

### **DISCLAIMER**

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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 31<sup>st</sup> 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 buy 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 to 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 Ltd. 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**

| Particulars   | ₹ in crores |
|---|-------------|
| Purchase price of mobile handsets by unrelated parties from Gama Inc. | 2,640       |
| Adjustments for functional differences                                |             |
| <b>Add:</b> Royalty payable by ACL [₹ 100 per mobile set x 15,00,000] | 15          |
| <b>Add:</b> Cost of capital for 1 month credit which is not given to  | 24          |

|  |             |
|--|-------------|
| unrelated party [12% x ₹200 crore (monthly average sales i.e., ₹2,400 crore /12 months)] |             |
| <b>Arm's Length Price of 15,00,000 sets</b>  | <b>2679</b> |

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.

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 assesseees 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

- (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)

| Q. No. | Answer |
|--------|--------|
| (i)    | (B)    |
| (ii)   | (A)    |
| (iii)  | (D)    |
| (iv)   | (C)    |
| (v)    | (C)    |
| (vi)   | (A)    |
| (vii)  | (A)    |
| (viii) | (B)    |
| (ix)   | (C)    |
| (x)    | (D)    |

**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 16<sup>th</sup> April, 2011. She invested in her name, ₹ 12 lakhs in the shares of domestic companies on 14<sup>th</sup> April, 2012 and ₹ 13 lakhs on 25<sup>th</sup> 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.

| Date       | Average of Telegraphic Transfer buying rate and selling rate of 1 US Dollar in Indian rupees. |
|------------|---|
| 14.03.2012 | ₹ 60  |
| 25.03.2015 | ₹ 65  |
| 28.03.2018 | ₹ 70  |

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:

F. Y. 2009-10 - 148; F. Y. 2011-12 - 184; F. Y. 2012-13 - 200;

F. Y. 2014-15 - 240; F.Y. 2015-16 - 254; and F.Y. 2017-18 - 272.

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 20<sup>th</sup> March, 2018.

Mr. Ram, his second son Mr. Kushwah and Mr. Ram's four non-resident friends formed a company by name Birta 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 Birta Inc. in the UK and in India are purchased from Tatla Inc., Singapore.

The total activity profile of Birta Inc. is given below:

| <b>Financial year</b><br><b>Particulars</b>                  | <b>2015-16</b> | <b>2016-17</b> | <b>2017-18</b> |
|--|----------------|----------------|----------------|
| Average value of total assets in India<br>(₹ in Crores)      | 180            | 220            | 300            |
| Total income of the company (₹ in Crores)                    | 90             | 100            | 180            |
| Total payroll expenses incurred by the company (₹ in Crores) | 180            | 200            | 200            |
| Average value of total assets of the company (₹ in Crores)   | 400            | 450            | 500            |
| Total average number of employees in India                   | 1,000          | 1,200          | 1,500          |
| Total turnover (₹ in Crores)                                 | 1,000          | 1,300          | 1,700          |
| Dividend from Indian companies (₹ in Crores)                 | 50             | 60             | 100            |
| Payroll expenses in India (₹ in Crores)                      | 100            | 105            | 110            |
| Total average number of resident employees in India          | 900            | 1,100          | 1,300          |
| Turnover in India (₹ in Crores)                              | 400            | 700            | 900            |
| Total average employees of the company for the year          | 2,000          | 2,200          | 2,200          |

**Note:** All the Board meetings of the company were held outside India during the financial year 2017-18.

Ms. Karuna Kapoor born in the USA was appointed as the CEO of Birta 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 recognized by the foreign country.
  - (D) Lower of cost of acquisition or open market value on the valuation date as per valuation report from a valuer 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. 31.03.2019<sup>1</sup>.
  - (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

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<sup>1</sup> printed as 2009 in the question paper

- (D) 60 days
- (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**

| Particulars  | Amount in ₹ |           |
|--|-------------|-----------|
| <b><u>Income from house property</u></b>   |             |           |
| Residential house at Mumbai [Annual Value would be Nil, assuming that the property is unoccupied and no other benefit is derived from such property]   |             | Nil       |
| 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]  |             | Nil       |
| <b>Capital Gains</b>   |             |           |
| <b>Long term capital gains on sale of shares of listed companies</b>   |             |           |
| [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 of 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.  |             |           |
| <b>Long term capital gain on sale of vacant site at Chennai (long term, since it is held for more than 24 months)</b>  |             |           |
| Full value of consideration  | 40,00,000   |           |
| As per section 50C, the full value of consideration would be higher of actual consideration of ₹ 35,00,000 and stamp duty value of ₹ 40,00,000   |             |           |
| Less: Indexed cost of acquisition (₹ 7,40,000 x 272/148)   | 13,60,000   |           |
|  | 26,40,000   |           |
| Less: Exemption under section 54F [Not available since investment in residential house in India is only eligible for exemption]  | -           | 26,40,000 |

|   |                  |
|---|------------------|
| <b>Gross Total income/Total Income</b>            | <b>26,40,000</b> |
| <b>Tax on total income</b>                        |                  |
| Tax@20% on long-term capital gains of ₹ 26,40,000 | 5,28,000         |
| Add: Education cess @2%                           | 10,560           |
| Secondary and higher education cess@1%            | 5,280            |
| <b>Tax liability</b>                              | <b>5,43,840</b>  |

**Working Note:**

**Computation of long-term capital gains on transfer of shares of listed companies in the hands of Smt. Sita**

| Particulars   | Amount in ₹ |
|---|-------------|
| Long term capital gain on transfer of shares purchased on 14.4.2012, since held for more than 12 months |             |
| Sale Consideration  | 14,00,000   |
| Less: Indexed Cost of acquisition (₹ 12,00,000 x 272/200)   | 16,32,000   |
| Long term capital gain  | (2,32,000)  |
| Long term capital gain on transfer of shares purchased on 25.3.2015, since held for more than 12 months |             |
| Sale Consideration  | 17,50,000   |
| Less: Cost of acquisition (₹ 13,00,000 x 272/240)   | 14,73,333   |
| Long term capital gain  | 2,76,667    |
| Long term capital gain exempt under section 10(38) [₹ 2,76,667 - ₹ 2,32,000]                            | 44,667      |

**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**

| Particulars   | Amount          |
|---|-----------------|
| <b>Income from Other Sources</b>  |                 |
| Interest on debentures in a listed company in India [50,000x100x8%]   | 4,00,000        |
| Dividend from listed domestic companies [Exempt u/s 10(34)]   | -               |
| <b>Gross Total Income</b>   | <b>4,00,000</b> |
| Less: Deduction under section 80C in respect of LIC premium (since premium does not exceed 20% of actual capital sum assured) | 1,00,000        |
| <b>Total Income</b>   | <b>3,00,000</b> |

#### **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 20<sup>th</sup> 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 =  $\frac{₹100 \text{ crore}}{₹180 \text{ crore}} \times 100 = 55.56\%$

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 =  $\frac{₹300 \text{ crores}}{₹500 \text{ crores}} \times 100 = 60\%$

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<sup>2</sup>

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  $\frac{1,500}{2,200} \times 100 = 68.18\%$

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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<sup>2</sup> 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  $\frac{₹110 \text{ crores}}{₹200 \text{ crores}} \times 100 = 55\%$

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+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)

| Q. No. | Answer |
|--------|--------|
| (i)    | (D)    |
| (ii)   | (C)    |
| (iii)  | (B)    |
| (iv)   | (B)    |
| (v)    | (C)    |
| (vi)   | (A)    |
| (vii)  | (D)    |
| (viii) | (C)    |
| (ix)   | (D)    |
| (x)    | (C)    |



**Case Study 3**

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 country, with which India had entered into Double Taxation Avoidance Agreement (DTAA). The particulars of assets and income of MS for the year ended 31.3.18 are:-
- He owns immovable properties (including residential house) in both India and country 'X'.
  - 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.
  - 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.
  - He has derived rental income of ₹ 6 lacs from the property located in India which was let-out during the year.
  - 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 is 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

- (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 30<sup>th</sup> 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<sup>3</sup>. 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 be 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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<sup>3</sup> 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 A.Y.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.

| Particulars   |   | ₹ in lakhs    |
|---|---|---------------|
| Amount by which total income of XYZ Ltd. is enhanced on account of adjustment in the value of international transactions: |   |               |
| (i)   | Difference in price of T-Shirt @ \$ 1 each for 1,50,000 pieces sold to Qilla Inc. [ $\$ 1 (\$ 4 - \$ 3) \times 1,50,000 \times ₹ 70$ ]                | 105.00        |
| (ii)  | Difference for excess payment of guarantee fee to Qilla Inc. for loan borrowed from foreign lender [ $\$ 5,000 (\$ 20,000 - \$ 15,000) \times ₹ 70$ ] | 3.50          |
| (iii)   | Difference for excess payment for services to Qilla Inc. [ $\$ 5,000 (\$ 20,000 - \$ 15,000) \times ₹ 70$ ]   | 3.50          |
|   |   | <b>112.00</b> |

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 to 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.<sup>4</sup> 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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<sup>4</sup>It 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)

| Q. No. | Answer |
|--------|--------|
| (i)    | C      |
| (ii)   | B      |
| (iii)  | D      |
| (iv)   | B      |
| (v)    | C      |
| (vi)   | A or D |
| (vii)  | C      |
| (viii) | C      |
| (ix)   | A      |
| (x)    | B      |

**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).