considered that the adjustment made by the Assessing Officer has been accepted by the assessee. Hence, secondary adjustment has to be made by A Ltd. in the A.Y.2018-19, if the “excess money” (i.e., ₹8 crores, in this case) which is available with A LLC., Cyprus is not repatriated to India within 90 days from the date of order of the Assessing Officer.

In the second scenario, where the assessee files an appeal before the CIT(Appeals) it is evident that the primary adjustment made by the Assessing Officer is not accepted by the assessee and therefore, secondary adjustment is not required.

(ii) If the CIT (Appeals) reduces the primary adjustment made by the Assessing Officer to ₹6 crores by considering the arm’s length interest rate to be 5% (instead of 4%) and the same is accepted by A Ltd., then, A Ltd. has to repatriate the “excess money” [i.e., ₹6 crores] within 90 days from the date of the order of CIT (Appeals).

3. (a) As an anti-avoidance measure, section 94A was introduced in the Income-tax Act, 1961 with respect to transactions with persons located in a Notified Jurisdictional Area (NJA). As per section 94A, the Central Government may, having regard to the lack of effective exchange of information with any country or territory outside India, specify the said country or territory as a notified jurisdictional area in relation to
transactions entered into by any assessee. Any payment made to a person located in a NJA shall be liable for withholding tax @ 30% or the rate prescribed in the Act or the rates in force, whichever is highest.

The Central Government invoked the provisions of section 94A of the Act and notified Cyprus as a NJA in November, 2013 owing to inadequate exchange of information by Cyprus tax authorities. However, in December 2016, the Central Government has rescinded the said Notification, thereby removing Cyprus as a NJA with retrospective effect from the date of original notification. Therefore, since the provisions of section 94A will not be applicable in respect of payment made to a person located in Cyprus, A Ltd. is justified in deducting tax at the rate of 10% being the most beneficial rate contained in the DTAA between India and Cyprus.

(b) Safe Harbour Rules specified under Section 92CB(2) may be opted by an assessee in respect of an eligible international transaction. Advancing of loan and provision of corporate guarantee are covered within the definition of eligible international transactions. However, receipt of intra-group loans or guarantee fees paid by the Indian entity do not form part of eligible international transactions and hence, A Ltd shall not be eligible to opt for safe harbor rules in respect of the loans taken from its AEs.

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

1. (d) Non-resident for P.Y. 2017-18 and Resident and ordinarily resident for P.Y. 2013-14
2. (b) Tax rebate of INR 2,500 from tax payable on her total income of INR 3,40,000
3. (d) Neither (a) nor (b)
4. (a) Basic Salary paid outside India
5. (d) Normal tax slab rates
6. (b) if she has income exceeding the basic exemption limit but after taking into account deduction under Chapter VI-A, her income falls below the basic exemption limit
7. (c) No capital gains would arise on sale of 300 GDRs, but capital gains arising on sale of 200 GDRs shall be taxed in India @10% without indexation benefit
8. (c) Civil Construction in connection with an approved turnkey project
9. (a) taxable @10%
10. (c) A broker in India dealing with the non-resident person only through a non-resident broker, where both non-residents carry on transactions in the ordinary course of business

ANSWERS TO DESCRIPTIVE QUESTIONS

1. (i) In accordance with the provisions of section 115A, where the total income of a non-corporate non-resident includes any income by way of royalty or fees for technical services other than the income referred to in section 44DA(1), received from an Indian concern in pursuance of an agreement made by him with the Indian concern and the agreement is approved by the Central Government, then, the special rate of tax at 10% of such fees for technical services is applicable. No deduction would be allowable under sections 28 to 44C while computing such income.

Section 90(2) makes it clear that where the Central Government has entered into a DTAA with a country outside India, then, in respect of an assessee to whom such agreement applies, the provisions of the Act shall apply to the extent they are more beneficial to the assessee. Therefore, if the DTAA provides for a rate lower than 10%, then, the provisions of DTAA would apply.
(a) In this case, since India does not have a DTAA with Country ‘X’, of which the Abhinav is a resident, the fees for technical services (FTS) of INR 10,00,000 from ABC Ltd. would be taxable @10%, by virtue of section 115A.

(b) In this case, the FTS from ABC Ltd. would be taxable @5%, being the rate specified in the DTAA, even though section 115A provides for a higher rate of tax, since the tax rates specified in the DTAA are more beneficial. However, since Abhinav is a non-resident, he has to furnish a tax residency certificate from the Government of Country X for claiming such benefit. Also, he has to furnish other information, namely, his nationality, his tax identification number in Country X and his address in Country X.

(c) In this case, the FTS from ABC Ltd. would be taxable @10% as per section 115A, even though DTAA provides for a higher rate of tax, since the provisions of the Act (i.e. section 115A in this case) are more beneficial.

(ii) Under section 206AA, any person who is entitled to receive any sum or income or amount on which tax is deductible under Chapter XVII-B has to furnish his Permanent Account Number (PAN) to the person responsible for deducting such tax, failing which tax shall be deducted at

- the rate mentioned in the relevant provisions of the Act or
- the rate or rates in force or
- the rate of 20%

whichever is higher.

For the purpose of reducing the compliance burden of non-corporate non-residents or foreign company, section 206AA(7) provides for non-applicability of the requirements contained in section 206AA to a non-corporate non-resident or foreign company, in respect of interest on long-term bonds as referred to in section 194LC and any other payment subject to prescribed conditions.

As per Rule 37BC, the provisions of section 206AA shall not apply to a non-corporate non-resident or foreign company not having PAN in respect of payments in the nature of interest, royalty, fees for technical services and payments on transfer of any capital asset, if the deductee furnishes the following details and documents to the deductor:

- Name, e-mail id, contact number;
- address in the country or specified territory outside India of which the deductee is a resident;
- a certificate of his being resident in any country outside India from the Government of that country, if the law of that country provides for issuance of such certificate;

- Tax Identification Number of the deductee in the country of his residence. In case no such number is available, then a unique number on the basis of which the deductee is identified by the Government of that country or the specified territory of which he claims to be a resident.

Hence, if Mr. Abhinav fails to furnish the PAN details to ABC Ltd., then the company can obtain the above information from him and deduct TDS @10% in accordance with provisions of section 115A. If he is not able to furnish the requisite details, tax has to be deducted @20% under section 206AA, being the highest of the following rates –

- rate under section 115A i.e., 10%,

- rates in force i.e., 10%,

- 20%.

(iii) By virtue of section 44DA, the income by way of fees for technical services received by Mr. Abhinav from ABC Ltd., India, would be computed under the head "Profits and gains of business or profession" in accordance with the provisions of Income-tax Act, 1961, since technical services are provided from a fixed place of profession situated in India and fees for technical services is received from an Indian concern in pursuance of an agreement with the non-resident and is effectively connected with such fixed place of profession. No deduction would, however, be allowed in respect of any expenditure or allowance which is not wholly and exclusively incurred for the fixed place of profession in India.

Mr. Abhinav is required to keep and maintain books of account and other documents in accordance with the provisions contained in section 44AA and get his accounts audited by an accountant and furnish the report of such audit in the prescribed form duly signed and verified by such accountant along with the return of income.

2. (i) The statement is incorrect, since as per section 195(1), the obligation to deduct tax at source from interest and other payment to non-resident which are chargeable to tax in India, is on “any person responsible for paying to a non-resident or to a foreign company”. The words “any person” used in section is intended to include both residents and non-residents. Therefore, if the income of payee non-resident is chargeable to tax, then tax has to be deducted at source, whether the payment is made by a resident or non-resident.

Further, Explanation 2 to section 195(1) also clarifies that the obligation to comply with section 195(1) and to make deduction thereunder applies and shall be deemed to have
always applied and extends to all persons, resident or non-resident, whether or not the non-resident has:

(a) a residence or place of business or business connection in India; or

(b) any other presence in any manner whatsoever in India.

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

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

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

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

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

### 3. Computation of Total Income of Mr. Abhinav for A.Y. 2018-19

<table>
<thead>
<tr>
<th>Particulars</th>
<th>INR</th>
<th>INR</th>
<th>INR</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Profits &amp; Gains of Business &amp; Profession</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income from partnership firm M/s Lotus &amp; Co., India</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Interest on Capital <em>[See Note (ii)]</em></td>
<td>5,00,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Share of Profit</td>
<td>4,00,000</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

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Less: Exempt under section 10(2A) \( \text{(4,00,000)} \)

| Fees for technical services received from ABC Ltd., India | 10,00,000 |
| Fees for technical services received from Government of Country “Y” \([\text{See Note (iii)}]\) | 15,00,000 |

**Capital Gains** \([\text{See Working Note}]\)

<table>
<thead>
<tr>
<th>Short-term capital gain on sale of shares of</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>- PQR Pvt. Ltd.</td>
<td>1,500</td>
</tr>
<tr>
<td>- Hello Pvt. Ltd</td>
<td>1,80,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Long-term capital gain on sale of shares of</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>- PQR Pvt. Ltd</td>
<td>Nil</td>
</tr>
<tr>
<td>- Prime Pvt. Ltd.</td>
<td>72,500</td>
</tr>
</tbody>
</table>

**Income from Other Sources**

<table>
<thead>
<tr>
<th>Interest earned on deposits:</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>- Interest earned on NRO saving deposits</td>
<td>4,000</td>
</tr>
<tr>
<td>- Interest earned on fixed deposits</td>
<td>5,000</td>
</tr>
<tr>
<td>- Interest on NRE savings account ([\text{Exempt u/s 10(4)(ii)}]) ([\text{See Note (v)}])</td>
<td>- 9,000</td>
</tr>
</tbody>
</table>

**Gross Total Income**

\[17,63,000\]

**Less: Deductions under Chapter VI-A**

**Deduction under section 80C** \([\text{See Note (viii)}]\)

| Life insurance premium for self and his spouse | 50,000 |
| Term deposit \([\text{Five year term deposit}}]\) | 60,000 |
| Repayment of housing loan borrowed for construction of residential house | - 1,10,000 |

**Deduction under section 80D** \([\text{See Note (ix)}]\)

| Health insurance of self and spouse | 20,000 |
| Health insurance of mother | 25,000 |

**Deduction u/s 80TTA** \([\text{See Note (x)}]\)

\[4,000 \quad 1,59,000\]

**Total Income** \[16,04,000\]
## Computation of Tax Liability of Mr. Abhinav for A.Y. 2018-19

<table>
<thead>
<tr>
<th>Particulars</th>
<th>INR</th>
<th>INR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax@10% on fee for technical services under section 115A</td>
<td></td>
<td>1,00,000</td>
</tr>
<tr>
<td>Tax@10% on long-term capital gain on sale of foreign exchange assets under section 115E&lt;sup&gt;1&lt;/sup&gt;</td>
<td></td>
<td>7,250</td>
</tr>
<tr>
<td>Tax on balance income of INR 5,31,500 (i.e., INR 6,90,500 - INR 1,59,000)</td>
<td></td>
<td>18,800</td>
</tr>
<tr>
<td>Add: Education cess @2%</td>
<td></td>
<td>2,521</td>
</tr>
<tr>
<td>Secondary higher education cess @1%</td>
<td></td>
<td>1,261</td>
</tr>
<tr>
<td><strong>Tax liability</strong></td>
<td></td>
<td><strong>1,29,832</strong></td>
</tr>
<tr>
<td><strong>Tax liability (rounded off)</strong></td>
<td></td>
<td><strong>1,29,830</strong></td>
</tr>
</tbody>
</table>

Woking Note:

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

<table>
<thead>
<tr>
<th>Particulars</th>
<th>INR</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>LTCG on sale of shares of Prime Pvt. Ltd., since held for more than 24 months</strong></td>
<td></td>
</tr>
<tr>
<td><em>(As per the provisions of Chapter XII-A, long term capital gain, on sale of any specified asset in foreign currency, shall be calculated at flat rate of 10% without indexation. Shares of Prime Pvt. Ltd fall under the category of “specified assets”)</em></td>
<td></td>
</tr>
<tr>
<td>Sale Consideration</td>
<td>12,00,000</td>
</tr>
<tr>
<td>Less: Cost of Acquisition</td>
<td>(6,20,000)</td>
</tr>
<tr>
<td>Long term capital gain</td>
<td>5,80,000</td>
</tr>
<tr>
<td>Less: Exemption under section 115F</td>
<td></td>
</tr>
<tr>
<td><strong>5,80,000*10,50,000/12,00,000</strong></td>
<td>(5,07,500)</td>
</tr>
<tr>
<td><strong>Long-term capital gain as per Chapter XII-A</strong></td>
<td>72,500</td>
</tr>
</tbody>
</table>

<sup>1</sup> Since the question specifies that the Abhinav has opted for Chapter XII-A, the resultant long-term capital gains would be taxable @10%, after providing for proportional exemption under section 115F, which is available in respect of investment of net consideration in another specified asset, shares of a private company in this case. It would have been more beneficial for Abhinav to have not opted for Chapter XII-A, as he could have claimed exemption of the entire capital gain of INR 5,80,000 under section 54F, since the amount invested in construction of house at Pune exceeds the net sale consideration of INR 12 lakhs on sale of shares of Prime Pvt Ltd.
### STCG on sale of shares of Hello Pvt. Ltd., since held for less than 24 months

<table>
<thead>
<tr>
<th>Description</th>
<th>INR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sale Consideration</td>
<td>9,30,000</td>
</tr>
<tr>
<td>Less: Cost of Acquisition</td>
<td>(7,50,000)</td>
</tr>
<tr>
<td>Short term Capital Gain</td>
<td>1,80,000</td>
</tr>
</tbody>
</table>

*(Provisions of Chapter XII-A are only applicable in respect of long term capital gain from transfer of foreign exchange assets.)*

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

<table>
<thead>
<tr>
<th>Particulars</th>
<th>INR</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>LTCG on sale of 1500 shares acquired on October 1, 2015</strong></td>
<td></td>
</tr>
<tr>
<td><em>(As per section 2(42A), share of an unlisted company, if sold after period of 24 months from the acquisition date will be considered as long-term capital asset)</em></td>
<td></td>
</tr>
<tr>
<td>Sale Consideration [1,500 x INR 15]</td>
<td>22,500</td>
</tr>
<tr>
<td>Less: Cost of Acquisition [1,500 x INR 10]</td>
<td>(15,000)</td>
</tr>
<tr>
<td>Long term Capital Gain</td>
<td>7,500</td>
</tr>
<tr>
<td>Less: Exemption u/s 54F [since the amount invested in construction of house at Pune exceeds the net sale consideration of INR 22,500 on sale of shares, the entire capital gain would be exempt. The construction of the house in Pune was completed within the prescribed time i.e., within three years after the date of transfer]</td>
<td>7,500</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>STCG on sale of 500 shares acquired on October 31, 2016</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Sale Consideration [500 x INR 15]</td>
<td>7,500</td>
</tr>
<tr>
<td>Less: Cost of Acquisition [500 x INR 12]</td>
<td>(6,000)</td>
</tr>
<tr>
<td>Short term Capital Gain</td>
<td>1,500</td>
</tr>
</tbody>
</table>

**Notes:**

(i) Mr. Abhinav is a person who, staying outside India, comes on a visit to India every year. Hence, the minimum period of stay in India for Mr. Abhinav to be treated as a resident is 182 days in any previous year. For A.Y.2018-19, Mr. Abhinav is a non-resident since his stay in India in the P.Y.2017-18 is less than 182 days. In case of a non-resident, only income which accrues or arises or is deemed to accrue or arise in India or is received or is deemed to be received in India is taxable in India. Income which accrues or arises outside India is not taxable in India. Rental income from property in Country ‘X’ received there and subsequently brought to India is not taxable in India in the hands of Mr. Abhinav, since it neither accrues to him in India nor is it received by him in India.

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

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

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

(iv) As per section 9(1)(v)(c), interest payable by a non-resident would be deemed to accrue or arise in India, where the interest is payable on any debt incurred, or money borrowed and used, for the purpose of a business or profession carried on by such non-resident in India. In the present case, Mr. George, a non-resident had purchased bonds of MNO Ltd., an Indian company out of the money borrowed. Consequently, the interest received by Mr. Abhinav in foreign currency equivalent to INR 1,95,000 will not be taxable in India, since such interest is neither received nor is it deemed to accrue or arise in India. Mr. George is a non-resident in India for A.Y.2018-19 since his stay in India during the P.Y.2017-18 is only 36 days.

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

(vi) Transfer outside India of Rupee denominated bonds of an Indian company issued outside India and Government Securities through an intermediary dealing settlement of securities by Mr. Abhinav, a non-resident, to Mr. Thomas, another non-resident, would not be regarded as a transfer under section 47 for levy of capital gains tax. Thomas is a non-resident since he has stayed in India only for 100 days in the P.Y.2017-18. Being a citizen of India residing in Country “X”, he has to come and stay in India for atleast 182 days in a year to be treated as a resident.

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

(viii) Under section 80C, deduction is allowed for life insurance premium paid for self or spouse or any child, even though such premium is paid outside India. It is assumed that the annual premium is not more than 10% of actual capital sum assured. However, deduction in respect of tuition fees paid by individual to any university, college, school or other educational institution for full time education of his two children would be allowed only if, such institution is situated in India. Thus, payment for life insurance premium paid by Mr. Abhinav is fully allowable as deduction but no deduction would be allowed for annual tuition fees, since it is for education abroad. Further, no deduction is allowable under section 80C for A.Y.2018-19 in respect of repayment of housing loan, since the property in Pune is under-construction and no amount is chargeable to tax as income from house property, during the previous year 2017-18.

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

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

Therefore, interest earned on fixed deposits by Mr. Abhinav shall not be eligible for deduction under section 80TTA.
SOLUTION TO CASE STUDY 3

I. ANSWERS TO MULTIPLE CHOICE QUESTIONS

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

II. ANSWERS TO DESCRIPTIVE QUESTIONS

1. (a) Mr. Harry Smith is a non-resident in India for A.Y.2018-19, since he has stayed in India only for 54 days in the P.Y.2017-18. Ms. Rita Smith would also be non-resident in India for A.Y.2018-19, since she has also stayed in India only for 54 days in the P.Y.2017-18.

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.2018-19

<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>
<tr>
<td>Income taxable under section 115BB</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income from horse races</td>
<td>25,000</td>
<td></td>
</tr>
<tr>
<td><strong>Total income</strong></td>
<td><strong>17,45,000</strong></td>
<td>**        **</td>
</tr>
<tr>
<td>Tax @ 20% under section 115BBA on ₹ 17,20,000</td>
<td>3,44,000</td>
<td></td>
</tr>
<tr>
<td>Tax @ 30% under section 115BB on income of ₹ 25,000 from horse races</td>
<td>7,500</td>
<td>3,51,500</td>
</tr>
<tr>
<td>Add: Education cess@2% and SHEC@1%</td>
<td></td>
<td>10,545</td>
</tr>
<tr>
<td><strong>Total tax liability of Harry Smith for the A.Y.2018-19</strong></td>
<td><strong>3,62,045</strong></td>
<td>**        **</td>
</tr>
</tbody>
</table>

Computation of tax liability of Rita Smith for the A.Y.2018-19

<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 music performances given in India</td>
<td>2,00,000</td>
<td></td>
</tr>
<tr>
<td><strong>Total income</strong></td>
<td><strong>2,00,000</strong></td>
<td>**        **</td>
</tr>
<tr>
<td>Tax @ 20% under section 115BBA on ₹ 2,00,000</td>
<td>40,000</td>
<td></td>
</tr>
<tr>
<td>Add: Education cess@2% and SHEC@1%</td>
<td></td>
<td>1,200</td>
</tr>
<tr>
<td><strong>Total tax liability of Rita Smith for the A.Y.2018-19</strong></td>
<td><strong>41,200</strong></td>
<td>**        **</td>
</tr>
</tbody>
</table>

(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@20.6% 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. 41,200 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 2018-19. 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 2018-19.

**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)</td>
<td>40 crores (60 crores – 20 crores)</td>
</tr>
<tr>
<td>Deemed income @5% u/s 44BBA</td>
<td>9 (180 crores × 5%)</td>
<td>2 (4 crores × 5%)</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.

(c) As per section 5(2), the total income of a non-resident would include all income which is, *inter alia*, deemed to accrue or arise to him in India in that year.

In the case of a non-resident, being a person engaged in the business of banking, any interest payable by the Permanent Establishment (PE) in India of such non-resident to the head office or any PE or any other part of such non-resident outside India, shall be deemed to accrue or arise in India [Explanation to section 9(1)(v)].

In the present case, the Indian branch, being a fixed place of business, is the PE in India of PQR Bank Ltd., being a non-resident engaged in the banking business, since such business is carried on in India through the Indian branch [Clause (iii) of section 92F].

Accordingly, the interest of ₹ 35 lakhs paid to its head office in Country Z and ₹ 17 lakhs paid to the other branch office in Country N by the Indian branch [being the PE in India of PQR Bank Ltd, a non-resident engaged in the business of banking] shall be deemed to accrue or arise in India and shall be liable to tax in India in the hands of head office and Country N branch, respectively, in addition to any income attributable to the PE in India.

3. (a) Computation of tax liability of Mr. Mahesh Sharma for A.Y. 2018-19

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Indian Income</td>
<td>45,00,000</td>
</tr>
<tr>
<td>Foreign Income</td>
<td>12,00,000</td>
</tr>
<tr>
<td><strong>Gross Total Income</strong></td>
<td><strong>57,00,000</strong></td>
</tr>
<tr>
<td>Less:</td>
<td></td>
</tr>
<tr>
<td><strong>Deduction under section 80C</strong></td>
<td></td>
</tr>
<tr>
<td>PPF Contribution</td>
<td>75,000</td>
</tr>
<tr>
<td><strong>Deduction under section 80D</strong></td>
<td></td>
</tr>
<tr>
<td>Medical insurance premium of father, being a resident senior citizen, restricted to</td>
<td>30,000</td>
</tr>
<tr>
<td><strong>Deduction under section 80DD</strong></td>
<td></td>
</tr>
<tr>
<td>Maintenance including medical treatment of his dependent sister, being a person with disability [Flat deduction, irrespective of expenditure incurred]</td>
<td>75,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total Income</strong></td>
<td><strong>55,20,000</strong></td>
</tr>
<tr>
<td>Tax on total income</td>
<td>14,68,500</td>
</tr>
</tbody>
</table>
Add: Surcharge@10% (since total income exceeds Rs.50 lakhs but is less than Rs.1 crore) | 1,46,850 
|---|---
| Add: Education cess@2% | 32,307 
| Secondary and higher education cess @ 1% | 16,153 
| 16,63,810 |

Average rate of tax in India [i.e., ₹ 16,63,810/₹ 55,20,000 x 100] = 30.14% 

Average rate of tax in Country P [i.e. ₹ 3,36,000/ ₹ 12,00,000 x 100] = 28% 

Doubly taxed income | 12,00,000 

Rebate under section 91 on ₹ 12,00,000 @28% (lower of average Indian tax rate and Country P tax rate) | 3,36,000 

Tax payable in India [₹ 16,63,810 – ₹ 3,36,000] = 13,27,810

Note: Deduction under section 91 is allowable to Mr. Mahesh Sharma, since he fulfils the following conditions are fulfilled:-

(a) He is a resident in India during the relevant previous year, since his stay in India during the P.Y.2017-18 was more than 182 days.

(b) The income of Rs.12 lakhs from concerts accrues or arises to him outside India in Country P during that previous year.

(c) Such income is not deemed to accrue or arise in India during the previous year.

(d) The income in question has been subjected to income-tax in Country P in his hands and he has paid tax on such income in Country P.

(e) There is no agreement under section 90 for the relief or avoidance of double taxation between India and Country P where the income has accrued or arisen.

In this case, Mr. Mahesh Sharma is eligible for deduction under section 91, since all the above conditions are fulfilled.

(b) The REIT enjoys pass-through status in respect of rental income from real estate asset owned by it directly and interest income from special purpose vehicle, (i.e., A Ltd., in this...
case, since it is an Indian company in which REIT holds controlling interest). Therefore, such income is taxable in the hands of the unit holders.

(1) **Rental income component of income distributed by REIT:** The distributed income or any part thereof, received by Vallish from the REIT, which is in the nature of income by way of renting or leasing or letting out any real estate asset owned directly by such REIT is deemed income of the unit-holder as per section 115UA(3). Accordingly, Rs.1,25,000 would be deemed income of Vallish as per section 115UA(3). The REIT has to deduct tax at source under section 194LBA@30.9% (being the rate in force) in case of distribution to Vallish, being a non-resident.

(2) **Interest component of income distributed by REIT:** Interest component of income received from a special purpose vehicle, A Ltd., in this case, and distributed to a unit holder is taxable@5% in the hands of the unit holder. Accordingly, such interest component of Rs.62,000 is taxable in the hands of Vallish. The REIT has to deduct tax at source under section 194LBA@5%, on Rs.62,000, since Vallish is a non-resident.

(3) **Dividend component of income distributed by REIT:** Any distributed income referred to in section 115UA, to the extent it does not comprise of interest [referred to in sub-clause (a) of section 10(23FC)] and rental income from real estate assets owned directly by the business trust [referred to in section 10(23FCA)] received by unit holders, is exempt in their hands under section 10(23FD). Therefore, by virtue of section 10(23FD), Rs.58,000, being the dividend component [referred to in sub-clause (b) of section 10(23FC)] of income distributed to Vallish would be exempt in his hands. Therefore, there is no liability on the REIT to deduct tax at source on the dividend component of income distributed by it to Mr. Vallish.
I. ANSWERS TO MCQs

<table>
<thead>
<tr>
<th>MCQ No.</th>
<th>Answer</th>
<th>MCQ No.</th>
<th>Answer</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>(d)</td>
<td>6.</td>
<td>(c)</td>
</tr>
<tr>
<td>2.</td>
<td>(c)</td>
<td>7.</td>
<td>(a)</td>
</tr>
<tr>
<td>3.</td>
<td>(d)</td>
<td>8.</td>
<td>(c)</td>
</tr>
<tr>
<td>4.</td>
<td>(b)</td>
<td>9.</td>
<td>(d)</td>
</tr>
<tr>
<td>5.</td>
<td>(d)</td>
<td>10.</td>
<td>(d)</td>
</tr>
</tbody>
</table>

II. ANSWERS TO DESCRIPTIVE QUESTIONS

Answer to Q.1

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

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

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount (in Euro)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Price per MT of steel to PQR Inc.</td>
<td>1,200</td>
</tr>
<tr>
<td>Less: Cost of insurance and freight per M.T.</td>
<td>400</td>
</tr>
<tr>
<td>Adjusted Price per M.T.</td>
<td>800</td>
</tr>
</tbody>
</table>

Since the adjusted price for PQR Inc., Country A and the price fixed for ABC Inc. are the same, the arm’s length price is Euro 800 per MT. Since the sale price to associated enterprise (i.e., ABC Inc.) and unrelated party (i.e., PQR Inc.) is the same, the transaction with associated enterprise ABC Inc. has also been carried out at arm’s length price.
(ii) Sigma Ltd., India and Epsilon Ltd., Country B are deemed to be associated enterprises, since Epsilon Ltd. holds shares carrying 26.66% [1,40,000 × 100/5,25,000], voting power in Sigma Ltd, from the information given in Exhibit C. Since Epsilon Ltd. is a non-resident, the transactions of purchase by Sigma Ltd. of goods manufactured by Epsilon Ltd. for sale in India would fall within the meaning of “international transaction” under section 92B. Therefore, transfer pricing provisions would be attracted in this case and the arm’s length price have to be applied to such transactions.

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

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

(1) Failure to report transactions with Epsilon Ltd. would attract penalty of Rs.132.252 lakhs, being @ 200% of the amount of tax payable on under reported income of Rs.2 crore, since it is a case of misreporting of income referred under section 270A(9) read with section 270A(8).

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Under-reported income [Rs. 8 crore – Rs.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 Rs. 2 crore plus total income of Rs. 6 crore declared [30% of Rs. 8 crore + surcharge@ 7% + EC &amp; SHEC@3%]</td>
<td>2,64,50,400</td>
</tr>
<tr>
<td>Less: Tax on total income declared [30% of Rs. 6 crore + Surcharge@7% + EC &amp; SHEC@3%]</td>
<td>1,98,37,800</td>
</tr>
<tr>
<td><strong>Penalty leviable@200% of tax payable on under-reported income</strong></td>
<td>1,32,25,200</td>
</tr>
</tbody>
</table>

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

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

Section 92A defines an “associated enterprise” and sub-section (2) of this section speaks of the situations when the two enterprises shall be deemed to associated enterprises. Applying the provisions of section 92A(2)(a) to (m) to the given facts in the case study along with Exhibit D, it is clear that “XYZ Motors Ltd.” is deemed to be associated with :-

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

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

However, GHI Inc., Country D is not an associated enterprise of XYZ Motors Ltd. since its voting power in XYZ Motors Ltd. is only 2.31% \( [3,000 \times 100/1,30,000] \). Further, HIT Ltd., Country D, is not an associated enterprise of XYZ Motors Ltd., since this company has financed an amount which is only 49.95% \( [74 \times 81 \times 100 /12,000] \) (i.e., less than 51%) of the book value of total assets of XYZ Motors Ltd. Also, it holds shares carrying only 0.77% \( [1,000 \times 100/1,30,000] \) voting power in XYZ Motors Ltd.

The transactions entered into by XYZ Motors Ltd. with LMN Inc. and RST Ltd. are, therefore, to be adjusted accordingly to work out the income chargeable to tax for the A.Y. 2018-19.

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

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

<table>
<thead>
<tr>
<th>Particulars</th>
<th>(Rs. in crores)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income of XYZ Motors Ltd. as computed under Chapter IV-D, prior to adjustments as per Chapter X</td>
<td>585.00</td>
</tr>
<tr>
<td>Add: Difference on account of adjustment in the value of international transactions:</td>
<td></td>
</tr>
<tr>
<td>(i) Difference in price of van @ Euro 280 each for 8,500 vans (Euro 280 x 8,500 x Rs.81) sold to LMN Inc.</td>
<td>19.278</td>
</tr>
<tr>
<td>(ii) Difference for excess payment of royalty of $ 20,000,000 ($20,000,000 x Rs.60) to RST Ltd.</td>
<td>12,000</td>
</tr>
<tr>
<td><strong>Total Income</strong></td>
<td><strong>616.278</strong></td>
</tr>
</tbody>
</table>

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

Answer to Q.3

(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 Rs.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% \([10 \times 100/68]\), 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% \([1 \times 100/18]\), 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.
Since the aggregate value of transactions entered into in the P.Y.2017-18 exceeds Rs.100 crore but does not exceed Rs.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.
I. ANSWERS TO MCQs (Most appropriate answers)

1. (c)
2. (b)
3. (b)
4. (d)
5. (d)
6. (b)
7. (b)
8. (a)
9. (c)
10. (b)
II. ANSWERS TO DESCRIPTIVE QUESTIONS

Answer to Q.1:

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

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

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

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

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

Answer to Q.2(a):

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

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

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

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

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

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

• Modifying the existing Permanent Establishment (PE) rule to provide whether an enterprise engaged in fully de-materialized digital activities would constitute a PE, if it maintained a significant digital presence in another country's economy.

• A virtual fixed place of business PE in the concept of PE i.e., creation of a PE when the enterprise maintains a website on a server of another enterprise located in a jurisdiction and carries on business through that website

• Imposition of a final withholding tax on certain payments for digital goods or services provided by a foreign e-commerce provider or imposition of a equalisation levy on consideration for certain digital transactions received by a non-resident from a resident or from a non-resident having PE in other contracting state.

Answer to Q.2(b)

The process of determination of POEM is primarily based on the fact as to whether or not the company is engaged in active business outside India.

A company shall be said to be engaged in “active business outside India”

- if the passive income is not more than 50% of its total income; and

- less than 50% of its total assets are situated in India; and

- less than 50% of total number of employees are situated in India or are resident in India; and

- the payroll expenses incurred on such employees is less than 50% of its total payroll expenditure.

Passive income is the aggregate of, -

(i) income from the transactions where both the purchase and sale of goods is from/to its associated enterprises; and

(ii) income by way of royalty, dividend, capital gains, interest or rental income;


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<thead>
<tr>
<th>(1)</th>
<th>(2)</th>
<th>(3)</th>
<th>(4)</th>
<th>(5)</th>
<th>(6)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Particulars</td>
<td>Country A</td>
<td>Country B</td>
<td>India</td>
<td>Total</td>
<td>% of (4) to total in (5)</td>
</tr>
<tr>
<td>Value of assets</td>
<td>Rs.400 lakhs</td>
<td>Rs.100 lakhs</td>
<td>Rs.210 lakhs</td>
<td>Rs.710 lakhs</td>
<td>29.58%</td>
</tr>
<tr>
<td>Number of employees</td>
<td>30</td>
<td>10</td>
<td>20</td>
<td>60</td>
<td>33.33%</td>
</tr>
<tr>
<td>Payroll expenses on employees</td>
<td>Rs.160 lakhs</td>
<td>Rs.35 lakhs</td>
<td>Rs.65 lakhs</td>
<td>260</td>
<td>25.00%</td>
</tr>
</tbody>
</table>

It can be seen that the value of assets in India is only 29.58% of the total assets of the company, the number of employees in India is only 33.33% 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 active business to be outside India.

**Passive income** = income from transactions where both purchases and sales are from/to associated enterprises + total income by way of dividend and interest = Rs.110 lakhs + Rs.35 lakhs = Rs.145 lakhs

Percentage of passive income to total income = 145/250 × 100 = 58%

In this case, the passive income is more than 50% of the company’s total income. Hence, the passive income test has failed, consequent to which the company cannot be said to have active business outside India.

**Answer to Q.3:**

(a) Equalization 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, Google Inc is a non-resident not having PE in India. It receives consideration of Rs.30 lakhs from Athena Ltd., a non-resident having PE in India, for online advertisement services provided by it. Hence, equalization levy@6% on Rs.30 lakhs is attracted in the hands of Google Inc.

In the hands of Athena Ltd., the amount of Rs.30 lakhs paid to Google Inc. would be allowable as business expenditure, provided equalization levy has been deducted at source.

(b) Athena Ltd. is liable to deduct equalization levy of Rs.1.80 lakhs from the amount of Rs.30 lakhs payable to Google 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, 2018. Further, penalty of an amount equal to Rs.1.80 lakhs would be attracted for failure to deduct equalization levy. Also, disallowance of the expenditure of Rs.30 lakhs would be attracted under section 40(a)(ib) while computing business income of Athena 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.
I. ANSWERS TO MCQs (Most appropriate answers)

1. (d)  
2. (c)  
3. (c)  
4. (c)  
5. (c)  
6. (b)  
7. (c)  
8. (b)  
9. (d)  
10. (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 2017, he stayed in India during the P.Y. 2017-18 for 183 days. Therefore, he is a resident in India for the P.Y.2017-18.

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

i) He is a resident in atleast 2 out of 10 years preceding the relevant previous year, and
ii) His total stay in India in last seven years preceding P.Y. 2017-18 is 730 days or more.
Thus, Shivam is Resident and Ordinarily Resident in India for the P.Y. 2017-18.

As per Country “Q” tax residency rules, Shivam qualifies to be resident for the year 2017-18 in Country “Q”, since he stays for 182 days (more than 180 days) in Country “Q” in the Financial Year 2017-18.

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 2017-18. 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) Article 28 of India-Country “Q” DTAA deals with the international exchange of information between the tax authorities of the countries. The purpose is wider than mere tax compliances; it is also meant to counter tax evasion and avoidance. The competent authorities of the two Contracting States can exchange information which is ‘foreseeably relevant’ for the proper application of agreement or for the administration or enforcement of their domestic laws, as long as taxation under the laws is not inconsistent with the treaty agreement.

Paragraph 3 of the Article lists the types of information, the request for which either country is not obligated to comply.

However, paragraph 4 of the Article further clarifies that even though obligation to provide information is subject to the limitation contained in paragraph 3, the requested country cannot decline to supply information solely because it has no domestic interest in such information.

Accordingly, Country “Q” tax authorities are not justified in denying to provide information stating that it will not get any revenue benefit by providing such information. Country “Q” is obligated to provide the requested information, even if it has no revenue interest in the case to which the request relates.

However, in case the reason of denial is in accordance with the specific limitations contained in paragraph 3, then, Country “Q” tax authorities shall be under no obligation to provide the requested
information. Hence, denial by tax authorities on the ground that exchange of such information would be contrary to public policy is justified.

2. (a) (i) 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.

(ii) As per section 245N(b)(A)(I), an application for advance ruling can be made inter-alia by a non-resident in relation to a transaction which has been undertaken or is proposed to be undertaken by it.

Hence, Cure House Inc., a non-resident applicant, can file an application to Authority of Advance Ruling, alongwith the prescribed fees, for determination in relation the transaction undertaken by it in India i.e., rendering consultancy services in the field of medicine.

As per section 245N(b)(A)(III), a resident applicant who has undertaken or has proposed to undertake one or more transactions of value of INR 100 crore or more in total can file an application for Advance Ruling for determination by the AAR in relation to his/her tax liability arising out of such transactions and such determination shall include the determination of any question of law or of fact specified in the application.

In the present case, since the project value is only INR 70 crore, Sudha, a resident Indian cannot file an application with AAR for determination of her tax liability arising out of the said project.

(b) Section 9(1)(i) requires existence of business connection for deeming business income to accrue or arise in India. DTAAs may, however, provide that business income is taxable only if there is a permanent establishment in India.

Therefore, in cases covered by DTAAs, where there is no permanent establishment in India, business income cannot be brought to tax due to existence of business connection as per section 9(1)(i). However, in cases not covered by DTAAs, business income attributable to business connection is taxable.

Hence, business income earned by a resident of Country Q can be brought to tax only if he has a PE in India. However, business income of a resident of Country N attributable to his business connection in India, can be brought to tax in India.

3. Computation of total income of Shivam for A.Y. 2018-19

<table>
<thead>
<tr>
<th>Particulars</th>
<th>INR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income from Salaries</td>
<td></td>
</tr>
<tr>
<td>Salary from services rendered in India (April - September 2017)</td>
<td></td>
</tr>
<tr>
<td>Basic Salary (INR 70,000 x 6)</td>
<td>4,20,000</td>
</tr>
<tr>
<td>Dearness Allowance (INR 30,000 x 6)</td>
<td>1,80,000</td>
</tr>
<tr>
<td>Special Allowance (INR 5,000 x 6)</td>
<td>30,000</td>
</tr>
</tbody>
</table>
### Bonus

[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]

<table>
<thead>
<tr>
<th>Bonus</th>
<th>3,00,000</th>
</tr>
</thead>
</table>

### Salary from services rendered in Country “Q” (October 2017 - March 2018)

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</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>Total</strong></td>
<td>6,74,880</td>
</tr>
</tbody>
</table>

### Income from House Property at Mumbai

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

### Income from Other Sources

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</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] [See Rule 115 in Note (i)]</td>
<td>7,292</td>
</tr>
<tr>
<td>Interest on Securities of a Country “Q” company [QGD 5000 x INR 48.52] [See Rule 115 in Note (i)]</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) [See Rule 115 in Note (i)]</td>
<td>48,520</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>3,38,412</td>
</tr>
</tbody>
</table>

### Gross Total Income

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total</strong></td>
<td>23,63,292</td>
</tr>
</tbody>
</table>

### Less: Deductions under Chapter VI-A

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deduction u/s 80DD</td>
<td>75,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>75,000</td>
</tr>
</tbody>
</table>

(Flat deduction of INR 75,000 is allowed in respect of medical treatment of dependent disabled, irrespective of the expenditure incurred)

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deduction u/s 80GG [See Note (iii)]</td>
<td>60,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>1,35,000</td>
</tr>
</tbody>
</table>

### Total Income

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total</strong></td>
<td>22,28,292</td>
</tr>
</tbody>
</table>

### Total Income (rounded off)

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total</strong></td>
<td>22,28,290</td>
</tr>
</tbody>
</table>

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Computation of tax liability of Shivam for A.Y. 2018-19

<table>
<thead>
<tr>
<th>Particulars</th>
<th>INR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax on INR 22,28,290</td>
<td>4,80,987</td>
</tr>
<tr>
<td>Add: Education cess @2%</td>
<td></td>
</tr>
<tr>
<td>Secondary higher education cess @1%</td>
<td></td>
</tr>
<tr>
<td>Tax Liability</td>
<td>4,95,417</td>
</tr>
<tr>
<td>Less: Foreign Tax Credit [See Note (v)]</td>
<td></td>
</tr>
<tr>
<td>- on salary income</td>
<td>1,01,232</td>
</tr>
<tr>
<td>- on interest income</td>
<td>36,390</td>
</tr>
<tr>
<td>Net tax liability</td>
<td>3,57,795</td>
</tr>
<tr>
<td>Net tax liability (rounded off)</td>
<td>3,57,800</td>
</tr>
</tbody>
</table>

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 last day of the month immediately preceding the month in which the income is due i.e. rate as on 28.02.2018
- **Interest earned on other than securities** i.e. interest on bank deposits - last day of the previous year i.e. rate as on 31.03.2018
- **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 28.02.2018

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

**Overseas salary for the period October 2017 to March 2018:**

<table>
<thead>
<tr>
<th>Month</th>
<th>Basic Salary in QGD</th>
<th>Cost of living Allowance (COLA)</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 17</td>
<td>1400</td>
<td>1000</td>
<td>45.95</td>
<td>64,330</td>
<td>45,950</td>
</tr>
<tr>
<td>Nov 17</td>
<td>1400</td>
<td>1000</td>
<td>46.85</td>
<td>65,590</td>
<td>46,850</td>
</tr>
<tr>
<td>Dec 17</td>
<td>1400</td>
<td>1000</td>
<td>45.10</td>
<td>63,140</td>
<td>45,100</td>
</tr>
<tr>
<td>Jan 18</td>
<td>1400</td>
<td>1000</td>
<td>46.95</td>
<td>65,730</td>
<td>46,950</td>
</tr>
<tr>
<td>Feb 18</td>
<td>1400</td>
<td>1000</td>
<td>47.83</td>
<td>66,962</td>
<td>47,830</td>
</tr>
<tr>
<td>Mar 18</td>
<td>1400</td>
<td>1000</td>
<td>48.52</td>
<td>67,928</td>
<td>48,520</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>8400</strong></td>
<td><strong>6000</strong></td>
<td><strong>-</strong></td>
<td><strong>3,93,680</strong></td>
<td><strong>2,81,200</strong></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 22,88,290 = INR 5,72,073
- Actual rent – 10% of adjusted total income = INR 3,00,000 (25,000*12) – INR 2,28,829 (10% of 22,88,290) = INR 71,171

Adjusted total income = Gross total income after providing for deduction under section 80C to 80U but before deduction under section 80GG = INR 23,63,292 – INR 75,000 = INR 22,88,292 (rounded off to INR 22,88,290).

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.2018-19 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 25 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:

<table>
<thead>
<tr>
<th>Calculation of foreign tax credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Doubly taxed Salary Income</td>
</tr>
<tr>
<td>Basic Salary</td>
</tr>
<tr>
<td>Cost of Living Allowance</td>
</tr>
<tr>
<td>Doubly taxed salary income</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% = INR 1,01,232
- Tax payable in India on salary income@22.23% = INR 1,50,046

Foreign tax credit = INR 1,01,232
<table>
<thead>
<tr>
<th><strong>Double taxed Interest Income</strong></th>
<th><strong>INR</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest Income on Securities of Country Q company</td>
<td>2,42,600</td>
</tr>
<tr>
<td><strong>Computation of foreign tax credit on doubly taxed interest income:</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Lower of:</strong></td>
<td></td>
</tr>
<tr>
<td>Tax withheld in Country Q on interest income at 15%, which is also the rate as per the DTAA</td>
<td>36,390</td>
</tr>
<tr>
<td>Tax payable in India on interest income@22.23%</td>
<td>53,930</td>
</tr>
<tr>
<td><strong>Foreign tax credit</strong></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. (c)
2. (d)
3. (a)
4. (b)
5. (a)
6. (c)
7. (b)
8. (b)
9. (b)
10. (c)

II. ANSWERS TO DESCRIPTIVE QUESTIONS

Answer to Q.1

(i) The eligibility of partnership firms for tax treaty benefits have been a controversial area and is a classic case of economic double taxation. This is due to the fact that each country has its own methodology to tax partnership firms. For instance, India taxes the income of a partnership in the firm’s hands, but the Contracting State, in this case, Country Y and Country Z, taxes such income in the hands of the partner directly, treating the partnership as “fiscally transparent entity”. In both cases, the income is subject to tax in both countries albeit in the hands of different persons i.e., in the hands of the partners in the country of residence and in the hands of the firm in the source country, namely, India.

The conditions for eligibility of benefits under the DTAA are provided in Article 1 read along with the other relevant articles of the DTAA. These conditions have to be fulfilled including the condition that the entity has to be a person and resident of the either of the contracting states.

(a) As per Article 3(1)(d) of the India-Country Y DTAA, the term ‘person’ includes any entity which is treated as a taxable unit under the tax laws in force in the respective States.

In order to be eligible for the DTAA, it has to be seen whether the partnership firm is a resident of the Contracting State. Article 4(1) of the India-Country Y DTAA defines a “resident of a Contracting State” to mean a person “liable to tax in that State by reason of his domicile, residence, place of management or any other criterion of similar nature”.

As per Article 2 of the India-Country Y DTAA, the scope of the DTAA extends to both income-tax and trade tax as may be levied under the laws of Country Y. Since trade tax is being levied on the Gryffindors Y partnership firm, it can held that the firm is “liable to tax” and therefore the requirement in Article 4 gets satisfied. Accordingly, Gryffindors Y partnership firm shall be eligible to access the India-Country Y DTAA based on this line of reasoning.
(b) As per Article 3(1)(d) of the India-Country Z DTAA, the term ‘person’ includes any other entity which is taxable under the laws in force in the either Contracting States.

Article 4(1) of the India-Country Z DTAA defines a “resident of a Contracting State” to mean any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management, place of incorporation, or any other criterion of a similar nature. Further, in the case of income derived or paid by a partnership, this term applies only to the extent that the income derived by such partnership, is subject to tax in that State as the income of a resident, either in its hands or in the hands of its partners.

Thus, Article 4(1) of the treaty clearly provides that in the case of income derived or paid by a partnership, the term “resident of a contracting state”, in case of a firm, applies to the extent that the income derived by such partnership, is subject to tax in that State as the income of a resident, either in its hands or in the hands of its partners. The article clearly permits a firm to be treated as a resident of a contracting state in respect of income which is either liable to tax in its hands or in the hands of the partners. Therefore, Gryffindors Z partnership firm would be entitled to the benefits of the India-Country Z tax treaty, even though it is a fiscally transparent entity as per the tax laws of Country Z.

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

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

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

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

As per sub-section (11) and (12) of section 2 of the Finance Act, 2017, the amount of income-tax as increased by the applicable surcharge shall be further increased by an additional surcharge to be called “Education cess” and “secondary and higher education cess”. Therefore, education cess and secondary and higher education cess are nothing but an additional surcharge. Since as per the DTAs, taxes covered include any surcharge on income-tax, additional surcharge called as education cess and SHEC are also included therein.

Therefore, if the tax treaty rate is invoked, the tax rate specified thereunder is all inclusive and there is no requirement to separately add surcharge, education cess and SHEC over and above the rate prescribed in the DTAA.
Answer to Q.2

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

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

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

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

(iii) Assuming that the income earned by Country X is taxable in India, M/s Gryffindors LLP, a Country X based partnership firm, can mitigate the tax by taking recourse to the grossing up provisions under section 195A of the Income-tax Act, 1961. In such a case, the resident payer shall have to bear the burden of tax on payments due to the non-resident. The amount paid by the resident payer will be considered as net of tax payment and the payment is required to be grossed up for calculation of tax liability. The grossed-up amount will be treated as the amount agreed to be paid and tax shall be calculated at the prescribed rate on the gross amount. Such tax would be payable by Abhimanyu Holdings Bank Ltd., India, in this case. Therefore, the Country X firm, being non-resident in India, can enter into a suitable agreement based on which the firm will not bear the Indian tax liability, even if taxes are to be withheld. The tax liability would be borne by Abhimanyu Holdings Bank Ltd., India, the payer, in this case.
(iv) The Country X firm, being a non-resident, may apply for an advance ruling under section 245N for determination of tax liability in relation to a transaction which is proposed to be undertaken by it with a view to avoiding litigation and providing certainty. Therefore, in this case, the Country X firm can make an application to the Authority of Advance Rulings in the prescribed form and manner to determine its taxability in India for the proposed Assignment C to be undertaken by it.

Note – Questions based on interpretation of articles of a DTAA may have alternate views.
CASE STUDY - 1

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

1. The provisions relating to limitation of interest deduction in respect of debt issued by a non-resident associated enterprise are not applicable to an Indian company engaged in the business of:

   (a) Information Technology

   (b) Banking and Insurance

   (c) Bio-technology

   (d) Aviation
2. The provisions relating to limitation of interest deduction in respect of debt issued by a non-resident associated enterprise would not apply where the expenditure by way of interest or similar nature is -

(a) ₹ 2.10 crore
(b) ₹ 2 crore
(c) ₹ 1.50 crore
(d) ₹ 1 crore

3. 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.

4. In respect of any payment made to a person located in a Notified Jurisdictional Area (NJA), tax is deductible at higher of the rate specified in the Income-tax Act 1961 or rates in force or -

(a) 10%
(b) 15%
(c) 20%
(d) 30%

5. 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
6. 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

7. Interest paid to non-resident associated enterprise disallowed under the relevant provision of the Income-tax Act, 1961, during the A.Y.2019-20 can be carried forward upto-

(a) A.Y.2023-24
(b) A.Y.2024-25
(c) A.Y.2027-28
(d) Indefinitely

8. 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

9. 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 
(d) A.Y.2017-18 and the amount of primary adjustment is ₹ 1 crore.

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

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”. (10 Marks)

2. (a) (i) Examine how thin capitalization is an anti-avoidance measure. (2 Marks)
(ii) Which Action Plan of BEPS is based on thin capitalization? Mention the provision incorporated in the Income-tax Act, 1961 in line with this Action Plan. (2 Marks)
(iii) 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)

(b) The Assessing Officer has, while carrying out the transfer pricing assessment for Assessment Year 2018-19, arrived at an arm’s length rate interest of 4% on the loan obtained from A LLC Cyprus (Interest paid ₹ 80 crores). Accordingly, he has made a primary adjustment to the tune of ₹ 40 crores for A.Y. 2018-19. In this regard,
(i) You are required to examine whether any secondary adjustment is to be made under the relevant provision of the Income-tax Act, 1961, where –

(1) A Ltd has not gone on an appeal on the said matter.

(2) A Ltd. has opted to file an appeal before the CIT (Appeals)

(ii) What would be the consequence if the CIT (Appeals) increases the Arm’s Length price determined by the Assessing Officer to ₹ 50 crores, by considering the arm’s length interest rate@5% instead of 4%, and the same is accepted by A Ltd.? (4 Marks)

3. (a) On the facts provided, A Ltd makes interest payment to A LLC, Cyprus. While making the interest payment to A LLC, Cyprus, A Ltd had withheld taxes at 10% based on Article 11 of India-Cyprus double taxation avoidance agreement. The Assessing Officer has issued a show cause notice contending that the assessee has deducted tax at a lower rate, based on the view that A LLC, Cyprus is a notified jurisdiction area. You are required to reply to the show cause notice of the Assessing Officer, giving your views. (4 Marks)

<table>
<thead>
<tr>
<th>Extract of ARTICLE 11 of DTAA between India and Cyprus</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>INTEREST</strong></td>
</tr>
<tr>
<td>1. Interest arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.</td>
</tr>
<tr>
<td>2. However, such interest may also be taxed in the Contracting State in which it arises, and according to the laws of that State, but if the beneficial owner of the interest is a resident of the other Contracting State, the tax so charged shall not exceed 10 percent of the gross amount of the interest.</td>
</tr>
<tr>
<td>3. Notwithstanding the provisions of paragraph 2, interest arising in a Contracting State shall be exempt from tax in that State, provided that it is derived and beneficially owned by:</td>
</tr>
<tr>
<td>(a) the Government, a political sub-division or a local authority of the other Contracting State; or</td>
</tr>
<tr>
<td>(b) in the case of India, the Reserve Bank of India, the Export-Import bank of India, the National Housing bank; and</td>
</tr>
<tr>
<td>(c) any other institution as may be agreed upon from time to time between the Competent authorities of the Contracting States through exchange of letters</td>
</tr>
<tr>
<td>4. The term &quot;interest&quot; as used in this Article means income from debt claims of every kind, whether or not secured by mortgage and whether or not carrying a right to participate in the debtor's profits, and in particular, income from government securities and income from bonds or debentures, including premiums and prizes</td>
</tr>
</tbody>
</table>
attaching to such securities, bonds or debentures. Penalty charges for late payment shall not be regarded as interest for the purpose of this Article.

5. The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the interest, being a resident of a Contracting State, carries on business in the other Contracting State in which the interest arises, through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the debt claim in respect of which the interest is paid is effectively connected with such permanent establishment or fixed base. In such case the provisions of Article 7 or Article 14, as the case may be, shall apply.

6. Interest shall be deemed to arise in a Contracting State when the payer is a resident of that State. Where, however, the person paying the interest, whether he is a resident of a Contracting State or not, has in a Contracting State a permanent establishment or a fixed base in connection with which the indebtedness on which the interest is paid was incurred, and such interest is borne by such permanent establishment or fixed base, then such interest shall be deemed to arise in the State in which the permanent establishment or fixed base is situated.

7. Where, by reason of a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the interest, having regard to the debt claim for which it is paid, exceeds the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship, the provisions of this Article shall apply only to the last mentioned amount. In such case, the excess part of the payments shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of this Agreement.

(b) A Ltd wants to understand whether it can opt for safe harbour rules in order to avoid litigation on transfer pricing related matters, for the intra-group loans that it has taken from its Associated Enterprises. If the answer is in the affirmative, what are the conditions to be satisfied? (3 Marks)

(c) 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)
CASE STUDY - 2

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 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.

Assignment 4 [Client – PQR Bank Ltd.]

PQR Bank Ltd. carrying on banking business is incorporated in Country Z. It has branches in different countries including India. During the financial year 2018-19, the Indian branch of the bank paid interest of Rs. 35 lakhs and Rs. 17 lakhs, respectively, to its head office in Country Z and to the branch office in Country N. It wants to know whether interest so paid shall be liable to tax in India in the hands of head office and Country N branch.

Assignment 5 [Client – Mahesh Sharma]

Mahesh Sharma, a citizen of India, is a musician deriving income of Rs. 12,00,000 from concerts performed in Country P. Tax of Rs. 3,36,000 was deducted at source in Country P. His income in India amounted to Rs. 45,00,000. He has deposited Rs. 75,000 in Public Provident Fund and paid medical insurance premium in respect of his father, aged 65 years, Rs. 32,000. He spent Rs. 50,000 on medical treatment of his handicapped sister, dependent on him. His father has not travelled outside India for the last 3 years. Mahesh Sharma visited Country P from 19th February, 2019 to 13th March, 2019 for giving concerts. He also visited Country S on a vacation from 2nd January, 2019 to 21st January, 2019. For the rest of the year he stays in India. He wants to know his tax liability for A.Y.2019-20.

Note - India does not have any double tax avoidance agreement with Countries L, N, P, X, Y & Z.

Based on the above facts, answer the following questions –

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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. In respect of income earned by Mr. Harry Smith in India –
   (a) Tax is deductible at source at the rates in force under section 195
   (b) Tax is deductible at source @30% plus cess on income from horse races and at the rates in force under section 195 on other income.
   (c) Tax is deductible at source@30% plus cess on income from horse races and @20% plus cess on other income
   (d) Tax is deductible at source@30% plus cess on income from horse races and income from advertisement of a product on TV, 20% plus cess on income from participation in international swimming competition in India and no tax is deductible at source on income from contribution of articles relating to swimming in India.

2. 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

3. If Harry Smith had been a match referee instead of a swimmer, then, in respect of income earned by him in India (assuming the other facts remain the same) -
   (a) Tax is deductible at source at the rates in force under section 195
   (b) Tax is deductible at source @30% plus cess on income from horse races and at the rates in force under section 195 on other income.
   (c) Tax is deductible at source@30% plus cess on income from horse races and @20% plus cess on other income
   (d) Tax is deductible at source@30% plus cess on income from horse races and advertisement of a product on TV, 20% plus cess on income from participation in

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international swimming competition in India and no tax is deductible at source on income from contribution of articles in India.

4. 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.

5. 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%

6. 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

7. If Country L is a notified jurisdictional area (NJA), then, the rate at which interest receivable from India Infradebt Ltd. is taxable in the hands of Mr. Vallish and the rate at which tax has to be deducted at source on such income are –

<table>
<thead>
<tr>
<th></th>
<th>Tax rate</th>
<th>TDS rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a)</td>
<td>5%</td>
<td>30%</td>
</tr>
<tr>
<td>(b)</td>
<td>5%</td>
<td>5%</td>
</tr>
<tr>
<td>(c)</td>
<td>30%</td>
<td>30%</td>
</tr>
<tr>
<td>(d)</td>
<td>30%</td>
<td>5%</td>
</tr>
</tbody>
</table>

**Note** – The above rates are exclusive of cess.
8. 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.

9. On the subject of principles of interpretation of tax treaties, match the principles given in Column A with the description/examples given in Column B and choose the correct option:

<table>
<thead>
<tr>
<th>Column A</th>
<th>Column B</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) Subjective Interpretation</td>
<td>(I) Such interpretation should not be done if it defeats the primary objective of the tax treaty as far as the particular item under consideration is concerned.</td>
</tr>
<tr>
<td>(ii) Purposive Interpretation</td>
<td>(II) Article 32 of Vienna Convention embodies this principle</td>
</tr>
<tr>
<td>(iii) Contemporanea Expositio</td>
<td>(III) Speeches of Finance Ministers of India can be relied upon to find out the common intent at the time of signing the treaties</td>
</tr>
<tr>
<td>(iv) Liberal Construction</td>
<td>(IV) The fact that treaties are entered into for promoting mutual trade and investment needs to be kept in mind while interpreting a treaty</td>
</tr>
<tr>
<td></td>
<td>(V) Any term used in the treaty has to be interpreted according to their plain and natural meaning</td>
</tr>
<tr>
<td></td>
<td>(VI) A treaty should be interpreted in a manner to have effect rather than to make it ineffective.</td>
</tr>
</tbody>
</table>
10. On the subject of BEPS Action Plans, match the BEPS Action Plans given in Column A with the description/examples given in Column B and choose the correct option:

<table>
<thead>
<tr>
<th>Column A</th>
<th>Column B</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i)</td>
<td>Action Plan 5</td>
</tr>
<tr>
<td>(iii)</td>
<td>Action Plan 13</td>
</tr>
<tr>
<td></td>
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</tr>
</tbody>
</table>

(a) (i)→(VI) (ii)→(V) (iii)→(III) (iv)→(I)  
(b) (i)→(III) (ii)→(IV) (iii)→(II) (iv)→(VI)  
(c) (i)→(III) (ii)→(IV) (iii)→(II) (iv)→(I)  
(d) (i)→(VI) (ii)→(IV) (iii)→(II) (iv)→(I)
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)

(c) Examine whether the interest paid by Indian branch of PQR Bank to its head office in Country Z and branch office is Country N is liable to tax in India in the hands of the head office and Country N branch. (3 Marks)

3. (a) Determine the tax liability of Mr. Mahesh Sharma for A.Y.2019-20. (6 Marks)

(b) Mr. Vallish is in receipt of income of Rs.2,45,000 being income distributed by a REIT. The components of income are as follows:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) Rental Income from real estate property owned by REIT</td>
<td>1,25,000</td>
</tr>
<tr>
<td>(ii) Interest Income of REIT from A Ltd.</td>
<td>62,000</td>
</tr>
<tr>
<td>(iii) Dividend Income of REIT from A Ltd.</td>
<td>58,000</td>
</tr>
</tbody>
</table>

A Ltd. is an Indian company in which the REIT holds controlling interest. The REIT holds 100% of shareholding of A Ltd.

Examine whether the above components of the income distributed by REIT would be chargeable to tax in the hands of Mr. Vallish. Also, examine whether the REIT is required to deduct tax at source on such income distributed to Mr. Vallish. (6 Marks)
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:**

**MULTIPLE CHOICE QUESTIONS**

Write the correct 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.
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. Which of the following statements does not hold good in the case of OECD Model Convention?

(a) OECD Model lays emphasis on the right of the State of Residence to tax income.
(b) The relevant article of the Convention providing for determination of business profits of a PE, does not provide for deduction of expenses
(c) The relevant article relating to PE of the Convention explicitly deals with mechanism of Service PE
(d) It is essentially a model treaty between two developed nations

4. To address the problem of dual residency, under OECD Model Convention, certain rules are provided. The rules are to be applied:

(a) At the discretion of competent authority of the respective countries based on permanent home and nationality of the assessee
(b) Sequentially in order of nationality, permanent home, centre of vital interest and habitual abode
(c) Sequentially in order of permanent home, centre of vital interest, habitual abode and nationality
(d) Only if an assessee is not able to produce Tax Residency Certificate from the respective country.

5. 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

6. 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

7. Form 67 has to be filed mandatorily on or before the due date of filing of return of income -

(i) if the assessee claims foreign tax credit in his return of income for the year in which such corresponding income was offered to tax

(ii) if the assessee owns directly, or as a beneficial owner, any foreign assets

(iii) if there is a carry backward of loss of the current year resulting in refund of foreign tax for which credit has been claimed in an earlier previous year.

The correct answer is -

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

8. While interpreting the treaty entered into by India with Country “P”, the Budget Speech of Shri Arun Jaitley was relied upon to understand the intent at the time of signing the treaty. Which law of interpretation has been followed in this case?

(a) Liberal Interpretation
(b) Subjective Interpretation
(c) Purposive Interpretation
(d) Objective Interpretation

9. An application for advance ruling was made on 31.05.2018 in relation to a transaction proposed to be undertaken by Mr. James, a resident of Country “P”. On 07.07.2018, he decides to withdraw the said application. Such application:

(a) cannot be withdrawn once filed
(b) can be withdrawn on 07.07.2018 only with special permission of Principal Chief Commissioner
(c) cannot be withdrawn since 30 days from date of application have passed

(d) can be withdrawn on 07.07.2018 with permission of the AAR, if the circumstances of the case so justify

10. 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
(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. (6 Marks)

   (ii) The Competent Authority in India has made a request to the concerned official in Country “Q” to provide certain information in order to prevent tax avoidance in India. The Country “Q” tax officer denied the request stating that they are not obliged to provide such information as Country “Q” will not get any revenue benefit by doing so. Is the officer justified in his denial? Examine.

   Will your answer change, if the officer denied stating that exchange of such information would be contrary to public policy? (4 Marks)

2. (a) (i) 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. (3 Marks)

   (ii) Can Cure House Inc. approach the Authority of Advance Rulings to determine its tax liability arising from project undertaken in India? Is Sudha eligible to file an application for advance ruling to determine her tax liability arising from the project? Examine. (4 Marks)

   (b) India has a DTAA with Country “Q” but does not have a DTAA with Country “N”. Examine the significance of the concepts of business connection and permanent establishment in bringing to tax business income earned by a resident of Country “Q” and Country “N” in India. (3 Marks)
3. 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. (10 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

(1) "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.

(2) "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.

(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);

(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”.

ARTICLE 26

EXCHANGE OF INFORMATION

1. The competent authorities of the Contracting States shall exchange such information as is foreseeably relevant for carrying out the provisions of this Agreement or to the administration or enforcement of the domestic laws concerning taxes of every kind and description imposed on behalf of the Contracting States, or of their political sub-divisions or local authorities, insofar as the taxation thereunder is not contrary to the Agreement. The exchange of information is not restricted by Articles 1 and 2.

2. Any information received under paragraph 1 by a Contracting State shall be treated as secret in the same manner as information obtained under the domestic laws of that State and shall be disclosed only to persons or authorities (including courts and administrative bodies) concerned with the assessment or collection of the enforcement or prosecution in respect of, the determination of appeals in relation to the taxes referred to in paragraph 1, or the oversight of the above. Such persons or authorities shall use the information only for such purposes. They may disclose the information in public court proceedings or in judicial decisions.

3. In no case shall the provisions of paragraphs 1 and 2 be construed so as to impose on a Contracting State the obligation:

   (a) to carry out administrative measures at variance with the laws and administrative practice of that or of the other Contracting State;

   (b) to supply information which is not obtainable under the laws or in the normal course of the administration of that or of the other Contracting State;
(c) to supply information which would disclose any trade, business, industrial, commercial or professional secret or trade process, or information the disclosure of which would be contrary to public policy.

4. If information is requested by a Contracting State in accordance with this Article, the other Contracting State shall use its information gathering measures to obtain the requested information, even though that other State may not need such information for its own tax purposes. The obligation contained in the preceding sentence is subject to the limitations of paragraph 3 but in no case shall such limitations be construed to permit a Contracting State to decline to supply information solely because it has no domestic interest in such information.

5. In no case shall the provisions of paragraph 3 be construed to permit a Contracting State to decline to supply information solely because the information is held by a bank, other financial institution, nominee or person acting in an agency or a fiduciary capacity or because it relates to ownership interests in a person.

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>
<th>E</th>
<th>F</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross rental receipts from commercial property</td>
<td>2</td>
<td>3</td>
<td></td>
</tr>
<tr>
<td>Share income from Partnership firm (loss)</td>
<td>-1</td>
<td>-1.5</td>
<td></td>
</tr>
<tr>
<td>Business income</td>
<td>2.2</td>
<td>3.3</td>
<td></td>
</tr>
<tr>
<td>STCG from sale of vacant site on 1.11.2018</td>
<td>15</td>
<td>Nil</td>
<td></td>
</tr>
<tr>
<td>Agricultural Income</td>
<td>1.2</td>
<td>1.8</td>
<td></td>
</tr>
</tbody>
</table>

**Income earned in India**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>(Rs. in lakhs)</th>
<th>E</th>
<th>F</th>
</tr>
</thead>
<tbody>
<tr>
<td>Business income</td>
<td></td>
<td>1.5</td>
<td></td>
</tr>
<tr>
<td>Long-term capital gains on sale of residential house in Mumbai on 1.3.2019</td>
<td></td>
<td>45</td>
<td></td>
</tr>
<tr>
<td>Agricultural income from lands in Bengaluru</td>
<td></td>
<td>3.2</td>
<td></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>
<th>E</th>
<th>F</th>
</tr>
</thead>
<tbody>
<tr>
<td>Purchase of residential house at Jaipur on 22-3-2019 in wife’s name</td>
<td></td>
<td>37</td>
<td></td>
</tr>
<tr>
<td>Contribution to PPF</td>
<td></td>
<td>1.50</td>
<td></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. Any term used in a DTAA with a foreign country and not defined in the agreement or the Act but assigned a meaning in the notification issued by the Central Government in the Official Gazette, shall have the meaning assigned in such notification and shall be effective from the -
   (a) Date on which the said DTAA came into force
   (b) Date on which the said notification became effective
   (c) Date on which the said notification published in the Official Gazette
   (d) Date on which the said DTAA entered

2. In case of conflict between the provisions of the DTAA and the Income-tax Act, 1961, then,
   (a) The provisions of the Act will always prevail over the DTAA.
   (b) The provisions of the DTAA will always prevail over the Act.
   (c) The provisions of the Act will apply to the extent they are more beneficial to the assessee
   (d) The issue will be resolved by mutual consent of the Contracting States

3. Where a person derives income from a nation with which India does not have a DTAA, such person is given credit in India in the following manner:
   (a) Entire tax paid in the foreign country is allowed as deduction.
   (b) Tax paid in the foreign country on income which is doubly taxed, is allowed as deduction.
   (c) Tax paid on income which is doubly taxed, is allowed as deduction, at the Indian rate of tax only.
   (d) Tax paid on income which is doubly taxed, is allowed as deduction, at the Indian rate of tax or rate of tax of the foreign country, whichever is lower.

4. 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.

5. 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

6. 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

7. Continuing the facts of MCQ 6., assume that the Assessing Officer has issued the notice under BM Act on 30-5-2019. The time limit for completion of assessment under the BM Act is

(a) 31-3-2022  
(b) 30-5-2021  
(c) 31-3-2023  
(d) 30-5-2022

8. Taxes on income and on capital imposed on behalf of a Contracting State or of its political subdivisions or local authorities, irrespective of the manner in which they are levied, are covered in the following Model Convention(s):

(a) only in the OECD Model Convention  
(b) only in the UN Model Convention  
(c) Neither (a) nor (b)  
(d) Both (a) and (b)

9. In the tax treaties based on OECD and UN Model Tax Conventions, where capital gains arises on alienation of an immovable property, such gains derived -

(a) Will always be taxed only in the place of residence of the taxpayer;  
(b) Will always be taxed only in the place of location of the immovable property;  
(c) Can be taxed in both States and appropriate relief allowed as per the terms of the DTAA in the place of residence;  
(d) None of the above.

10. A separate article on “Independent Personal Services” is present –

(a) Only in the OECD Model Convention  
(b) Only in the UN Model Convention  
(c) Neither in the OECD Model Convention nor in UN Model Convention  
(d) Both in the OECD and UN Model Conventions
II. DESCRIPTIVE QUESTIONS

1. Ascertain the income-tax liability of Mr. Arjun Batra for the assessment year 2019-20.  
   \(\text{(20 marks)}\)

2. In respect of the foreign income and foreign asset unearthed by the Income-tax department during the search on 30-4-2019, are there any tax implications 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)? If so, in what year will the impugned items be taxed and what is the rate of tax? Compute the amount of tax on such items.  
   \(\text{(10 Marks)}\)
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
importance can be approved by Mrs. Indra. If the matter involves expenditure of more than Rs. 25,000, the approval of Mr. Rai would be mandatory.

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

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

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

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

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

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

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

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

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

I. MULTIPLE CHOICE QUESTIONS

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

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

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

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

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

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

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

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

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

   (a) Habitual abode
   (b) Centre of vital interests
   (c) Own house in Calcutta given on rent for the last ten years
   (d) Flat taken on rent in Pune where he is living for the last ten years.

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

   (a) Country X, being the place of incorporation
   (b) Country Y, being the place of effective management
   (c) Country X or Y, determine by mutual agreement by competent authorities
   (d) Either Country X or Y at the option of the assessee i.e., company

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

   (a) Yes, since the provisions of the treaty override the domestic law
   (b) No, due to the non-aggravation principle
   (c) No, due to the equivalent beneficiary principle
   (d) No, due to allocation of taxing rights principle

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

   (a) a branch
   (b) an office for carrying out routine administrative work.
   (c) a factory for manufacture of goods
   (d) a warehouse for storage of goods in preparatory nature
9. During the previous year 2018-19, RB Pvt. Ltd. entered into contracts for purchase and sale of barley grains with PB Pvt Ltd. PB Pvt. Ltd. is a company incorporated in New Delhi. On account of which of the following facts, would the companies be considered to be associated enterprises?

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

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

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

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

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

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

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

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

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

II. DESCRIPTIVE QUESTIONS

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

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

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

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

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

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

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

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

3. (a) RB Pvt. Ltd. wants a binding advice relating to their tax liability in India. They have been informed by Modern Foods that while making the payments relating to the product sales, taxes have to be withheld. Is there an avenue available under domestic law for obtaining such binding advice? (4 Marks)
(b) Should RB Pvt. Ltd. make such application or Modern Bazaar? The total value of the transactions between RB Pvt. Ltd. and Modern Bazaar is Rs.50,00,000 in the previous year 2018-19. (3 Marks)

(c) Are there grounds on which the request may be denied? (3 Marks)
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>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>
</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>
</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 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. The provisions relating to taxation of indirect transfer of shares of an Indian company were introduced _vide_ Finance Act, 2012, as a consequence of which of the following decisions of the Supreme Court -
   (a) McDowell & Co. Ltd. v. CTO
   (b) Vodafone International Holdings B.V. vs. UOI
2. Based on the facts in the case, where US Co proposes to transfer shares of Singapore Intermediary Co, which of the following Double Taxation Avoidance Agreements (‘DTAA’), would be applicable for analysing the taxability in the hands of US Co in India -
   (a) US-Singapore DTAA
   (b) India- Singapore DTAA
   (c) India-US DTAA
   (d) None of the DTAA are applicable

3. 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

4. Assuming the transfer of shares of Singapore Intermediary Co by US Co is taxable in India and ignoring DTAA provisions, if any, what would be the rate of tax on the gains arising from such transfer:
   (a) 10%
   (b) 20%
   (c) 30%
   (d) 40%

   (Note – The above tax rates are excluding cess and surcharge, if any)

5. 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

6. Which of the following incomes is not deemed to accrue or arise in India under section 9(1)(i) of the Income-tax Act, 1961?
   (a) Income from any business connection in India
   (b) Income through or from any property in India
   (c) Income arising from transfer of a capital asset situated in India
   (d) Income relating to operations which are confined to purchase of goods in India for the purpose of export

7. 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
8. 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

9. What are the penal consequences on Ind Co if it fails 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) INR 100,000
(b) INR 500,000
(c) 2% of the value of the transaction in respect of which there is a failure to report
(d) There is no requirement on Ind Co to furnish information

10. The fair market value of an unlisted share, held directly or indirectly by a company or an entity registered or incorporated outside India, for the purposes of section 9(1)(i), shall be computed in accordance with which of the following methods -

(a) Net asset value, as certified by a Chartered Accountant
(b) Discounted Cash Flow method, as certified by a Chartered Accountant, as increased by liabilities, if any, considered in such valuation
(c) Any internationally accepted valuation methodology for valuation of shares on arm’s length basis, as determined by a merchant banker or a Chartered Accountant, as increased by liabilities, if any, considered in such valuation
(d) Fair market value of all assets of the company computed on an arm’s length basis, as certified by a Chartered Accountant

II. DESCRIPTIVE QUESTIONS

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

(a) Transfer of shares of Singapore Intermediary Co by US Co to an unrelated Buyer (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)

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

US Co had acquire shares of Singapore Intermediary Co for INR 10 crores. (5 Marks)

(ii) As an alternative, Group A is also evaluating the option of transferring shares held by Singapore Intermediary Co in Ind Co to an unrelated Buyer for a consideration of INR 45 crores. Singapore Intermediary Co had acquire shares of Ind Co for INR 5 crores. Evaluate the capital gains
chargeable to tax in India considering the provisions of the Income-tax Act, 1961 and the applicable DTAA. (4 Marks)

(iii) As an alternative to the (i) and (ii) above, if proposal of corporate restructuring is considered instead of exit proposal, Group A is evaluating the option of amalgamating US Co with another group company in US (US Co 2) as a result of which shares of Singapore Intermediary Co would be transferred to US Co 2. What are the conditions under which such transfer of shares of Singapore Intermediary Co to US Co 2 be exempt from capital gains tax in India? If the US Co has more than one undertaking, what is other option, if any, available with US Co to transfer shares of Singapore Intermediary Co by way of corporate restructuring without attracting income-tax in India? (6 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 movable 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 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 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.

4. 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.

5. 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. ABC Ltd., an Indian Company, supplied steel manufactured by it to ABC Inc., Country A during the previous year 2018-19. ABC Limited also supplied the same product to another Country A based company, PQR Inc. The transactions with ABC Inc. are priced at Euro 800 per MT (FOB), whereas the transactions with PQR Inc. are priced at Euro 1200 per MT (CIF). Insurance and Freight amounts to Euro 400 per MT. ABC Ltd. wants to know if transfer pricing provisions would be attracted in such a case.

2. Sigma Ltd., operating in India, is one of the dealers for the goods manufactured by Epsilon Ltd., Country B. During the course of assessment, the Assessing Officer, after verification of transactions between Sigma Ltd. and Epsilon Ltd., opined that transfer pricing provisions would become applicable in this case. The Assessing Officer adjusted the total income of Sigma Ltd. by making an addition of ₹ 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.

3. XYZ Motors Ltd., an Indian company declared business income of ₹ 585 crores computed in accordance with Chapter IV-D of the Income-tax Act, 1961 but before making transfer pricing adjustments in respect of the following transactions for the year ended on 31.3.2019:
   (i) 8,500 vans sold to LMN Inc., Country A, at a price which is less by Euro 280 each van than the price charged from PQR Inc., Country A.
   (ii) 4500 vans sold to GHI Inc., Country D at a price which is less by Euro 100 each van than the price charged from PQR Inc., Country A.
(iii) Royalty of $ 80,00,000 was paid to RST Ltd., Country C, for use of technical know-how in the manufacturing of van. However, RST Ltd. had provided the same know-how to Birla Motors Ltd. for $ 60,00,000.

(iv) Loan of Euro 74 crores carrying interest @8% p.a. advanced by HIT Ltd., a Country D company, was outstanding on 31.3.2019. The said Country D company had also advanced a loan of similar amount to Aravalli Ltd. @7% p.a. Total interest paid for the year was EURO 5.92 crores.

XYZ Motors Ltd. wants to know the provisions of the Income-tax Act, 1961 affecting all these transactions. It also wants to know its business income chargeable to tax for A.Y.2019-20.

(4) OMR Limited, an Indian company, is engaged in manufacturing electronic components. OMR Limited has borrowed Country L $ equivalent to ₹ 1,600 crore from Omega Inc., a Country L based company at LIBOR plus 200 points. The LIBOR prevalent at the time of borrowing is 5% for Country L $. The borrowings allowed under the External Commercial Borrowings guidelines issued under Foreign Exchange Management Act are LIBOR plus 300 basis points. OMR Limited wants to know whether transfer pricing provisions are attracted in respect of this transaction.

(5) 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 exhibits 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 rollback of the said APA. However, rollback provision shall not be available in respect of the said transaction for a rollback year, if –

   (i) such application has the effect of reducing total income declared in the return of income
of the said year
(ii) determination of the arm’s length price of the said transactions for the said year has been the subject matter of appeal before Commissioner (Appeals) and the Commissioner (Appeals) has passed an order disposing of such appeal at any time before signing of the agreement
(iii) determination of the arm’s length price of the said transactions for the said year has been the subject matter of appeal before the Appellate Tribunal and the Appellate Tribunal has passed an order disposing of such appeal at any time before signing of the agreement
(iv) return of income for the relevant roll back year has been furnished by the company under section 139(4)

The most appropriate answer is -

(a) (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.
6 Which of the following pairs of companies are Associated Enterprises/deemed to be associated enterprises?
(i) ABC Ltd. & ABC Inc.
(ii) Satpura Ltd. & Sigma Ltd.
(iii) XYZ Motors Ltd. & RST Ltd.
(iv) XYZ Motors Ltd. & HIT Ltd.
The correct answer is -
(a) Only (i) above
(b) (i) and (ii) above
(c) (i) and (iii) above
(d) (i), (iii) and (iv) above.

7 If Himalaya Ltd. has two Units, Unit 1 is engaged in power generation business and Unit 2 is engaged in manufacture of wires. Both the units were set up in Himachal Pradesh in the year 2014. In the year 2018-19, fourteen lakh metres of wire are transferred from Unit 2 to Unit 1 at ₹ 150 per metre when the market price per metre was ₹ 200. Which of the following statements is correct?
(a) Transfer pricing provisions would be attracted in this case
(b) Transfer pricing provisions would not be attracted in this case, since Unit 1 and Unit 2 belong to the same company and are not associated enterprises.
(c) Transfer pricing provisions would not be attracted in this case as it is not an international transaction as both the Units are in India. For the purpose of Chapter VIA deduction, the profits of power generation business shall, however, be computed as if the transfer has been made at the market value of ₹ 200 per MT.
(d) Transfer pricing provisions would not be attracted in this case due to reasons mentioned in both (b) and (c) above.

8 Ram, an individual aged 35 years resident in India, bought 3,000 equity shares of ₹ 10 each of ABC Ltd. at ₹ 70 per share on 1.6.2018. He sold 1800 equity shares at ₹ 50 per share on 3.11.2018 and the remaining 1200 shares at ₹ 60 per share on 23.3.2019. ABC Ltd. declared a dividend of 40%, the record date being 14.8.2018. On 15.3.2019, Ram sold a house from which he derived a long-term capital gain of ₹ 1,25,000. Assuming Ram’s interest income from bank fixed deposit is ₹ 3,00,000, his tax liability (rounded off) for A.Y.2019-20 would be -
(a) 18,620
(b) 19,920
(c) 20,110
9. Which of the following is not an eligible international transaction for application of safe harbor rules?
   (i) Preparation of user documentation
   (ii) Receipt of intra-group loans where the amount of loan is denominated in Indian rupees
   (iii) Providing implicit corporate guarantee
   (iv) Purchase and export of core auto components
   (v) Receipt of intra-group services from group member
   (a) Only (ii)
   (b) (ii) and (v)
   (c) (ii), (iv) and (v)
   (d) (ii), (iii), (iv) and (v)

10. Let us consider two hypothetical cases -
   Case 1: Ganga Ltd., Yamuna Ltd. and Saraswati Ltd. merge to form Ganga Ltd. and Ganga Ltd. is the APA applicant
   Case 2: Ganga Ltd., Yamuna Ltd. and Saraswati Ltd. merge to form new company, Triveni Sangam Ltd. and Triveni Sangam Ltd. is the APA applicant

Which companies are eligible to apply for rollback provisions post amalgamation/merger in the above cases, assuming that all other conditions are satisfied?
   (a) In Cases 1 & 2: Ganga Ltd., Yamuna Ltd. and Saraswati Ltd.
   (b) In Case 1: Ganga Ltd and in Case 2 : Ganga Ltd., Yamuna Ltd. and Saraswati Ltd.
   (c) In Case 1: Ganga Ltd., Yamuna Ltd. and Saraswati Ltd. and in Case 2, None.
   (d) In Case 1: Ganga Ltd. and in Case 2, None.

II. DESCRIPTIVE QUESTIONS

1. (i) Would transfer pricing provisions be attracted in respect of the transaction of supply of steel by ABC Ltd. to ABC Inc.? If so, compute the arm's length price of such transaction. (4 Marks)
   (ii) Examine whether transfer pricing provisions would be attracted in respect of transactions between Sigma Ltd. and Epsilon Ltd. If so, what is the penalty leviable for defaults, if any, by Sigma Ltd. in compliance of the requisite provisions under the Income-tax Act? (6 Marks)

2. (i) Examine whether transfer pricing provisions are attracted in respect of the transactions entered into by XYZ Motors Ltd. Also, compute the total income of XYZ Motors Ltd. chargeable to tax for A.Y. 2019-20. (7 Marks)
(ii) Would transfer pricing provisions be attracted in respect of the transaction of borrowal of funds by OMR Ltd. from Omega Inc? Examine.  

(3 Marks)

3. With respect to the transactions listed in (a) to (c) under para (5) 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: Shareholding pattern of ABC Ltd.

<table>
<thead>
<tr>
<th>Shareholder</th>
<th>Number of equity shares</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ganga Ltd., India</td>
<td>20,000</td>
</tr>
<tr>
<td>Yamuna Ltd., India</td>
<td>10,000</td>
</tr>
<tr>
<td>Saraswati Ltd., India</td>
<td>10,000</td>
</tr>
<tr>
<td>Thames Inc., Country A</td>
<td>30,000</td>
</tr>
<tr>
<td>ABC Inc., Country A</td>
<td>1,20,000</td>
</tr>
<tr>
<td>General public</td>
<td>1,10,000</td>
</tr>
</tbody>
</table>

Exhibit B: Details relating to PQR Inc.

(1) Shareholding pattern of PQR Inc.

<table>
<thead>
<tr>
<th>Shareholder</th>
<th>Number of equity shares</th>
</tr>
</thead>
<tbody>
<tr>
<td>Peru Inc., Country A</td>
<td>30,000</td>
</tr>
<tr>
<td>Andes Inc., Country A</td>
<td>40,000</td>
</tr>
<tr>
<td>Niagra Inc., Country A</td>
<td>25,000</td>
</tr>
<tr>
<td>Atlanta Inc., Country A</td>
<td>15,000</td>
</tr>
<tr>
<td>EFG Ltd., India</td>
<td>50,000</td>
</tr>
<tr>
<td>----------------</td>
<td>--------</td>
</tr>
<tr>
<td>General Public</td>
<td>80,000</td>
</tr>
</tbody>
</table>

(2) **List of Lenders:**

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

(3) **List of Borrowers:**

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

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

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

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

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

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

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

(10) **List of Debtors for sales:**

1. Michigan Inc., Country A
2. Celro Inc., Country A
3. Dolphin Inc., Country A
4. Elephanta Inc., Country A
Exhibit C: Details relating to Sigma Ltd.

(1) Shareholding pattern of Sigma Ltd.

<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>Aravali Ltd., India</td>
<td>25,000</td>
</tr>
<tr>
<td>General public</td>
<td>1,50,000</td>
</tr>
</tbody>
</table>

(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>

Exhibit D: Details relating to XYZ Motors Ltd.

(1) Shareholding pattern of XYZ Motors Ltd.

<table>
<thead>
<tr>
<th>Shareholder</th>
<th>Number of equity shares</th>
</tr>
</thead>
<tbody>
<tr>
<td>DEF Ltd., India</td>
<td>6,000</td>
</tr>
<tr>
<td>GHI Inc., Country D</td>
<td>3,000</td>
</tr>
<tr>
<td>LMN Inc., Country A</td>
<td>50,000</td>
</tr>
<tr>
<td>RST Ltd., Country C</td>
<td>10,000</td>
</tr>
<tr>
<td>HIT Ltd., Country D</td>
<td>1,000</td>
</tr>
<tr>
<td>Others</td>
<td>60,000</td>
</tr>
</tbody>
</table>
(2) Total book value of its assets. as on 31.3.2019: ₹ 12,000 crores.

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

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

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

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

(1) **Shareholding pattern of Birla Motors Ltd.**

<table>
<thead>
<tr>
<th>Shareholder</th>
<th>Number of equity shares</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sahara Ltd., India</td>
<td>15,000</td>
</tr>
<tr>
<td>Thar Ltd., India</td>
<td>20,000</td>
</tr>
<tr>
<td>Gobi Ltd., India</td>
<td>7,000</td>
</tr>
<tr>
<td>Sunderbans Ltd., India</td>
<td>8,000</td>
</tr>
<tr>
<td>General Public</td>
<td>1,50,000</td>
</tr>
</tbody>
</table>

(2) **List of Lenders:**

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>State Bank of India</td>
</tr>
<tr>
<td>2</td>
<td>Bank of Baroda</td>
</tr>
<tr>
<td>3</td>
<td>Union Bank of India</td>
</tr>
<tr>
<td>4</td>
<td>Sundaram Finance Ltd.</td>
</tr>
<tr>
<td>5</td>
<td>Apple Finance Ltd.</td>
</tr>
</tbody>
</table>

(3) **List of Borrowers:**

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Xansa Ltd., India</td>
</tr>
<tr>
<td>2</td>
<td>Munnar Ltd., India</td>
</tr>
<tr>
<td>3</td>
<td>Podhigai Ltd., India</td>
</tr>
<tr>
<td>4</td>
<td>Vanasthali Ltd., India</td>
</tr>
</tbody>
</table>
(4) Birla Motors Ltd. has not provided guarantee in respect of loan taken by any person.

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

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

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

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

**Exhibit F: Details relating to OMR Ltd.**

(1) Shareholding pattern of OMR Ltd.

<table>
<thead>
<tr>
<th>Shareholder</th>
<th>Number of equity shares</th>
</tr>
</thead>
<tbody>
<tr>
<td>A Ltd., India</td>
<td>5,000</td>
</tr>
<tr>
<td>B Inc., Country L</td>
<td>7,000</td>
</tr>
<tr>
<td>C Inc., Country L</td>
<td>14,000</td>
</tr>
<tr>
<td>D Ltd., India</td>
<td>12,000</td>
</tr>
<tr>
<td>E Inc., Country L</td>
<td>8,000</td>
</tr>
<tr>
<td>Omega Inc., Country L</td>
<td>10,000</td>
</tr>
<tr>
<td>Others</td>
<td>24,000</td>
</tr>
</tbody>
</table>

(2) Total book value of assets of OMR Ltd as on 31.3.2019: ₹3,000 crores.

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

**Exhibit G: Details relating to RST Ltd.**

(1) Shareholding pattern of RST Ltd.

<table>
<thead>
<tr>
<th>Shareholder</th>
<th>Number of equity shares</th>
</tr>
</thead>
<tbody>
<tr>
<td>X Ltd., India</td>
<td>13,000</td>
</tr>
<tr>
<td>Z Ltd., Country C</td>
<td>25,000</td>
</tr>
<tr>
<td>AB Ltd., Country D</td>
<td>60,000</td>
</tr>
<tr>
<td>Others</td>
<td>24,000</td>
</tr>
</tbody>
</table>
(2) RST Ltd. has not provided guarantee in respect of loan taken by any person

(3) The directors of RST Ltd. are appointed by AB Ltd. and Z Ltd.

**Note**: In all the above exhibits, the shareholding pattern is reflective of the voting power, i.e., all shares have equal voting rights.
I. ANSWERS TO OBJECTIVE TYPE QUESTIONS

1. (b) Banking and Insurance business
2. (d) ₹ 1 Crore
3. (c) A Inc., USA; A LLC, Cyprus; and AA Ltd., China.
4. (d) 30%
5. (c) ₹ 95 lakhs
6. (d) ₹ 1 lakh – fixed penalty
7. (c) A.Y.2027-28
8. (d) 90 days from 30th November of the assessment year
9. (c) A.Y.2018-19 and the amount of primary adjustment is ₹1.05 crore
10. (c) Deemed loan approach

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>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>Interest paid or payable to non-resident AE</td>
<td>101.50</td>
</tr>
<tr>
<td>EBITDA</td>
<td>200.00</td>
</tr>
</tbody>
</table>

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

- Interest paid or payable to non-resident AE in excess of 30% of EBITDA [₹ 101.50 crores - ₹ 60.00 crores] ₹ 41.50 crores
- Interest paid or payable to non-resident AE ₹ 101.50 crores

Therefore, interest paid or payable allowable as deduction under the head “Profits and gains of business or profession” would be ₹ 76.25 crores (₹ 60 crores (₹ 101.50 crores – ₹ 41.50 crores), being the amount paid or payable to non-resident AE **plus** ₹ 16.25 crores, being the amount paid to other entities).

**Notes:**

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

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

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

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

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

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

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

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

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

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

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

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

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

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

In the present case, interest paid is towards delayed payment to AA Ltd China, being its creditor for supply of raw material can be considered as an arrangement that gives rise to interest or other finance charges that are deductible in computation of Income under the head "Profits and gains of business or profession1".

1 CIT v. Vijay Ship Breaking Corporation decision of Supreme Court [2008] 175 Taxman 77 (SC)
Further, since 90% of raw materials required by A Ltd. is supplied by AA Ltd., China and price and other conditions for supply of raw material are also influenced AA Ltd., China, AA Ltd., is deemed to be an AE of A Ltd. Thus, the amount of interest paid towards delayed payment has to be considered for the purpose of limitation of interest deduction under section 94B.

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

The intent behind insertion of this section also appears to restrict the interest paid to non-resident 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>Interest paid or payable to non-resident AE (computed above)</td>
<td><strong>101.50</strong></td>
</tr>
<tr>
<td>EBITDA</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 EBITDA ₹ **57.75 crores**
  [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. (a) (i) A company is typically financed or capitalized through a mixture of debt and equity. The manner in which company raises capital has a significant impact on the amount of profit it reports for tax purposes. This is due to the reason that tax legislations of countries typically allow a deduction for interest paid or payable in arriving at the profit for tax purposes while the dividend paid on equity contribution is not deductible. Therefore, the higher the level of debt in a company, and thus, the amount of interest it pays, the lower will be its taxable profit. For this reason, debt is often a more tax efficient method of finance than equity. Since in such a structure, equity financing is less, it is referred to as Thin Capitalization. Thin capitalization, thus, refers to the process of funding an entity by debt instead of equity with a view to take advantage of interest deduction benefits.

(ii) 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.

(iii) 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.

(b) (i) Section 92CE, provides that where a primary adjustment for an amount exceeding ₹ 1 crore has been made by the Assessing Officer in respect of A.Y.2017-18 or thereafter, which has been accepted by the assessee, a secondary adjustment shall be made. In the first scenario, where the assessee has not gone on an appeal against the order passed by the Assessing Officer, it may be considered that the adjustment made by the Assessing Officer has been accepted by the assessee. Hence, secondary adjustment has to be made by A Ltd. in the A.Y.2018-19. Further, if the “excess money” (i.e., ₹ 40 crores, in this case) which is available with A LLC., Cyprus is not repatriated to India within 90 days from the date of order of the Assessing Officer then, such excess money would be deemed to be an advance made by the A Ltd. to A LLC, Cyprus and interest on such advance shall be computed in the prescribed manner.

In the second scenario, where the assessee files an appeal before the CIT(Appeals) it is evident that the primary adjustment made by the Assessing Officer is not accepted by the assessee and therefore, secondary adjustment is not required.

(ii) If the CIT (Appeals) increases the Arm’s Length Price determined by the Assessing Officer to ₹ 50 crores by considering the arm’s length interest rate to be 5% (instead of 4%) and the same is accepted by A Ltd., then, A Ltd. has to make secondary adjustment and the “excess money” [i.e., ₹ 30 crores, (₹ 80 crores – ₹ 50 crores)] has to repatriated to India within 90 days from the date of the order of CIT (Appeals).

3. (a) As an anti-avoidance measure, section 94A was introduced in the Income-tax Act, 1961 with respect to transactions with persons located in a Notified Jurisdictional Area (NJA). As per section 94A, the Central Government may, having regard to the lack of effective exchange of information with any country or territory outside India,
specify the said country or territory as a notified jurisdictional area in relation to transactions entered into by any assessee. Any payment made to a person located in a NJA shall be liable for withholding tax @ 30% or the rate prescribed in the Act or the rates in force, whichever is highest.

The Central Government invoked the provisions of section 94A of the Act and notified Cyprus as a NJA in November, 2013 owing to inadequate exchange of information by Cyprus tax authorities. However, in December 2016, the Central Government has rescinded the said Notification, thereby removing Cyprus as a NJA with retrospective effect from the date of original notification. Therefore, since the provisions of section 94A will not be applicable in respect of payment made to a person located in Cyprus, A Ltd. is justified in deducting tax at the rate of 10% being the most beneficial rate contained in the DTAA between India and Cyprus.

(b) Safe Harbour Rules specified under Section 92CB(2) may be opted by an assessee in respect of an eligible international transaction. Advancing of loan is covered within the definition of eligible international transactions. However, receipt of intra-group loans by the Indian entity do not form part of eligible international transactions and hence, A Ltd shall not be eligible to opt for safe harbor rules in respect of the loans taken from its AEs.

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

1. (c)
2. (c)
3. (b)
4. (d)
5. (c)
6. (d)
7. (a)
8. (b)
9. (c)
10. (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>
<tr>
<td>Income taxable under section 115BB</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income from horse races</td>
<td>25,000</td>
<td></td>
</tr>
<tr>
<td><strong>Total income</strong></td>
<td><strong>17,45,000</strong></td>
<td></td>
</tr>
<tr>
<td>Tax@ 20% under section 115BBA on ₹ 17,20,000</td>
<td></td>
<td>3,44,000</td>
</tr>
<tr>
<td>Tax@ 30% under section 115BB on income of ₹ 25,000 from horse races</td>
<td></td>
<td>7,500</td>
</tr>
<tr>
<td>Add: Health &amp; Education cess@4%</td>
<td></td>
<td>3,51,500</td>
</tr>
<tr>
<td><strong>Total tax liability of Harry Smith for the A.Y.2018-19</strong></td>
<td></td>
<td><strong>3,65,560</strong></td>
</tr>
</tbody>
</table>

Computation of tax liability of Rita 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 music performances given in India</td>
<td>2,00,000</td>
<td></td>
</tr>
<tr>
<td><strong>Total income</strong></td>
<td><strong>2,00,000</strong></td>
<td></td>
</tr>
<tr>
<td>Tax@ 20% under section 115BBA on ₹ 2,00,000</td>
<td></td>
<td>40,000</td>
</tr>
<tr>
<td>Add: Health &amp; Education cess@4%</td>
<td></td>
<td>1,600</td>
</tr>
<tr>
<td><strong>Total tax liability of Rita Smith for the A.Y.2018-19</strong></td>
<td></td>
<td><strong>41,600</strong></td>
</tr>
</tbody>
</table>

(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>Deemed income</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fare</td>
<td>180 crores (280 crores – 100 crores)</td>
<td></td>
</tr>
<tr>
<td>Deemed income</td>
<td>9 (180 crores × 5%)</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Fare for travel from Country Y to Delhi (₹)</th>
<th>Deemed income</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fare</td>
<td>40 crores (2 × 4)</td>
<td></td>
</tr>
<tr>
<td>Deemed income</td>
<td>2 (4 crores × 5%)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>60 crores</td>
<td></td>
</tr>
</tbody>
</table>

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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.

(c) As per section 5(2), the total income of a non-resident would include all income which is, inter alia, deemed to accrue or arise to him in India in that year.

In the case of a non-resident, being a person engaged in the business of banking, any interest payable by the Permanent Establishment (PE) in India of such non-resident to the head office or any PE or any other part of such non-resident outside India, shall be deemed to accrue or arise in India [Explanation to section 9(1)(v)].

In the present case, the Indian branch, being a fixed place of business, is the PE in India of PQR Bank Ltd., being a non-resident engaged in the banking business, since such business is carried on in India through the Indian branch [Clause (iiia) of section 92F]. Accordingly, the interest of ₹ 35 lakhs paid to its head office in Country Z and ₹ 17 lakhs paid to the other branch office in Country N by the Indian branch [being the PE in India of PQR Bank Ltd, a non-resident engaged in the business of banking] shall be deemed to accrue or arise in India and shall be liable to tax in India in the hands of head office and Country N branch, respectively, in addition to any income attributable to the PE in India.

3. (a) Computation of tax liability of Mr. Mahesh Sharma for A.Y.2019-20

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Indian Income</td>
<td>45,00,000</td>
</tr>
<tr>
<td>Foreign Income</td>
<td>12,00,000</td>
</tr>
<tr>
<td><strong>Gross Total Income</strong></td>
<td>57,00,000</td>
</tr>
</tbody>
</table>

Less: Deduction under section 80C

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>PPF Contribution</td>
<td>75,000</td>
</tr>
</tbody>
</table>

Deduction under section 80D

Medical insurance premium of father, being a resident senior citizen, fully allowable, since it does not exceed ₹ 50,000.

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deduction under section 80DD</td>
<td>32,000</td>
</tr>
</tbody>
</table>

Maintenance including medical treatment of his dependent sister, being a person with disability [Flat deduction, irrespective of expenditure incurred]

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deduction under section 80DD</td>
<td>75,000</td>
</tr>
<tr>
<td>Total Income</td>
<td>55,18,000</td>
</tr>
<tr>
<td>--------------------------------------------------</td>
<td>-----------</td>
</tr>
<tr>
<td>Tax on total income</td>
<td>14,67,900</td>
</tr>
<tr>
<td>Add: Surcharge@10% (since total income exceeds</td>
<td></td>
</tr>
<tr>
<td>Rs.50 lakhs but is less than Rs.1 crore)</td>
<td>1,46,790</td>
</tr>
<tr>
<td>Add: Health and Education cess@4%</td>
<td>64,588</td>
</tr>
<tr>
<td>Average rate of tax in India [i.e., ₹ 16,79,278/</td>
<td>30.43%</td>
</tr>
<tr>
<td>₹ 55,18,000 x 100]</td>
<td></td>
</tr>
<tr>
<td>Average rate of tax in Country P [i.e. ₹ 3,36,000/</td>
<td>28%</td>
</tr>
<tr>
<td>₹ 12,00,000 x 100]</td>
<td></td>
</tr>
<tr>
<td>Doubly taxed income</td>
<td>12,00,000</td>
</tr>
<tr>
<td>Rebate under section 91 on ₹ 12,00,000 @28%</td>
<td>3,36,000</td>
</tr>
<tr>
<td>(lower of average Indian tax rate and Country P tax rate)</td>
<td></td>
</tr>
<tr>
<td>Tax payable in India [₹ 16,79,278 – ₹ 3,36,000]</td>
<td>13,43,278</td>
</tr>
<tr>
<td>Tax Payable (rounded off)</td>
<td>13,43,280</td>
</tr>
</tbody>
</table>

**Note:** Deduction under section 91 is allowable to Mr. Mahesh Sharma, since he fulfils the following conditions are fulfilled:

(a) He is a resident in India during the relevant previous year, since his stay in India during the P.Y.2018-19 was more than 182 days.

(b) The income of Rs.12 lakhs from concerts accrues or arises to him outside India in Country P during that previous year.

(c) Such income is not deemed to accrue or arise in India during the previous year.

(d) The income in question has been subjected to income-tax in Country P in his hands and he has paid tax on such income in Country P.

(e) There is no agreement under section 90 for the relief or avoidance of double taxation between India and Country P where the income has accrued or arisen.

In this case, Mr. Mahesh Sharma is eligible for deduction under section 91, since all the above conditions are fulfilled.
The REIT enjoys pass-through status in respect of rental income from real estate asset owned by it directly and interest income from special purpose vehicle, (i.e., A Ltd., in this case, since it is an Indian company in which REIT holds controlling interest). Therefore, such income is taxable in the hands of the unit holders.

1) **Rental income component of income distributed by REIT:** The distributed income or any part thereof, received by Vallish from the REIT, which is in the nature of income by way of renting or leasing or letting out any real estate asset owned directly by such REIT is deemed income of the unit-holder as per section 115UA(3). Accordingly, Rs.1,25,000 would be deemed income of Vallish as per section 115UA(3). The REIT has to deduct tax at source under section 194LBA @31.2% (being the rate in force) in case of distribution to Vallish, being a non-resident.

2) **Interest component of income distributed by REIT:** Interest component of income received from a special purpose vehicle, A Ltd., in this case, and distributed to a unit holder is taxable @5.2% in the hands of the unit holder. Accordingly, such interest component of Rs. 62,000 is taxable in the hands of Vallish. The REIT has to deduct tax at source under section 194LBA @5.2%, on Rs. 62,000, since Vallish is a non-resident.

3) **Dividend component of income distributed by REIT:** Any distributed income referred to in section 115UA, to the extent it does not comprise of interest [referred to in sub-clause (a) of section 10(23FC)] and rental income from real estate assets owned directly by the business trust [referred to in section 10(23FCA)] received by unit holders, is exempt in their hands under section 10(23FD). Therefore, by virtue of section 10(23FD), Rs. 58,000, being the dividend component [referred to in sub-clause (b) of section 10(23FC)] of income distributed to Vallish would be exempt in his hands. Therefore, there is no liability on the REIT to deduct tax at source on the dividend component of income distributed by it to Mr. Vallish.
SOLUTION TO CASE STUDY 3

I. ANSWERS TO MCQs (Most appropriate answers)

1. (d)
2. (c)
3. (c)
4. (c)
5. (c)
6. (b)
7. (c)
8. (b)
9. (d)
10. (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) Article 26 of India-Country “Q” DTAA deals with the international exchange of information between the tax authorities of the countries. The purpose is wider than mere tax compliances; it is also meant to counter tax evasion and avoidance. The competent authorities of the two Contracting States can exchange information which is ‘foreseeably relevant’ for the proper application of agreement or for the administration or enforcement of their domestic laws, as long as taxation under the laws in not inconsistent with the treaty agreement.

Paragraph 3 of the Article lists the types of information, the request for which either country is not obligated to comply.

However, paragraph 4 of the Article further clarifies that even though obligation to provide information is subject to the limitation contained in paragraph 3, the requested country cannot decline to supply information solely because it has no domestic interest in such information.

Accordingly, Country “Q” tax authorities are not justified in denying to provide information stating that it will not get any revenue benefit by providing such information. Country “Q” is obligated to provide the requested information, even if it has no revenue interest in the case to which the request relates.
However, in case the reason of denial is in accordance with the specific limitations contained in paragraph 3, then, Country “Q” tax authorities shall be under no obligation to provide the requested information. Hence, denial by tax authorities on the ground that exchange of such information would be contrary to public policy is justified.

2. (a) (i) 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.

(ii) As per section 245N(b)(A)(I), an application for advance ruling can be made inter-alia by a non-resident in relation to a transaction which has been undertaken or is proposed to be undertaken by it.

Hence, Cure House Inc., a non-resident applicant, can file an application to Authority of Advance Rulings, alongwith the prescribed fees, for determination in relation the transaction undertaken by it in India i.e., rendering consultancy services in the field of medicine.

As per section 245N(b)(A)(III), a resident applicant who has undertaken or has proposed to undertake one or more transactions of value of INR 100 crore or more in total can file an application for Advance Ruling for determination by the AAR in relation to his/her tax liability arising out of such transactions and such determination shall include the determination of any question of law or of fact specified in the application.

In the present case, since the project value is only INR 70 crore, Sudha, a resident Indian cannot file an application with AAR for determination of her tax liability arising out of the said project.

(b) Section 9(1)(i) requires existence of business connection for deeming business income to accrue or arise in India. DTAs may, however, provide that business income is taxable only if there is a permanent establishment in India.

Therefore, in cases covered by DTAs, where there is no permanent establishment in India, business income cannot be brought to tax due to existence of business connection as per section 9(1)(i). However, in cases not covered by DTAs, business income attributable to business connection is taxable.

Hence, business income earned by a resident of Country “Q” can be brought to tax only if he has a PE in India. However, business income of a resident of Country “N” attributable to his business connection in India, can be brought to tax in India.

3. 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><em>Salary from services rendered in India (April - September 2018)</em></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>Description</td>
<td>Amount</td>
<td></td>
</tr>
<tr>
<td>-----------------------------------------------------------------------------</td>
<td>------------</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><strong>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</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Salary from services rendered in Country “Q” (October 2018 - March 2019)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Basic Salary [See Note (i)]</td>
<td>3,93,680</td>
<td></td>
</tr>
<tr>
<td>Cost of Living Allowance [See Note (i)]</td>
<td>2,81,200</td>
<td></td>
</tr>
<tr>
<td><strong>Less: Standard deduction u/s 16(ia)</strong></td>
<td>40,000</td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>15,64,880</td>
<td></td>
</tr>
<tr>
<td>Income from House Property at Mumbai</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net Annual Value [See Note (ii)]</td>
<td>6,00,000</td>
<td></td>
</tr>
<tr>
<td><strong>Less: Standard deduction @ 30%</strong></td>
<td>1,80,000</td>
<td></td>
</tr>
<tr>
<td><strong>Income from Other Sources</strong></td>
<td>4,20,000</td>
<td></td>
</tr>
<tr>
<td>Interest earned from investment of security deposit (INR 1,00,000 @10%)</td>
<td>10,000</td>
<td></td>
</tr>
<tr>
<td>Interest earned on saving bank account with Country “Q’ [QGD 150 x INR 48.61] [See Rule 115 in Note (i)]</td>
<td>7,292</td>
<td></td>
</tr>
<tr>
<td>Interest on Securities of a Country “Q” company [QGD 5000 x INR 48.52] [See Rule 115 in Note (i)]</td>
<td>2,42,600</td>
<td></td>
</tr>
<tr>
<td>Interest on bonds issued by Country “P” Government</td>
<td>30,000</td>
<td></td>
</tr>
<tr>
<td>Dividend from a Country “Q” Company (QGD 1000 x INR 48.52) [See Rule 115 in Note (i)]</td>
<td>48,520</td>
<td></td>
</tr>
<tr>
<td><em>(Dividend from foreign company is taxable in India)</em></td>
<td>3,38,412</td>
<td></td>
</tr>
<tr>
<td><strong>Gross Total Income</strong></td>
<td>23,23,292</td>
<td></td>
</tr>
<tr>
<td><strong>Less: Deductions under Chapter VI-A</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Deduction u/s 80DD</td>
<td>75,000</td>
<td></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>
<td></td>
</tr>
<tr>
<td>Deduction u/s 80GG [See Note (iii)]</td>
<td>60,000</td>
<td></td>
</tr>
<tr>
<td><strong>Total Income</strong></td>
<td>21,88,292</td>
<td></td>
</tr>
<tr>
<td><strong>Total Income (rounded off)</strong></td>
<td>21,88,290</td>
<td></td>
</tr>
</tbody>
</table>
### Computation of tax liability of Shivam for A.Y. 2019-20

<table>
<thead>
<tr>
<th>Particulars</th>
<th>INR</th>
<th>INR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax on INR 21,88,290</td>
<td></td>
<td>4,68,987</td>
</tr>
<tr>
<td>Add: Health and education cess @4%</td>
<td></td>
<td>18,759</td>
</tr>
<tr>
<td>Tax Liability</td>
<td></td>
<td>4,87,746</td>
</tr>
<tr>
<td>Less: Foreign Tax Credit [See Note (v)]</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- on salary income</td>
<td>98,709</td>
<td></td>
</tr>
<tr>
<td>- on interest income</td>
<td>36,390</td>
<td>1,35,099</td>
</tr>
<tr>
<td><strong>Net tax liability</strong></td>
<td></td>
<td><strong>3,52,647</strong></td>
</tr>
<tr>
<td><strong>Net tax liability (rounded off)</strong></td>
<td></td>
<td><strong>3,52,650</strong></td>
</tr>
</tbody>
</table>

**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><strong>Total</strong></td>
<td><strong>8400</strong></td>
<td><strong>6000</strong></td>
<td></td>
<td><strong>3,93,680</strong></td>
<td><strong>2,81,200</strong></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></td>
<td>6,74,880</td>
</tr>
<tr>
<td><strong>Less:</strong> Standard deduction (40,000 x 6,74,880/16,04,880)</td>
<td>16,821</td>
</tr>
<tr>
<td><strong>Doubly taxed salary income</strong></td>
<td>6,58,059</td>
</tr>
<tr>
<td><strong>Computation of foreign tax credit on doubly taxed salary income:</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Lower of:</strong></td>
<td></td>
</tr>
<tr>
<td>Tax withheld in Country “Q” on salary income at 15%</td>
<td>98,709</td>
</tr>
<tr>
<td>Tax payable in India on salary income@22.29% (INR 4,87,746/ INR 21,88,290)</td>
<td>1,46,681</td>
</tr>
<tr>
<td><strong>Foreign tax credit</strong></td>
<td>98,709</td>
</tr>
</tbody>
</table>

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Double taxed Interest Income

<table>
<thead>
<tr>
<th>Description</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:**

<table>
<thead>
<tr>
<th>Description</th>
<th>INR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax withheld in Country “Q” on interest income at 15%, which is also the rate as per the DTAA</td>
<td>36,390</td>
</tr>
<tr>
<td>Tax payable in India on interest income@22.29%</td>
<td>54,076</td>
</tr>
<tr>
<td><strong>Foreign tax credit</strong></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. (c)  
3. (d)  
4. (a)  
5. (d)  
6. (c)  
7. (a)  
8. (d)  
9. (c)  
10. (b)  

II. ANSWERS TO DESCRIPTIVE QUESTIONS
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><strong>Income from house property</strong></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>1.5 3.5</td>
</tr>
<tr>
<td><strong>Profits and gains of business or profession</strong></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>(2.5) 4.5</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><strong>Capital gains</strong></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 Jaipur 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 23.0</td>
</tr>
<tr>
<td><strong>Income from other sources</strong></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>- 3.0</td>
</tr>
<tr>
<td><strong>Gross Total Income</strong></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><strong>Total Income</strong></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>Description</th>
<th>Amount</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>(-) Tax on Rs.5.7 lakhs, being agricultural Income [Rs.3.2 lakhs] + Basic Exemption Limit [Rs.2.5 lakhs]</td>
<td></td>
</tr>
<tr>
<td>Add: Health and education cess @4%</td>
<td></td>
</tr>
<tr>
<td>Indian rate of tax = 8,08,080 x 100/32,50,000 = 24.864%</td>
<td></td>
</tr>
<tr>
<td>Less: Rebate u/s 91 on income of Country E + Country F</td>
<td>4,49,179</td>
</tr>
<tr>
<td>Tax payable in India</td>
<td></td>
</tr>
<tr>
<td>Tax payable (Rounded off)</td>
<td>3,58,901</td>
</tr>
</tbody>
</table>

Computation of average rate of tax in Country E

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</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>Total income</td>
<td>19.2</td>
</tr>
</tbody>
</table>

Rates of tax in Country E

<table>
<thead>
<tr>
<th>Description</th>
<th>Rate</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>
</tbody>
</table>

Average rate of tax in Country E = 3.354 x 100/19.2 = 17.469%

Doubly Taxed Income (in Country E)

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</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>Double Taxation Relief at India rate of tax or rate of tax in Country E, whichever is lower</td>
<td>17.6</td>
</tr>
</tbody>
</table>

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

Doubly Taxed Income (in Country F)

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</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>
</tbody>
</table>
Business income 3.3
Share of loss from partnership firm (1.5)
Agricultural income 1.8
Total income 5.7
Rate of Tax in Country F 27%
Double Taxation Relief at Indian rate of tax (24.864%) or rate of tax in Country F (27%), whichever is lower 24.864%
Double Taxation Relief = 24.864% of Rs.5.7 lakhs = Rs.1,41,725
Double Taxation Relief [Country E & Country F] = Rs.3,07,454 + Rs.1,41,725 = 4,49,179

Answer to Q.2:
As per section 3(1) of Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 ("BM Act"), every assessee would be liable to tax@30%, in respect of his undisclosed foreign income or foreign asset of the previous year. However, an undisclosed asset located outside India shall be charged to tax on its value in the previous year in which such asset comes to the notice of the Assessing Officer.

Any undisclosed foreign income will be taxed as the income of the previous year to which it pertains. Hence Rs.5 lakhs will be taxed as the income of the previous year 2017-18.

An undisclosed asset located outside India shall be charged to tax on its value in the previous year in which such asset comes to the notice of the Assessing Officer. Thus, the value of the undisclosed foreign asset will be taxed as the income of the previous year 2019-20.

The undisclosed asset is gold jewellery. The value of the same is the higher of:

(a) Purchase price (Rs 4.2 lakhs), and
(b) Value as on valuation date (1st April of the previous year) as per report of a Valuer recognized by the Government (Rs 5.2 lakhs).

The tax consequences are as under:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>P.Y. 2017-18</th>
<th>P.Y. 2019-20</th>
<th>Tax (@30%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Undisclosed income</td>
<td>Rs.5,00,000</td>
<td></td>
<td>Rs.1,50,000</td>
</tr>
<tr>
<td>Undisclosed jewellery</td>
<td></td>
<td>Rs.5,20,000</td>
<td>Rs.1,56,000</td>
</tr>
</tbody>
</table>

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

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

MULTIPLE CHOICE QUESTIONS

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

II. ANSWERS TO DESCRIPTIVE QUESTIONS

Answer to Q.1:

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

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

<table>
<thead>
<tr>
<th>(1) Particulars</th>
<th>(2) Mauritius</th>
<th>(3) India</th>
<th>(4) Total</th>
<th>(5) % 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>Description</td>
<td>Amount</td>
</tr>
<tr>
<td>----------------------------------------------------------------------------</td>
<td>--------------</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 = \( \frac{4}{15} \times 100 = 27\% \)

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

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

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

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

**Answer to Q.2:**

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

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

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

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

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

**Answer to Q.3:**

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

In the present case, RB Pvt. Ltd. seeks to understand whether or not Modern Bazaar can withhold taxes at source when making payments to it. Hence, this avenue would be a viable option for RB Pvt. Ltd.
(b) In order to approach the AAR the applicant must be eligible under Section 245N of the Income-tax Act, 1961. Eligible applicants include non-residents and some residents. A resident can apply as long as the application pertains to tax liability of the non-resident in India in relation to a transaction which has been undertaken or is proposed to be undertaken by a resident applicant with such non-resident. The value of transactions undertaken does not matter.

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

(c) The AAR does not have jurisdiction to hear matters where it feels that the transaction has been entered into, for prima facie tax avoidance. Additionally, the matter may not be heard if it is already pending before an income tax authority/tribunal or any court or involves computation of the fair market value of any property. Here, none of these conditions are applicable.
SOLUTION TO CASE STUDY 6

I. ANSWERS TO MCQs (Most appropriate answers)
1. (b)
2. (c)
3. (d)
4. (a)
5. (d)
6. (d)
7. (c)
8. (b)
9. (c)
10. (c)

II. ANSWERS TO DESCRIPTIVE QUESTIONS

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

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

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

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

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

Further, section 90(2) provides that where the Indian Government has entered into DTAs 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.

**Answer to Q.2:**

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

<table>
<thead>
<tr>
<th>S. No</th>
<th>Particulars</th>
<th>Amount (INR crores)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Full value of consideration for transfer of shares of Singapore Intermediary Co</td>
<td>50.00</td>
</tr>
<tr>
<td>2.</td>
<td>Cost of acquisition of shares of Singapore Intermediary Co</td>
<td>10.00</td>
</tr>
<tr>
<td>3.</td>
<td><strong>Long-term capital gains</strong></td>
<td><strong>40.00</strong></td>
</tr>
<tr>
<td>4.</td>
<td>Fair Market Value of all the assets of the Singapore Intermediary Co as on the specified date (31 May 2019)</td>
<td>50.00</td>
</tr>
<tr>
<td>5.</td>
<td>Fair Market Value of assets of the Singapore Intermediary Co located in India as on the specified date (31 May 2019), i.e., Fair value of Ind Co as held by Singapore Intermediary</td>
<td>40.00</td>
</tr>
<tr>
<td>6.</td>
<td>Long-term capital gains (income) attributed to assets located in India [(3)*(5)/(4)]</td>
<td>32.00</td>
</tr>
<tr>
<td>7.</td>
<td><strong>Long-term capital gains tax at 10% (as per section 112)</strong></td>
<td><strong>3.20</strong></td>
</tr>
</tbody>
</table>
Notes:
1. The capital assets, being transferred, in the instant case, are the shares of Singapore Intermediary Co. Since, the shares of Singapore Intermediary Co have been held by US Co for more than 24 months, the capital gains would be long-term capital gains.

2. As per Rule 11UC, the income attributed to assets located in India would be based on the proportion of fair market value of assets located in India on the specified date, from which the share derives its value substantially to the fair market value of all assets of Singapore Intermediary Co.

3. As per section 112(1)(c)(iii), in case of a foreign company, the long term capital gain on unlisted securities is chargeable to tax @10% without indexation and fluctuation benefit.

4. The rate of 10% is excluding cess and surcharge, if any, depending on the total income of the company.

(ii) Computation of capital gains chargeable to tax and tax amount in India on transfer of shares of Ind Co by Singapore Intermediary Co

<table>
<thead>
<tr>
<th>S. No</th>
<th>Particulars</th>
<th>Amount (INR crores)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Full value of consideration for transfer of shares of Ind Co</td>
<td>45.00</td>
</tr>
<tr>
<td>2.</td>
<td>Cost of acquisition of shares of Ind Co</td>
<td>5.00</td>
</tr>
<tr>
<td>3.</td>
<td>Short-term capital gains (since shares of Ind Co have been held for less than 24 months)</td>
<td>40.00</td>
</tr>
<tr>
<td>4.</td>
<td>Short-term capital gains chargeable to tax @40%</td>
<td>14.00</td>
</tr>
</tbody>
</table>

Note: The rate of 40% is excluding cess and surcharge, if any, depending on the total income of the company.

Taxability as per India-Singapore DTAA

Under the provisions of the Income-tax Act, 1961, the capital gains from transfer of shares of Ind Co would be chargeable to tax in India in the hands of Singapore Intermediary Co. However, the provisions of the India-Singapore DTAA can be applied to the extent they are more beneficial to the taxpayer.

As per Clause 4B of Article 13 of the India-Singapore DTAA, dealing with capital gains, gains arising 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 taxable in that State.

However, where such gain arise during the period beginning on 1 April 2017 and ending on 31 March 2019, it 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.

In the instant case, Singapore Intermediary Co acquired shares of Ind Co on 1 March 2018 (i.e., after 1 April 2017). Accordingly, the gains may be taxable in India, being Contracting State in which the Ind Co is resident. However, restriction of 50% of tax rate shall not be applicable in this case since the capital gain arises after 31.3.2019.

(iii) Amalgamation of US Co with another group company US Co 2

As per section 47(viab), any transfer, in a scheme of amalgamation, of a capital asset, being a share of a foreign company, referred to in the Explanation 5 to section 9(1)(i), which derives, directly or indirectly, its value substantially from the share or shares of an Indian company, held by the amalgamating foreign company to the amalgamated foreign company, shall not be regarded as transfer, if—
(A) at least twenty-five per cent of the shareholders of the amalgamating foreign company continue to remain shareholders of the amalgamated foreign company; and

(B) such transfer does not attract tax on capital gains in the country in which the amalgamating company is incorporated;

Accordingly, in the instant case, if 25% of shareholders of US Co continue to remain shareholders of US Co 2 and if such transfer (by way of amalgamation) does not attract capital gains tax in US, then the amalgamation of US Co with US Co 2 would not be regarded as a ‘transfer’ under the Income-tax Act, 1961 and hence, not chargeable to tax in India.

Other option available with US Co is to demerge its one or more undertaking

As per section 47(vicc), any transfer, in a scheme of demerger, of a capital asset, being a share of a foreign company, referred to in the Explanation 5 to section 9(1)(i), which derives, directly or indirectly, its value substantially from the share or shares of an Indian company, held by the demerged foreign company to the resulting foreign company, shall not be regarded as transfer, if—

(A) the shareholders, holding not less than three-fourth in the value of the shares of the demerged foreign company, continue to remain shareholders of the resulting foreign company; and

(B) such transfer does not attract tax on capital gains in the country in which the demerged foreign company is incorporated;

Accordingly, if three-fourth value of the shares of US Co continue to remain shareholders of resulting company and if such transfer (by way of demerger) does not attract capital gains tax in US, then the demerger of one or more undertaking of US Co would not be regarded as a ‘transfer’ under the Income-tax Act, 1961 and hence, not chargeable to tax in India.
I. ANSWERS TO MCQs

<table>
<thead>
<tr>
<th>MCQ No.</th>
<th>Answer</th>
<th>MCQ No.</th>
<th>Answer</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>(d)</td>
<td>6.</td>
<td>(c)</td>
</tr>
<tr>
<td>2.</td>
<td>(c)</td>
<td>7.</td>
<td>(a)</td>
</tr>
<tr>
<td>3.</td>
<td>(d)</td>
<td>8.</td>
<td>(c)</td>
</tr>
<tr>
<td>4.</td>
<td>(b)</td>
<td>9.</td>
<td>(d)</td>
</tr>
<tr>
<td>5.</td>
<td>(d)</td>
<td>10.</td>
<td>(d)</td>
</tr>
</tbody>
</table>

II. ANSWERS TO DESCRIPTIVE QUESTIONS

Answer to Q.1

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

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

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount (in Euro)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Price per MT of steel to PQR Inc.</td>
<td>1,200</td>
</tr>
<tr>
<td>Less: Cost of insurance and freight per M.T.</td>
<td>400</td>
</tr>
<tr>
<td>Adjusted Price per M.T.</td>
<td>800</td>
</tr>
</tbody>
</table>

Since the adjusted price for PQR Inc., Country A and the price fixed for ABC Inc. are the same, the arm’s length price is Euro 800 per MT. Since the sale price to associated enterprise (i.e., ABC Inc.) and unrelated party (i.e., PQR Inc.) is the same, the transaction with associated enterprise ABC Inc. has also been carried out at arm’s length price.
Sigma Ltd., India and Epsilon Ltd., Country B are deemed to be associated enterprises, since Epsilon Ltd. holds shares carrying 26.66% \[ \frac{1,40,000 \times 100}{5,25,000} \], voting power in Sigma Ltd, from the information given in Exhibit C. Since Epsilon Ltd. is a non-resident, the transactions of purchase by Sigma Ltd. of goods manufactured by Epsilon Ltd. for sale in India would fall within the meaning of “international transaction” under section 92B. Therefore, transfer pricing provisions would be attracted in this case and the arm’s length price 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>

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

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**

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

Section 92A defines an “associated enterprise” and sub-section (2) of this section speaks of the situations when the two enterprises shall be deemed to associated enterprises. Applying the provisions of section 92A(2)(a) to (m) to the given facts in the case study along with Exhibit D, it is clear that “XYZ Motors Ltd.” is deemed to be associated with :-

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

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

However, GHI Inc., Country D is not an associated enterprise of XYZ Motors Ltd. since its voting power in XYZ Motors Ltd. is only 2.31% \([3,000 \times 100/1,30,000]\). Further, HIT Ltd., Country D, is not an associated enterprise of XYZ Motors Ltd., since this company has financed an amount which is only 49.95% \([74 \times 81 \times 100 /12,000]\) (i.e., less than 51%) of the book value of total assets of XYZ Motors Ltd. Also, it holds shares carrying only 0.77% \([1,000 \times 100/1,30,000]\) voting power in XYZ Motors Ltd.

The transactions entered into by XYZ Motors Ltd. with LMN Inc. and RST Ltd. are, therefore, to be adjusted accordingly to work out the income chargeable to tax for the A.Y. 2019-20.

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

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

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

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

Answer to Q.3

(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 ₹ 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% \([10 \times 100/68]\), 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% \([1 \times 100/18]\), 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.

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% [32 × 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.