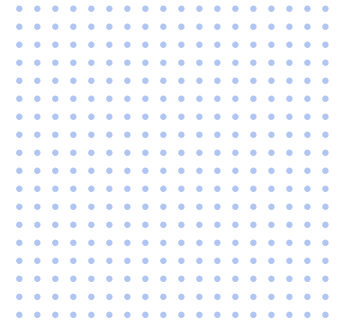




FOR CA FINAL EXAM PREPARATION

CA Final 2023 Suggested Answers · Paper 6C International Taxation (Old Scheme)

EXAM	YEAR	TYPE
CA Final	2023	Suggested Answers

SUBJECT	DATE
Paper 6C International Taxation (Old Scheme)	May 2023

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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 assumptions made or views taken.

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PAPER 6C: INTERNATIONAL TAXATION

The Question Paper comprises of **five** case study questions. The candidates are required to answer any **four** case study questions out of five.

All questions relate to Assessment Year 2023-24, unless otherwise stated in the questions/case studies.

Case Study 1**Mega Ltd., Delhi**

Mega Ltd. is a subsidiary of Lion Pte. of Singapore which has 60% of the share capital in Mega Ltd. Pacific Inc. of USA has 80% shareholding in Lion Pte. of Singapore. The Board of Directors of Pacific Inc. decided to sell its entire shareholding in Lion Pte. to Dean Jones Inc. of USA. The book value of assets of all the companies always exceeded ₹100 crores.

For the financial year 2022-23, Mega Ltd. had to pay interest of ₹70 lakhs to Atlanta Inc. of Country Z for the rupee denominated bonds issued in February, 2019 and ₹80 lakhs by way of interest to Indiana Ltd. of Country W in respect of rupee denominated bonds issued in May, 2020. On both the occasions, Mega Ltd. issued rupee denominated bonds outside India after complying with all the requirements of relevant laws/regulations.

Mega Ltd. required working capital assistance of ₹10 crores and solicited help from its buyer Mini Pte. of Canada. The total borrowings of Mega Ltd. was ₹20 crores before seeking assistance from Mini Pte. The goods manufactured by Mega Ltd. are sold by Mini Pte in African countries. In order to provide working capital assistance, Mini Pte. deposited money in a bank account and based on that, a bank guarantee was given to advance money to Mega Ltd. by SBI, Mumbai. The interest on loan was @ 9% per annum. In return for the guarantee, Mega Ltd. had to pay 0.5% of the loan annually to Mini Pte as guarantee fee. Similar such facility was offered by Super Inc. Canada at 0.2% of the loan as guarantee fee.

Mega Ltd. sold 50 lakhs units of Goods manufactured for ₹2,000 per unit to Mini Pte during the previous year 2022-23. Similar goods were sold to others in Canada for ₹2,100 per unit. Mega Ltd. allowed 3 months credit period to Mini Pte and whereas for other buyers it allowed 1 month credit period. Cost of capital may be taken as 8% per annum.

The EBITDA of Mega Ltd. for the year ended 31.03.2023 was ₹12 crores. Interest paid to SBI for the loan was ₹95 lakhs and interest in respect of other borrowings from unrelated parties was ₹300 lakhs for the year ended 31.03.2023.

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, 2022.

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Mega Ltd. has been exporting its goods to Chat Ltd. of UK as per the agreement entered into by them. Every year, the exports exceeded ₹ 100 crores. Now, due to increased demand of products of Mega Ltd., the terms of trade between Mega Ltd. and Chat Ltd. had to be revisited and accordingly, a fresh agreement for 7 years was entered into on 10.09.2022. The Board of Directors of Mega Ltd. apprehend that the transfer price adjustment may be required in the light of the fresh agreement entered into by the parties. Based on the pending assessments and litigation before Assessing Officer and CIT (Appeals), they want to analyse the possibility of entering into advance pricing agreement with rollback benefits.

Laxman, Managing Director

Laxman, the Managing Director of Mega Ltd. is a resident of India. His brother Anand left India in 2015 for employment in USA and he is a non-resident. Both invested in Real Estate Investment Trust (REIT) in September, 2020. REIT received dividend of ₹ 120 lakhs from ABC Ltd., a special purpose vehicle in which the Business Trust has 90% shareholding. Both Laxman and Anand have 10% of the units in the Business Trust. ABC Ltd. has not opted for section 115BAA.

In December, 2018, Anand bought 600 Global Depository Receipts (GDRs) of Maxima Ltd., India. These GDRs were issued in accordance with the notified scheme of the Central Government against the company's initial issue of shares. Anand purchased GDRs in foreign currency through an approved intermediary. In October, 2022 Anand sold 400 GDRs outside India to Ramesh a citizen and resident of a country outside India and the balance 200 GDRs to Rajini, a resident and but not ordinarily resident in India.

Ravinder, Marketing Manager of Mega Ltd.

Ravinder, Marketing Manager of Mega Ltd. (looking after business interests in Europe and America) is born and brought up in USA and is a citizen of USA. His parents and paternal grandparents were born and brought up in USA but his maternal grandparents were born in Dhaka, Bangladesh before 1930. He visited India every financial year from 1st November to 31st January.

Parthiv, CEO of Mega Ltd.

Parthiv a management graduate from Harvard University was employed in Tomato LLP of Country S since June, 2014. He came to India on 15.11.2022 and joined as CEO of Mega Ltd. Parthiv was in India before he left for overseas education in December, 2010 and was subsequently employed outside India. There is no income-tax on the salary income earned from Tomato LLP in Country S. He earned interest income of ₹ 2,40,000 (net) in Country Q and salary income of ₹ 9 lakhs up to the date of his return to India in the financial year 2022-23. Tomato LLP is wholly owned and managed by Deepak and his family who are residents and living in Mumbai.

Salary income of Parthiv from Mega Ltd. up to 31.03.2023 was ₹ 13,50,000 (computed as per provisions of the Income-tax Act, 1961)

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Parthiv acquired shares in listed companies which were sold in the financial year 2022-23, the details of which are given below:

Name of company	No. of shares	Date of acquisition	Cost of acquisition per share	Date of transfer	Sale price (per share)	FMV as on 31.01.2018
Mango Ltd.	200	30.10.2016	₹ 2,000	25.01.2023	₹ 5,000	₹ 4,000
Almond Ltd.	200	10.01.2018	₹ 3,000	10.03.2023	₹ 3,500	₹ 2,500
Walnut Ltd.	100	15.07.2017	₹ 2,000	22.03.2023	₹ 3,500	₹ 3,800

He has paid S TT both at the time of purchase and at the time of sale. Parthiv has opted for the provisions of section 115BAC.

REQUIRED

Choose the most appropriate alternative for the following MCQs:

- 1.1 For considering the taxability in India, which of the Double Taxation Avoidance Agreements would be preferred for deciding the taxability of the transfer of shares of Lion Pte. Singapore by Pacific Inc. of USA?
 - (A) India-Singapore DTAA
 - (B) Singapore-USA DTAA
 - (C) India-USA DTAA
 - (D) Both India-Singapore DTAA and India-USA DTAA
- 1.2 At what rate tax is deductible at source on the interest paid by Mega Ltd. in respect of rupee denominated bonds for the assessment year 2023-24?
 - (A) Tax deductible at source@ 5% (plus applicable surcharge and cess) in both the cases
 - (B) No tax is deductible at source in both the cases
 - (C) No tax is deductible at source for the interest paid to Atlanta Inc and TDS@5% (plus applicable surcharge and cess) in respect of interest paid to Indiana Ltd.
 - (D) No tax is deductible at source for the interest paid to Indiana Ltd. and TDS@5% (plus applicable surcharge and cess) in respect of interest paid to Atlanta Inc.
- 1.3 At what rate tax is required to be deducted at source by REIT out of dividend received from ABC Ltd. distributed to Laxman and Anand?
 - (A) 10% for Laxman and 20% for Anand
 - (B) 0% for Laxman and 5% for Anand
 - (C) 30% for both Laxman and Anand
 - (D) 0% for both Laxman and Anand means TDS is not to be made on dividend distributed to Laxman and Anand.

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- 1.4 Which one of the following statements is correct in respect of "GDRs" sold by Anand to Ramesh?
- (A) Profit from sale of 'GDRs' shall be charged under the head "Income from other sources".
- (B) Profit from sale of 'GDRs' shall be taxable under the head "Capital Gain".
- (C) Sale of 'GDRs' shall not be regarded as "transfer" for the purpose of "Capital Gain".
- (D) Profit from sale of "GDRs" shall be charged under the head "Business Income".
- 1.5 What is the residential status of Ravinder for the assessment year 2023-24 under the Income-tax Act, 1961?
- (A) Resident and ordinarily resident
- (B) Resident but not ordinarily resident
- (C) Non-resident
- (D) Resident but could not be determined whether ordinarily resident with the given information
- (5 x 2 = 10 Marks)**

DESCRIPTIVE QUESTIONS

You are required to answer the following Descriptive questions:

- 1.6 Determine the residential status of Parthiv as per the provisions of the Income-tax Act, 1961 and compute his total income for the assessment year 2023-24. **(5 Marks)**
- 1.7 Determine whether Mega Ltd. and Mini Pte are Associated Enterprises. Also, compute the adjustment, if any, to the total income of Mega Ltd. is required in respect of goods supplied to Mini Pte and the interest paid for the loan availed by Mega Ltd. You may also consider the impact of EBITA. **(5 Marks)**
- 1.8 As the International Tax Manager of Mega Ltd., advise the company regarding the possibility of entering into advance pricing agreement (including pre-filing consultation) and on the rollback benefits. **(5 Marks)**

Solution to Case Study 1**Answers to Q.1.1 to Q.1.5**

MCQ No.	Correct Option
1.1	C
1.2	C
1.3	D
1.4	C
1.5	C

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Answer to Q.1.6

Determination of Residential Status of Parthiv for the AY 2023-24

As per section 6(1), in order to be a resident of India in the P.Y.2022-23, Parthiv should satisfy either of the following two conditions -

- (1) His stay in India should be for a period of 182 days or more in the P.Y.2022-23; or
- (2) His stay in India should be for a period of 60 days or more in the P.Y.2022-23 and for a period of 365 days or more in the four immediately preceding previous years.

Parthiv's stay in India in the P.Y.2022-23 is 137 days (i.e., 16 days + 31 days + 31 days + 28 days + 31 days). The question mentions that he left India in December, 2010. Since there is no information in the question relating to his visits to India thereafter, his stay in India in the four immediately preceding previous years would be Nil.

Therefore, he does not satisfy either condition (1) or condition (2) for being a resident.

As per section 6(1A), an individual who is a citizen of India would be deemed to be a resident of India if his total income, other than income from foreign sources, exceed ₹ 15 lakh during the relevant previous year and he is not liable to tax in any other country by reason of his domicile or residence or any other criteria of similar nature.

Parthiv's total income, other than income from foreign sources, would be ₹ 17,00,000 for A.Y.2023-24 as shown below -

Particulars	₹
Salary income of Parthiv from Mega Ltd. (₹ 13,50,000 + ₹ 50,000 standard deduction not allowable), assuming that salary of ₹13,50,000 has been computed as per the regular provisions of the Act	14,00,000
Long-term capital gains (See Working Note below)	<u>3,00,000</u>
	17,00,000
<p>Note – It is possible to consider salary income from Mega Ltd. as ₹ 13,50,000 assuming that the same has been computed as per section 115BAC, in which case the total income (excluding income from foreign sources) would be ₹ 16,50,000.</p> <p>Mr. Parthiv is not liable to income-tax in Country S in respect of his salary income. Assuming that he is a citizen of India and that he is also not liable to pay income-tax in respect of interest income earned in Country Q, he would be deemed resident in India under section 6(1A) for A.Y.2023-24. A deemed resident is, by default, a not ordinarily resident.</p> <p>In such a case, his total income for A.Y.2023-24 would be ₹ 17,00,000/₹ 16,50,000, depending on the assumption made, as worked out above.</p>	

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Alternatively, if it is assumed that Mr. Parthiv is not an Indian citizen or that he is liable to pay income-tax in respect of interest income earned in Country Q, then, the provisions of section 6(1A) would not apply to him. He would be a non-resident for A.Y.2023-24.

In such a case, his total income would comprise of salary earned from Mega Ltd. (₹ 14,00,000/₹ 13,50,000, depending on the assumption made) and long-term capital gains of ₹ 3,00,000. His total income for A.Y.2023-24 would accordingly be ₹ 17,00,000 / ₹ 16,50,000, depending on the assumption made.

Working Note - Long-term capital gains on sale of shares of listed companies

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Name of the company	No. of shares	Sale Price	FMV as on 31.1.2018	Lower of (3) and (4)	Cost at which shares were acquired	Cost of acquisition Higher of (5) and (6)	Capital gains [(3) – (7)] x (2)
		₹	₹	₹	₹	₹	₹
Mango Ltd.	200	5,000	4,000	4,000	2,000	4,000	2,00,000
Almond Ltd.	200	3,500	2,500	2,500	3,000	3,000	1,00,000
Walnut Ltd.	100	3,500	3,800	3,500	2,000	3,500	-
Long-term capital gains							3,00,000

Answer to 1.7

Two enterprises would be deemed to be associated enterprises as per section 92A(2), if one enterprise guarantees not less than 10% of the borrowings of the other enterprise.

Mega Ltd. and Mini Pte are deemed to be associated enterprises, since Mini Pte has given a constructive guarantee to borrowings of ₹ 10 crores by Mega Ltd. from SBI, Mumbai, which represents 33.33% of total borrowings of Mega Ltd.

Adjustment to the total income of Mega Ltd. on account of goods supplied to NRAE Mini Pte, applying CUP method

Particulars	Amount per unit (in ₹)
Sale price per unit to unrelated party in Canada	2,100
Add: Cost of credit for 2 months [₹ 2,100 x 8/100 x 2/12]	<u>28</u>
Arm's Length Price per unit	2,128
Less: Sale price per unit to Mini Pte	<u>2,000</u>
Arm's Length Adjustment per unit	<u>128</u>
Total number of units sold to Mini Pte - 50 lakh	

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<p>Arm's length adjustment (50,00,000 x ₹ 128) = ₹ 6,400 lakhs</p> <p>Guarantee fee (falls within the meaning of interest) – Arm's length adjustment</p> <p>Guarantee fee paid by Mega Ltd to NRAE – 0.5%</p> <p>Guarantee fee charged by unrelated party – 0.2%</p> <p>Arm's length adjustment = (0.5% - 0.2%) x ₹ 10 crores = ₹ 3 lakhs</p>	
Interest disallowance u/s 94B	
<p>Since the interest is paid to SBI, Mumbai, which is an Indian bank (resident in India), there is no base erosion and profit shifting. Hence, section 94B would not be attracted on payment of interest to SBI, Mumbai. Further, the provisions of section 94B would not be attracted in respect of guarantee fee paid to Mini Pte, since the same does not exceed ₹ 1 crore.</p> <p>Note - In any case, section 94B would not apply since the interest payable by Mega Ltd. (including guarantee fee) does not exceed ₹ 1 crore.</p>	

Answer to 1.8

Since Mega Ltd. has undertaken international transactions (being export of goods) with Chat Ltd. UK (assumed to be its associated enterprise), it is eligible to enter into an Advance Pricing Agreement.

Mega Ltd. has to make an application in writing requesting for a pre-filing consultation in the prescribed form to the Director General of Income-tax (International Taxation).

The pre-filing consultation would, amongst other things, -

- (i) determine the scope of the APA;
- (ii) identify transfer pricing issues;
- (iii) determine the suitability of international transaction of export of goods for the APA;
- (iv) discuss broad terms of the APA.

The pre-filing consultation, however, shall not –

- (i) bind the Board or the person to enter into an APA or initiate the APA process;
- (ii) be deemed to mean that the person has applied for entering into an APA.

For entering into APA, Mega Ltd. has to furnish an application in the prescribed form along with proof of payment of requisite fee as specified, to the Director General of Income-tax (International Taxation) in case of unilateral agreement and to the competent authority in India in case of bilateral or multilateral agreement. The application may be filed at any time before 1.4.2023, in which case the APA would apply from A.Y.2024-25.

The APA may also provide for determining the arm's length price or specify the manner in which arm's length price shall be determined in relation to the international transaction of export of goods entered into by Mega Ltd. during the rollback year.

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Mega Ltd. can make an application for rollback for any previous year, falling within a period not exceeding four previous years, preceding P.Y.2023-24, being the first of the five previous years for which the APA applies.

However, the international transaction has to be the same as the international transaction to which the agreement (other than the rollback provision) applies. In this case, this condition is satisfied since it is for export of goods, and hence, the international transaction is the same.

Mega Ltd. has to furnish modified return of income in respect of roll back years to which APA applies along with proof of payment of additional tax arising as a consequence of roll back provision.

The appeal before Commissioner (Appeals) to the extent of the subject covered under the APA has to be withdrawn by Mega Ltd. before furnishing the modified return for the said year.

Case Study 2**Autofit Limited**

Resident of Country X, Autofit Limited ("Autofit") is engaged in the business of manufacture and sale of automotive emission test equipment. The Company has established a wholly-owned subsidiary in India, AFL India; to help identify customers and carry out market research, as well as play a coordination role between the Parent company and the customers in India. It has an office in Pune India, which maintains stock of goods for storage, display as well as delivery to third party customers in India. The company considers this activity as preparatory in nature because all sales order and contracts are negotiated and executed by Autofit in Country X.

The DTAA between India and Country X is in line with the OECD Model Convention

AFL India

For the F.Y.2022-23, AFL India has reported revenue of INR 12,50,00,000 which entirely comprises of service revenue from Autofit Limited. APL India has reported a net profit of INR 1,12,00,000 after debiting interest on various loans as detailed below, depreciation and amortization of INR 23,00,000 and tax of INR 52,00,000. Further, APL India had a disallowed excess interest of INR 34,00,000 in the Assessment Year 2022-23, as per the EBITDA norms.

- Interest on a loan of INR 8 crores availed from AFL UK on 01 Sept. 2022 at an interest rate of 6.6%. Autofit Limited holds 25% voting power in AFL UK and the rest being held by a unrelated joint venture partner. AFL India has no. direct or indirect participation in the management, control or capital of AFL UK;
- Interest on a working capital loan of INR 10 crores availed from the India branch of MNC Bank of the UK, at an interest rate of 7.9%. The loan was provided by the Bank on 1 May 2022 against a corporate guarantee provided by Autofit;
- Interest on a loan of USD 2 million @5% issued by the New York branch of the Bank of USA, based on a back-to-back deposit made by Autofit of the same amount. For the FY 2022-23, AFL India paid an interest to the tune of INR 1,05,00,000 on this loan;

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- Interest on delayed payments @7% made to AFL China, amounting to INR 1,07,00,000 for the FY 2022-23. Autofit holds 25% voting power in AFL China. Autofit appoints more than half of the directors on the board of AFL China;

Mr. Bernard, an employee of Autofit Limited

During the FY 2022-23, Autofit Limited deputed one of its employees, Mr. Bernard, to India, to assist with installation of Auto fit's products at one of its customers' premises. He came to India for the first time on 24th April 2022 and left India on 30th November 2022.

New manufacturing unit

Autofit Limited is setting up a new manufacturing unit under a new subsidiary in India - AFL Precision. It is intended that AFL Precision would avail new beneficial tax rate of 18% under section 115BAB of the Income-tax Act, 1961. For the set-up of the manufacturing facility, AFL Precision has awarded a composite contract to AFL Sweden, another wholly-owned subsidiary of Autofit Limited. The entire consideration of the contract is split between (i) design consultancy, (ii) offshore supply of equipment and (iii) local supplies and installation.

REQUIRED

Choose the most appropriate alternative for the following MCQs:

- 2.1 Which of the following statement is correct regarding Mr. Bernard's presence in India during the F.Y. 2022-23? Assume that at present, Autofit does not have a fixed place PE in India and DTAA between India and country X is in line with OECD convention-
- Mr. Bernard's presence in India, being less than 12 months, would not create Autofit's Permanent Establishment ('PE') in India
 - Mr. Bernard's presence in India, being more than 183 days, would create Autofit's PE in India
 - Mr. Bernard will be eligible for short stay exemption because his stay in India did not exceed 300 days
 - Mr. Bernard will be eligible for short stay exemption only if Autofit declares that it has a PE and claims the salary expense as a deduction from the income offered for tax
- 2.2 Given the facts regarding Mr. Bernard and assuming that Autofit Limited does not have a Fixed place PE in India, how many minimum number of days of Mr. Bernard's presence in India during the previous year would constitute a PE, if the DTAA between India and Country X is in line with the UN Model Convention 2017?
- 1 day
 - 182 days
 - 183 days
 - 184 days

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- 2.3 Which of the following measures proposed under the Base Erosion and Profit Shifting (BEPS) initiative of the OECD may restrict Autofit in claiming exemption from Permanent Establishment as activities being preparatory or auxiliary in nature?
- (A) Limitation of Benefit (LoB) rule
 (B) Anti-fragmentation rules
 (C) Controlled Foreign Company (CFC) rules
 (D) Principal Purpose Test (PPT) rule
- 2.4 In which of the following circumstance, in cases AFL India is constituent entity of 'Autofit' International Group, the provision of furnishing of report in respect of international group shall apply if the total consolidated group revenue
- (A) In the accounting year exceeds ₹ 5,500 crores.
 (B) In the preceding accounting year exceeds ₹ 5,500 crores.
 (C) In the preceding accounting year exceeds ₹ 6,400 crores.
 (D) In the accounting year exceeds ₹ 6,400 crores.
- 2.5 Autofit is considering obtaining an Advance Ruling in respect of some transactions it proposes to undertake in India and for seeking clarity on the aspect of PE in India. Which of the following statement is incorrect in regard to Advance Rulings?
- (A) Autofit, if aggrieved by the ruling pronounced by the Board of Advance Ruling may appeal to the High Court within 60 days from the date of communication of that ruling
 (B) Autofit can withdraw the application within 30 days from the date of the application
 (C) Autofit can file application only in relation to Eligible transactions it has undertaken and not in relation to those it proposes to undertake
 (D) The ruling is binding on the Principal Commissioner and authorities subordinate to him.

(5 x 2 = 10 Marks)**DESCRIPTIVE QUESTIONS**

You are required to answer the following descriptive questions:

- 2.6 Please advise Autofit Limited on whether maintenance of stock of goods solely for storage, display and delivery by AFL India would constitute Permanent Establishment in India. Would your answer be different, if India's DTAA with Country X was in line with the UN Model Convention, 2017? **(3 Marks)**
- 2.7 Based on the details provided in respect of interest paid by AFL India during the FY 2022-23, determine the amount of interest permissible as deduction while computing income under the head "Profits and gains of business or profession", as per the EBITDA norms. Provide brief reason for the treatment of each item of interest regarding the limitation of interest deduction computation. **(7 Marks)**

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- 2.8 Examine whether the Assessing Officer (AO) can challenge the allocation of composite price paid by AFL Precision to AFL Sweden, between various components (supply of designs, offshore supply of equipment and onsite supply and installation) under the GAAR provisions. Enumerate the conditions to be satisfied for the GAAR provisions to be invoked. Can the AO examine the arrangement under any Specific Anti-avoidance Rules instead of GAAR? **(5 Marks)**

Solution to Case Study 2**Answers to Q.2.1 to Q.2.5**

MCQ No.	Correct Option
2.1	A
2.2	D
2.3	B
2.4	C
2.5	C or D

Note – MCQ 2.5 requires the candidates to choose the incorrect statement in regard to Advance Rulings in respect of some transactions proposed to be undertaken by Autofit and for seeking clarity on the aspect of PE in India. The statements in both options (C) and (D) are incorrect.

Answer to 2.6

Autofit Ltd. is a Country X company, which has a DTAA with India in line with OECD Model Convention.

Article 5(2) of OECD Model Convention specifically includes an office in the definition of PE. However, as per Article 5(4), PE shall be deemed not to include maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery, provided that such activity is of a preparatory or auxiliary character.

Autofit Ltd. has an office in Pune. However, it would not constitute a PE, since office in Pune is to maintain stock of goods solely for storage, display and delivery of goods to third party customers in India, and these activities are of preparatory or auxiliary character since all the sales orders and contracts are negotiated and executed directly by Autofit in Country X.

Test of the existence of PE as per UN Model Convention

If the India's DTAA with Country X is in line with the **UN Model Convention**, PE shall be deemed not to include maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage and display. Under UN Model Convention, "delivery" of goods does not qualify as an exception to the definition of PE.

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Since the office in Pune of Autofit maintains stock of goods for also delivery to third party customers in India, it may constitute PE in India.

Answer to 2.7

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.

However, section 94B is not applicable in case of interest paid in respect of a debt issued by a lender which is a PE in India of a non-resident, being person engaged in the business of banking.

Computation of permissible deduction under the head “Profits and gains from business or profession” of AFL India for A.Y. 2023-24

Particulars		₹ in lakhs
(i)	Interest on loan to AFL UK [₹ 30,80,000 (₹ 8 crores x 6.6% x 7/12)] [AFL UK is not an associate enterprise of AFL India since AFL India has no direct or indirect participation in the management, control or capital of AFL UK. Also, Autofit Ltd., 100% holding company of AFL India, does not hold 26% or more of the voting power in AFL UK. Hence, the amount of interest paid on such debt is not to be considered for the purpose of section 94B.]	-
(ii)	Interest to Indian branch of MNC Bank of UK [₹ 72,41,667 (₹10 crores x 7.9% x 11/12)] [Disallowance u/s 94B is not applicable on interest paid for loan issued by Indian branch of a non-resident bank]	-
(iii)	Interest of ₹ 1,05,00,000 to New York branch of the Bank of USA [Since AFL India is a wholly owned subsidiary of Autofit, both are associated enterprises. The debt issued by New York branch of Bank of USA would be deemed as issued by Autofit, being the AE, since such loan is given based on deposits made by Autofit. Hence, the amount of interest paid on such debt has to be considered for the purpose of section 94B.]	1,05,00,000
(iv)	Interest on delayed payment of ₹ 1,07,00,000 to AFL China [Autofit Ltd. is an associated enterprise of AFL China, since it appoints more than half of the directors on the board of AFL China. Autofit Ltd. is the holding company of AFL India. Since Autofit Ltd.	1,07,00,000

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participates in the management of AFL China and has capital and control over AFL India, AFL India and AFL China would be associated enterprises. Hence, interest on delayed payment to AFL China has to be considered for the purpose of section 94B]	
Interest paid or payable to non-resident AE for section 94B	2,12,00,000
<u>Computation of EBITDA</u>	₹
Net profit	1,12,00,000
Add: Depreciation	23,00,000
Tax	52,00,000
Interest	
[₹ 30,80,000 + ₹ 72,41,667 + ₹ 1,05,00,000 + ₹ 1,07,00,000]	<u>3,15,21,667</u>
EBITDA	<u>5,02,21,667</u>
30% of EBITDA = 30% of ₹ 5,02,21,667	1,50,66,500
<u>Excess Interest: Lower of the following would be disallowed</u>	
- Interest paid or payable to non-resident AE in excess of 30% of EBITDA [₹ 2,12,00,000 – ₹ 1,50,66,500]	₹ 61,33,500
- Interest paid or payable to non-resident AE	₹ 2,12,00,000
Lower of the above is ₹ 61,33,500. Hence, disallowance u/s 94B would be ₹ 61,33,500.	
Excess Interest of ₹ 34,00,000 carried forward from A.Y. 2022-23 is not allowed in A.Y. 2023-24.	
Interest allowed as deduction (₹ 3,15,21,667 – ₹ 61,33,500)	2,53,88,167

Note - Section 94B(1), 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).

The above solution has been worked out on the basis of the provisions of section 94B(1) read with the intent expressed in the Explanatory Memorandum to the Finance Bill, 2017.

However, 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.

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An alternate view may be possible on the basis of the interpretation as per the plain reading of section 94B(2). Accordingly, the alternative computation on the basis of plain reading of section 94B(2) is given below -

Alternate Solution

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.

However, section 94B is not applicable in case of interest paid in respect of a debt issued by a lender which is a PE in India of a non-resident, being person engaged in the business of banking.

Computation of permissible deduction under the head “Profits and gains from business or profession” of AFL India for A.Y. 2023-24

Particulars	Amount (₹ in crores)
Interest paid or payable to non-resident associated enterprises (as computed above)	2,12,00,000
Interest paid to other enterprises:	
Interest paid to AFL UK	30,80,000
Interest paid to Indian branch of MNC Bank of UK	72,41,667
Total interest paid or payable	3,15,21,667
EBITDA (as computed above) ₹ 5,02,21,667	
30% of EBITDA = 30% of ₹ 5,02,21,667 ₹ 1,50,66,500	
Excess Interest: Lower of the following would be disallowed -	1,64,55,167
- Interest paid or payable in excess of 30% of EBITDA [₹ 3,15,21,667 – ₹ 1,50,66,500]	
- Interest paid or payable to non-resident AE ₹ 2,12,00,000	
Excess Interest of ₹ 34,00,000 carried forward from A.Y. 2022-23 is not allowed in A.Y. 2023-24.	
Therefore, interest paid or payable allowable as deduction under the head “Profits and gains of business or profession” would be ₹ 1,50,66,500 (₹ 3,15,21,667 – ₹ 1,64,55,167).	1,50,66,500

Answer to 2.8**Application of GAAR Provisions**

The allocation of composite price paid by AFL Precision to AFL Sweden between different components can be challenged by the Assessing Officer by invoking GAAR provisions, if it has been done in a manner as to reduce tax liability of the foreign company in India (for example, a higher value is attributed to the component which has a lower tax rate or which is not chargeable to tax and a lower value is attributed to the component which has a higher tax rate).

Conditions for invoking GAAR provisions

1. The main purpose or one of the main purpose of the arrangement entered into by AFL Precision to AFL Sweden is to obtain tax benefit and any of the following tests is satisfied
 - creates, rights, or obligations, which are not ordinarily created between persons dealing at arm's length
 - results, directly or indirectly, in the misuse, or abuse, of the provisions of the Act
 - lacks commercial substance or is deemed to lack commercial substance
 - is entered into, or carried out, by means, which are not ordinarily employed for bona fide purpose.
2. The tax benefit in the relevant assessment year arising, in aggregate, to AFL Precision and AFL Sweden to the arrangement should exceed ₹ 3 crores.

Examination of arrangement under SAAR provisions

AFL Precision and AFL Sweden are associated enterprises since both are subsidiaries of Autofit Limited. Accordingly, transfer pricing provisions would be applicable in the hands of AFL Precision on the transactions between AFL Precision and AFL Sweden, if such transactions are not at arm's length. However, the transfer pricing adjustment should not have the effect of reducing the income chargeable to tax or increasing the loss of AFL Precision.

Case Study 3**Manish Ltd., Delhi**

Manish Ltd., Delhi is engaged in manufacturing of Men's apparel. It is a subsidiary of Skylark Inc. of Country N, which has 28% shareholding in it. For the year ended 31st March, 2022, Manish Ltd. declared dividend and the quantum of dividend eligible for its holding company Skylark Inc. of Country N was ₹ 2.10 crore. The DTAA between India and Country N provides for taxation of dividend @15%. Country N is an OECD Country since 1st April, 2012. The DTAA between India and Country N came in to force w.e.f. 1st January, 2017. Later on, India entered in to a DTAA with Country T which came into force w.e.f. 25th April, 2019 which provided for taxation of dividend @ 5%. Country T was a member of OECD since 1st January, 2018. On 25th October, 2022, Manish Ltd. celebrated its golden Jubilee and to add colour to the occasion,

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invited Allan Wilson of Italy, a famous football player and Richie Rich a famous cricket umpire from Australia. The company paid ₹ 20 lakhs to Allan Wilson and ₹ 10 lakhs to Richie Rich. It was agreed that the company would bear their income-tax liability in respect of those incomes.

Manish Ltd. has a subsidiary company in a low tax jurisdiction with 90% shareholding. It has made its investment in the subsidiary by way of share capital of ₹ 45 crores, The normal profit of the subsidiary company is 20% of capital employed. Manish Ltd. on 20th August, 2022 received 90% of the post-tax profits of the subsidiary company of the year ended 31st March, 2022 being ₹ 8.10 crore by way of interest-free loan.

Availing service from foreign companies

Donald, the Production Manager of Dolly GmbH of Germany, was sent to Manish Ltd. for doing some supervisory activities for quality control of goods manufactured in India by Manish Ltd. He was paid salary of ₹ 4,50,000 per month by Dolly GmbH. He stayed in India for 2 months during the financial year 2022-23. Donald had no other income in India except the said salary income. Dolly GmbH has no business activity in India and has sent Donald only for short stay in India.

Eagle Ltd. of Country S rendered some technical services to Manish Ltd. during the previous year 2022-23. The amount payable to Eagle Ltd. towards fee for technical services (FTS) amounts to ₹ 200 lakhs. The treaty between India and Country S provides for 10% as tax withholding rate on FTS. The agreement is not covered by any approval from Indian Government. The services were rendered for Manish Ltd. in India by the personnel deputed by Eagle Ltd. (who are regular employees of Eagle Ltd.). The period of stay of employees was from 1.7.2022 to 30.11.2022. Salary of those employees for the period of stay aggregating to ₹ 60 lakhs was paid directly in India by Manish Ltd. However, the original employer of those employees viz; Eagle Ltd. paid them special allowance into their bank account in Country S aggregating to ₹ 15 lakhs (converted in INR).

Jagdish, CEO of Manish Ltd.

Jagdish was Chief Executive Officer of Manish Ltd. for about 30 years and up to 31.07.2018. He had acquired an apartment in the financial year 2017-18 for ₹ 40 lakhs of which only 50% was disclosed in his ITR filed for assessment year 2018-19. Based on the information from the Enforcement Directorate vide its report dated 05.06.2021 it came to light that the apartment was acquired outside India by earning income in India which was not disclosed for income-tax purposes. Notice under section 10 of the Black Money Act was issued on 30th June, 2022. The fair market value of the apartment as on 01.04.2021 was ₹ 80 lakhs and as on 01.04.2022 ₹ 100 lakhs.

Ramesh, Director of Manish Ltd.

Ramesh is a director of Manish Ltd. who joined on 01.10.2022. His income in India for the previous year 2022-23 consisted of (i) salary income without deduction under section 16(ia) ₹ 21 lakhs (computed); (ii) received as unit holder of Real Estate Investment Trust (REIT) ₹ 2,84,400 being interest component received from Hyper Ltd. a special purpose vehicle which has opted for section 115BAA. His income outside India for the year ended 31.03.2023 consisted

of (a) Gross rent from a property in Country X ₹ 5 lakhs; (ii) loss from rubber business in Country Y ₹ 3 lakhs; and (iii) agricultural income in Country Z ₹ 2 lakhs. The rate of tax in Country X, Country Y and Country Z are 25%, 15% and 20% respectively. The DTAA between India and Country Z provides for income from agriculture being taxed in the Source State and not taxable in the Resident State. There is no agreement between India and Country X and between India and Country Y. Assume there is no basic exemption limit in foreign countries where he has earned income and that he has opted for section 115BAC of the Income-tax Act, 1961.

REQUIRED

Choose the correct alternative for the following MCQs:

- 3.1 What is the income tax payable by Manish Ltd. for the payments made to Allan Wilson and Richie Rich, respectively?
 - (A) ₹ 5.25 lakhs / 4.29 lakhs
 - (B) ₹ 4.53 lakhs / 4.29 lakhs
 - (C) ₹ 5.25 lakhs / 4.53 lakhs
 - (D) ₹ 5 lakhs / 4.53 lakhs
- 3.2 How much is the optimal tax liability of Donald in respect of his salary income in India for the assessment year 2023-24?
 - (A) ₹ 85,800
 - (B) ₹ 62,400
 - (C) ₹ 54,600
 - (D) ₹ Nil
- 3.3 What is the scope of section 192 for Manish Ltd. in respect of the salary paid by it to the employees of Eagle Ltd. in India and special allowance paid to them in USA by Eagle Ltd.?
 - (A) TDS u/s 192 would apply only in respect of salary paid to them in India by Manish Ltd.
 - (B) TDS at the rate applicable for fee for technical services as per DTAA between India and USA or at the rate prescribed, whichever is lower, is deductible.
 - (C) TDS u/s 192 would apply both for salary paid to them in India by Manish Ltd. and allowance paid by Eagle Ltd. in USA to those employees.
 - (D) TDS at the rate applicable for fee for technical services as per DTAA between India and USA or at the rate prescribed, whichever is higher.
- 3.4 Which of the BEPS action plan is intended to curb the act of Manish Ltd. obtaining its share of dividend in the guise of loan from the subsidiary company located in low tax jurisdiction?
 - (A) Action Plan 5 - Counter harmful tax practices

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- (B) Action Plan 4 - Interest deductions and other financial payments
- (C) Action Plan 3 - Strengthen Controlled Foreign Company Rules
- (D) Action Plan 2-Neutralise the effects of hybrid mismatch arrangements
- 3.5 How much would be the undisclosed foreign asset liable to tax under the Black Money (Undisclosed Foreign income and Assets) and Imposition of Tax Act, 2015 in the hands of Jagdish?
- (A) ₹ 40 lakhs
- (B) ₹ 50 lakhs
- (C) ₹ 80 lakhs
- (D) ₹ 100 lakhs

(5 x 2 = 10 Marks)**DESCRIPTIVE QUESTIONS****You are required to answer the following questions:**

- 3.6 (i) Examine whether as per UN Model Convention, Eagle Ltd. had PE in India in the previous year 2022-23?
- (ii) State the documents to be furnished by Eagle Ltd. to obtain treaty benefit in respect of its income by way of FTS.
- (iii) Would your answer be different, if the employees of Eagle Ltd. stay up to 10.01.2023, as per the OECD Model Convention? **(5 Marks)**
- 3.7 Compute the total income and tax liability of Ramesh for the assessment year 2023-24. [Tax rates may be calculated upto 2 decimal places] **(4 Marks)**
- 3.8 Explain briefly what is meant by the 'Most Favoured Nation' clause in treaties and examine whether Skylark Inc. can seek concessional rate of tax in respect of its dividend income by invoking the said clause based on the DTAA between India and Country T. Assume that the protocol annexed to India's DTAA's with all the OECD member countries contain the tax parity clause. **(6 Marks)**

Solution to Case Study 3**Answers to Q.3.1 to Q.3.5**

MCQ No.	Correct Option
3.1	C
3.2	D
3.3	C
3.4	C
3.5	A or B

Note – For Q. No. 3.5, undisclosed asset located outside India is to be charged to tax on its value in the previous year in which the asset comes to the notice of the Assessing Officer. Accordingly, the fair market value of the property as on the 1st April of the said previous year is to be considered for the purpose of determining the value of such undisclosed asset.

In the facts given in the question relating to Jagdish, CEO of Manish Ltd., it is stated that based on the information from the Enforcement Directorate vide its report dated 05.6.2021 it came to the light that apartment was acquired outside India which was not disclosed for income-tax purposes. Notice under section 10 of the Black Money Act was issued on 30th June 2022. The date of report of ED is 5.6.2021 and date of issue of notice by the Assessing Officer is 30.3.2022. However, the date when the asset comes to the notice of the Assessing Officer is not mentioned – it could be any time between 5.6.2021 and 30.3.2022.

In the absence of such information, it is possible to assume that such apartment, being undisclosed asset came to the notice of the AO in the P.Y. 2021-22 (i.e., between the date of ED report 5.6.2021 and 31.3.2022). In such case, the value of undisclosed foreign asset would be ₹40 lakhs (₹80 lakhs, being the FMV as on 1.4.2021 x 50%). Alternatively, if it is assumed that such asset came to the notice of the AO in the P.Y. 2022-23, being the year in which notice is issued, the value of undisclosed foreign asset would be ₹50 lakhs (₹100 lakhs, being the FMV as on 1.4.2022 x 50%). Accordingly, either option (A) or option (B) can be chosen as the correct answer.

Answer to 3.6

- (i) The UN Model Convention, 2017 incorporates the concept of service PE. To constitute a PE, the activities carried on through the personnel engaged by the enterprise for furnishing services, including consultancy services should continue within a Contracting State for a period of periods aggregating more than 183 days in any 12 month period commencing or ending in the fiscal year concerned.

In this case, the personnel deputed by Eagle Ltd. stayed for a period from 1.7.2022 to 30.11.2022 i.e., for a period of 153 days in the P.Y.2022-23, and hence, a PE is **not** constituted.

- (ii) As per section 90(4), Eagle Ltd. is required to furnish Tax Residence Certificate (TRC) obtained by him from the Government of Country S declaring its residence in Country S.

In addition to such certificate, the following documents and information¹, to be furnished by the Eagle Ltd. for claiming treaty benefits in respect of its income by way of FTS:

- i. Status of Eagle Ltd. (company, in this case);
- ii. Country of incorporation or registration (Country S in this case);

¹ Prescribed by the CBDT vide Notification No. 57/2013 dated 01.08.2013

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- iii. Eagle Ltd.'s tax identification number in the Country S and in case there is no such number, then, a unique number on the basis of which Eagle Ltd. is identified by the Government of Country S;
- iv. Period for which the residential status, as mentioned in the certificate referred to in section 90(4) or section 90A(4), is applicable; and
- v. Address of the Eagle Ltd. in the Country S, during the period for which the certificate, as mentioned in (iv) above, is applicable.

However, Eagle Ltd. may not be required to provide the information or any part thereof, if the information or the part thereof, as the case may be, is already contained in the TRC referred to in section 90(4) or section 90A(4).

- (iii) The OECD Model Convention, 2017 does not incorporate the concept of service PE. Accordingly, no PE is constituted in India through personnel engaged by Eagle Ltd. in for deputing personnel in India though their stay is more than 183 days.

Answer to 3.7

Computation of total income and tax liability of Ramesh for A.Y. 2023-24

Particulars		Amount (₹)
Salary Income (computed)		21,00,000
Gross rent from a property in Country 'X'	₹ 5,00,000	
Less: Deduction @30%	₹ <u>1,50,000</u>	3,50,000
Interest from REIT [₹ 2,84,400 x 100/90]	₹ 3,16,000	
Less: Loss from rubber business in Country 'Y'	₹ <u>3,00,000</u>	16,000
Agricultural income in Country "Z" [Not included in total income, since the DTAA between India and Country Z provides that agriculture income is taxed in Source State (i.e., Country Z) and is not taxable in the Resident State (i.e., India)]		-
Total Income		24,66,000
Computation of tax liability as per section 115BAC		
Tax on ₹ 24,66,000	₹	₹
Upto ₹ 2,50,000	Nil	
₹ 2,50,001 – ₹ 5,00,000 [@5% of ₹ 2.50 lakhs]	12,500	
₹ 5,00,001 – ₹ 7,50,000 [@10% of ₹ 2.50 lakhs]	25,000	
₹ 7,50,001 – ₹ 10,00,000 [@15% of ₹ 2.5 lakhs]	37,500	
₹ 10,00,001 – ₹ 12,50,000 [@20% of ₹ 2.5 lakhs]	50,000	

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₹ 12,50,001 – ₹ 15,00,000 [@25% of ₹ 2.5 lakhs]	62,500	
₹ 15,00,001 – ₹ 24,66,000 [@30% of ₹ 9,66,000]	<u>2,89,800</u>	4,77,300
Add: Health and education cess@4%		<u>19,092</u>
Total tax liability		4,96,392
Average rate of tax in India	20.13%	
[i.e., ₹ 4,96,392/₹ 24,66,000 x 100]		
Rate of tax in Country X	25%	
Doubly taxed income	3,50,000	
Rebate under section 91 on ₹ 3,50,000 @20.13%		
(lower of average Indian tax rate and rate of tax in Country X)		<u>70,455</u>
Tax liability		<u>4,25,937</u>
Tax liability (rounded off)		4,25,940

Answer to 3.8

Most Favoured Nations (MFN) clause is usually found in Protocols to DTAA's. The underlying provision in MFN clause is that if, after signature/entry into force of the DTAA with the first State, India enters into DTAA with another OECD Member State, wherein India limits its Source taxation rights in relation to certain items of income (like dividend, interest, royalties, fees for technical services etc.) to a rate lower or a scope more restricted than the scope provided for those items of income in the DTAA with the first State, such beneficial treatment should also be extended to the first State.

The CBDT has, vide *Circular No. 3/2022 dated 3.2.2022*, clarified that the applicability of the Most Favoured Nation (MFN) clause and benefit of the lower rate or restricted scope of source taxation rights in relation to certain items of income including dividends provided in India's DTAA's with the third State (Country T, in this case) will be available to the first (OECD) State (Country N, in this case) only when **all** the following conditions are met:

Condition	Satisfaction of condition in the case on hand
i. The second treaty (with the third State) is entered into after the signature/ Entry into Force of the treaty between India and the first state	This condition is satisfied as India has entered into a DTAA with Country T on 25.4.2019, after it has entered into a DTAA with Country N on 1.1.2017.
ii. The second treaty is entered into between India and a State which is a member of the OECD	This condition is satisfied as India has entered into a DTAA on 25.4.2019 with Country T, which is a member of OECD since January 2018. Hence, on 25.4.2019, Country T was an OECD member.

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at the time of signing the treaty with it;	
iii. India limits its taxing rights in the second treaty in relation to rate or scope of taxation in respect of relevant items of income	This condition is satisfied since in DTAA between India and Country T, dividend is taxable@ 5%.
iv. A separate notification has been issued by India, importing the benefits of the second treaty into the treaty with the first State as required by the provisions of section 90(1) of the Income-tax Act, 1961.	In this case, conditions (i), (ii) and (iii) mentioned above have been satisfied. The concessional rate of 5% can be applied for taxing the dividend received by Skylark Inc. of Country N from Manish Ltd., an Indian company, only if India has issued a separate notification importing the benefits of India-Country T tax treaty into India-Country N tax treaty, as required by the provisions of sections 90(1). If such notification has been issued, then, the concessional rate of 5% can be applied for taxing the dividend received by Skylark Inc. from Manish Ltd., an Indian company; otherwise it cannot be applied, even if other conditions are satisfied.

Case Study 4**Rohan Ltd., Kolkata**

Rohan Ltd., Kolkata, an associated enterprise of Glamour Inc. of USA, is engaged in manufacturing activities besides software development. The following aspects/information are made available to you:

(i) Software development:

During the financial year 2022-23, Glamour Inc. bid a contract for USD 500 million for software development meant for use in medical treatment. Rohan Ltd., Glamour Inc. and yet another group company were involved in developing the software contributing 40%, 30% and 30% respectively. The cost incurred by Rohan Ltd. was USD 50 million. The total profit earned by Glamour Inc. was USD 150 million. Glamour Inc. shared revenue of USD 100 million to its Indian subsidiary Rohan Ltd.

(ii) Royalty due to Mike Ltd.:

Rohan Ltd. entered into an agreement in April, 2022 with Mike Ltd. of UK for use of technology owned by Mike Ltd. to develop software, being the patented product of Mike Ltd. The agreement was a regular agreement with neither the approval thereof from the Central Government, nor being covered in the Industrial Policy of the Central Government. As per the agreement, Rohan Ltd. had to pay ₹ 55 lakhs as royalty to Mike Ltd. for the year ended 31st March, 2023. The DTAA between India and UK provides for withholding tax@ 15%.

(iii) Liability to additional income-tax:

For the assessment year 2021-22, an addition of ₹ 205 lakhs due to ALP adjustment, was determined in the assessment of Rohan Ltd., which was completed on 31st December, 2022. The assessee had filed the ITR of assessment year 2021-22 in March, 2022 under section 139(4) and had decided to accept the addition to the ALP made by the Assessing Officer vide order dated 31st December, 2022. The additional income-tax and interest was paid on 10th April, 2023. All the transactions of Rohan Ltd. were denominated in US dollars. The rate of interest applicable is @ 6-month LIBOR as on 30th September 2022 may be taken as 6%.

(iv) Remittance of tax for own sources and seeking refund:

In March, 2023, Rohan Ltd. had to pay ₹ 25 lakhs to McDermott Ltd. of Country N for availing certain services. As per agreement between the parties, tax deductible on such income under section 195 had to be borne by Rohan Ltd. The said services were rendered by McDermott Ltd. online and no personnel came to India for rendering the said service. Rohan Ltd. remitted on 31st March, 2023, the tax deductible under section 195. The DTAA between India and Country N provided for no tax in respect of such transaction. Rohan Ltd. now wants to invoke relevant provisions of the Income-tax Act, 1961 to seek refund of tax so remitted by it previously.

(v) Tax consequence of one of the directors: Chatterjee (aged 65) is one of the directors of Rohan Ltd., whose residential status for the assessment year 2023-24 is non-resident. He received ₹ 3 lakhs being component of rental income distributed by a REIT in which he is a unit holder. He received ₹ 2 lakhs by way of dividend component distributed by the REIT and the company whose income was so distributed by the REIT had exercised option under section 115BAA. Chatterjee has to pay income-tax both on the aforesaid rental income and dividend income components in the country of which he is presently a resident, under appropriate heads of income there.**(vi) Payment of fee for technical services:**

Rohan Ltd. had imported some machines from Blue Moon Ltd. of Country A. Since the machines did not operate at 100% efficiency, Rohan Ltd. solicited the services of the supplier who deputed its engineers to Rohan Ltd. The engineers came on 2nd June, 2022 and returned on 13th June, 2022. Again, the engineers came on 4th October, 2022 and returned on 28th March, 2023. It paid ₹ 50 lakhs to Blue Moon Ltd. on 28.3.2023 net of the withholding tax, as per the provisions of Income-tax Act, 1961. The agreement for getting technical services and fee payable thereon is covered by approval from the Central Government.

(vii) David & Co LLP, Singapore:

David & Co LLP in Singapore is a non-resident entity in which Rohan Ltd. has 30% profit sharing rights. David & Co LLP is an e-commerce operator who sold goods of Rohan Ltd. The receipts of David & Co LLP for the financial year 2022-23 consisted of (i) ₹ 180 lakhs

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received for sale of goods from persons resident in India; and (ii) ₹ 66 lakhs received for sale of goods from persons who are not residents of India but residents in Europe. The said sum of ₹ 66 lakhs included receipt of ₹ 40 lakhs from persons who used internet protocol address located in India.

REQUIRED

Choose the most appropriate alternative for the following MCQs:

- 4.1 What would be the additional income tax liability and interest (if any) payable by Rohan Ltd., when it makes payment on 10th April, 2023?
- (A) Additional income-tax liability ₹ 42,98, 112 plus interest ₹ 1,05,981
 (B) Additional income tax liability ₹ 20,96,640 plus interest ₹ 53,134
 (C) Additional income tax liability ₹ 22,01,472 plus interest ₹ 54,283
 (D) Additional income tax liability ₹ 42,98,112 plus interest ₹ 1,07,041
- 4.2 Which of the following statement is correct in respect of tax liability of Mike Ltd. (In India) on the royalty paid by Rohan Ltd.?
- (A) No tax liability being non-resident.
 (B) Liability computed under normal provisions of Income-tax Act, 1961.
 (C) Liability as computed as per India-UK DTAA.
 (D) Liability as computed under the provisions of the Income-tax Act, 1961 and as per India-UK DTAA, whichever is lower.
- 4.3 Assuming that Chatterjee is liable to pay income-tax in India in respect of rental income and dividend income distributed by REIT and also has to pay tax in the country where he is presently a resident, it is an example of
- (A) Territorial double taxation
 (B) Economic double taxation
 (C) Juridical double taxation
 (D) Municipal double taxation
- 4.4 What should be the tax deducted at source by REIT in respect of payments made to Chatterjee?
- (A) @30% on rental component of income distributed and @10% on dividend component of income distributed by the REIT.
 (B) @31.2% on rental component of income distributed and @10.4% on dividend component of income distributed by the REIT.
 (C) @31.2% on rental component of income distributed and @5.2% on dividend component of income distributed by the REIT.

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- (D) @20% on rental component of income distributed and @5% on dividend component of income distributed by the REIT.
- 4.5 How much should be paid by David & Co LLP, Singapore, as equalization levy for the sale of goods for the financial year 2022-23?
- (A) ₹ 14,76,000
(B) ₹ 4,92,000
(C) ₹ 13,20,000
(D) ₹ 4,40,000

(5 x 2 = 10 Marks)

DESCRIPTIVE QUESTIONS**You are required to answer the following descriptive questions:**

- 4.6 Determine the Arm's Length Price (ALP) adjustment in respect of the transaction between Rohan Ltd. and Glamour Inc. What would be the ALP adjustment in the hands of Rohan Ltd., if the Glamour Inc. group has a practice of marking a minimum return of 30% on cost incurred? **(5 Marks)**
- 4.7 Briefly outline the procedure for Rohan Ltd. to claim refund of tax remitted by it in respect of the amounts paid to McDermott Ltd. as per the provisions of the Income-tax Act, 1961. **(5 Marks)**
- 4.8 Examine whether the permanent establishment of Blue Moon Ltd. is located in India as per the UN Model Convention. How much would be the amount of tax deductible in respect of the payment made towards fees for technical services? Would your answer be the same, in case the DT AA between India and Country A is as per the OECD Model? **(5 Marks)**

Solution to Case Study 4**Answers to Q.4.1 to Q.4.5**

MCQ No.	Correct Option
4.1	None of the options are correct
4.2	D
4.3	C
4.4	B
4.5	D

Answer to 4.6

In the present case, Rohan Ltd., Glamour Inc. (AE of Rohan Ltd.) and another group company involved in developing the software meant for use in medical treatment. Since such international transaction is entered into between Rohan Ltd. and AEs, the Arm's Length Price adjustment

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need to be determined applying the most appropriate method.

Since such international transaction involving development of software, which are so interrelated that they cannot be evaluated separately, profit split method would be the most appropriate method. Accordingly, arm's length adjustment would be determined as follows:

I. In case the combined profits are USD 150 million	\$ in Million
(A) Combined net profit of AEs	150
(B) Relative contribution of Rohan, Glamour and other AE is 40%, 30% and 30%, respectively	
(C) Share of profits in proportion to relative contribution of Rohan [40% of USD 150 Million]	60
(D) Actual profit arising in the hands of Rohan Ltd. [USD 100 Million – USD 50 Million]	50
Arm's Length adjustment [(C) – (D)]	10
II. In case combined profits are 30% of cost (where residuary profits are split in the agreed ratio)	
(A) Combined Profit [30% of USD 350 Million (USD 500 Million – USD 150 Million)]	105
(B) Residuary profits = USD 150 Million – USD 105 Million = USD 45 Million	
(C) Arm's length share of profits 30% of Cost = 30% of USD 50 Million = USD 15 Million 40% of Residuary Profits = 40% of USD 45 Million = USD 18 Million	
(D) Arm's length profit = USD 15 Million + USD 18 Million	33
(E) Actual profit arising in the hands of Rohan Ltd. [USD 100 Million – USD 50 Million]	50
Arm's Length price adjustment [Since Actual profit > Arm's length profit]	Nil
<p>Note - The second part of the question requires determination of the ALP adjustment in the hands of Rohan Ltd., if the Glamour Inc. group has a practice of marking a minimum return of 30% on cost incurred. 30% of cost incurred would be USD 105 Million as computed above. The residuary profits would be USD 45 Million as computed above.</p> <p>The arm's length share of profit of Rohan Ltd. can also be arrived at by considering its share (i.e., 40%) of combined profits and dividing residuary profits equally. An alternate solution has been worked out below on this basis-</p>	

II. In case combined profits are 30% of cost (where residuary profits are split equally)	
(A) Combined Profit [30% of USD 350 Million (USD 500 Million – USD 150 Million)]	105
(B) Residuary profits = USD 150 Million – USD 105 Million = USD 45 Million	
(C) Arm's length share of profits 40% of USD 105 Million = USD 42 Million Residuary Profits to be divided equally = USD 45 Million/3 = USD 15 Million	
(D) Arm's length profit = USD 42 Million + USD 15 Million	57
(E) Actual profit arising in the hands of Rohan Ltd. [USD 100 Million – USD 50 Million]	<u>50</u>
Arm's Length price adjustment [(D) – (E)]	<u>7</u>

Answer to 4.7

As per section 239A, where under a DTAA, the tax deductible on any income, other than interest, under section 195 is to be borne by the person by whom the income is payable, and such person having paid such tax to the credit of the Central Government, claims that no tax was required to be deducted on such income, such person can file an application before the Assessing Officer for refund of such tax within 30 days from the date of payment of such tax.

In this case, Rohan has to file an application before the Assessing Officer for refund of such tax on or before 30th April, 2023.

Thereafter, the Assessing Officer has to follow the procedure for refund laid down in CBDT Circular No.7/2007 dated 23.10.2007, which lays down the procedure for refund of TDS u/s 195 to the person deducting tax at source from the payment to a non-resident.

In accordance with this Circular, Rohan Ltd. can claim the refund of tax deducted at source under section 195 on the amount paid to Mc Dermott Ltd of Country N which was remitted by it to the Government account on 31.3.2023, since –

- i. the tax deductible on the amount paid to Mc Dermott Ltd of Country N is borne by Rohan Ltd; and
- ii. the DTAA between India and Country N provides for no tax in respect of such transaction

In this case, since income has accrued but no tax is due on that income as per DTAA between India and Country N, the amount deposited to the credit of Government to that extent under section 195, cannot be said to be "tax".

The Assessing Officer may, after giving intimation to the deductor, adjust the refund against any existing tax liability of the deductor under the Income-tax Act, 1961. The balance amount would be refunded to the deductor. A refund in terms of this Circular should be granted only after

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obtaining an undertaking that no certificate under section 203 has been issued to the non-resident.

Answer to 4.8

- (i) The UN Model Convention, 2017 incorporates the concept of service PE. To constitute a PE, the activities carried on through the personnel engaged by the enterprise for furnishing services, including consultancy services should continue within a Contracting State for a period of periods aggregating more than 183 days in any 12 months period commencing or ending in the fiscal year concerned.

In this case, since Blue Moon Ltd. deputed its engineers to Rohan Ltd. for 188 days (12 days + 176 days) in the P.Y.2022-23, which is more than 183 days, a service PE of Blue Moon Ltd. is constituted.

- (ii) The services rendered by the engineers of Blue Moon Ltd. would fall within the definition of Fees for technical services.

As per UN Model Convention, since service PE is constituted such amount attributable to the service PE would be taxable as per Article 7.

As per section 115A of the Income-tax Act, where the total income of a foreign company includes any income by way of 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, such FTS is taxable @10%.

No deduction would be allowable under sections 28 to 44C and section 57 while computing such income.

Assuming that tax rate of 10% plus health and education cess @4% per the Income-tax rate is more beneficial than DTAA, tax is to be deducted of ₹ 5.80 lakhs [(₹ 50 lakhs x 100/89.6) x 10.4%].

Note - Section 44DA brings to tax income by way of FTS received from an Indian concern in pursuance of an agreement foreign company, where such foreign company carries on business through a PE situated in India or performs professional services from a fixed place of profession situated in India and such FTS is effectively connected with such PE or fixed place of profession. Such income shall be computed under the head "Profits and gains from business or profession".

However, in the present case, since engineers of Blue Moon Ltd. rendered professional services at Rohan Ltd.'s place and Blue Moon Ltd. does not have a fixed place of profession in India, such FTS would be taxable as per section 115A.

- (iii) The OECD Model Convention, 2017 does not incorporate the concept of service PE. Accordingly, no PE is constituted in India through engineers deputed by Blue Moon Ltd. for rendering services to Rohan Ltd. in India though their stay is more than 183 days.

In the absence of a PE, the fees for technical services cannot be taxed in India, since provisions of DTAA are more beneficial. Accordingly, no tax is required to be deducted on the amount paid by Rohan Ltd. to Blue Moon Ltd.

Case Study 5

Albert Ltd., Mumbai

Albert Ltd., Mumbai is a subsidiary of Pele Ltd. of Country J. Albert Ltd. has been manufacturing semi-finished goods for supply to Pele Ltd. Also, it sold goods to unrelated parties, both in India and world-wide. The annual turnover of Albert Ltd. is ₹ 500 to ₹ 600 crores, while the annual turnover of Pele Ltd. was more than ₹ 7,000 crores. The accounting year of Country J is the same as that of India, that is, 1st April to 31st March. Albert Ltd. is the notified resident constituent entity who furnished the CbC report for the year ended 31st March, 2022 on 9th April, 2023.

Albert Ltd. has paid ₹ 3,00,000 to Hendricks Ltd., UK for procuring online advertisement space up to 31.10.2022 and had to pay ₹ 4,00,000 being the balance amount for the year ended 31.03.2023.

Albert Ltd. has been undertaking supply of goods to its associated enterprises in foreign jurisdictions. It has identified comparable enterprises who have undertaken similar transactions and the data set constructed with the comparable entities is given below for the year ended 31.03.2023:

S. No	1	2	3	4	5	6	7
Company	A Co Ltd.	B Co Ltd.	C Co Ltd.	D Co Ltd.	E Co Ltd.	F Co Ltd.	G Co Ltd.
Values	3.2%	7%	9.2%	10%	11.10%	12.9%	13%

The transfer price of the international transaction of Albert Ltd. is computed at 6.8%. The total transaction value by way of supply of goods to the AEs is ₹ 150 crores for the financial year 2022-23.

APA and rollback options

Albert Ltd. applied for Advance Pricing Agreement (APA) in June, 2022 and it was entered into on 1st September, 2022. It applied for rollback in November, 2022 and it was entered into on 20th January, 2023. For assessment year 2021-22, the ITR was filed under section 139(4) in March, 2022; For the assessment year 2020-21, there was some dispute about the ALP determination and it was contested before CIT (Appeals) who decided against the assessee in May 2022. For the assessment year 2019-20, against transfer pricing adjustment, appeal was made to the ITAT and it was decided against the assessee by the ITAT in November, 2022.

Pele Ltd., Country J

Pele Ltd. was already engaged in the supply of mobile handsets directly to customers throughout South East Asia except India. During the financial year 2022-23, it supplied mobile handsets to various customers in India directly, based on their orders procured through internet facility. For the financial year 2022-23, the total direct sale of mobile handsets to customers in India was

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₹ 240 lakhs. It may be noted that the branch of Pele Ltd. at Chennai was not engaged in the supply of such type of mobile handsets in India. The gross profit mark-up was 20% in respect of mobile handsets directly sold by Pele Ltd. to the customers in India.

Kishore, CFO of Albert Ltd.

Kishore a Chartered Accountant joined Albert Ltd. as CFO on 01.11.2022 after remaining in employment as General Manager (Finance) of Brita Ltd. of Country K. He is originally a citizen of India who went on employment outside India in April, 2015 and had been visiting India for 40 days in every financial year up to the financial year 2021-22. He returned to India permanently on 1st July, 2022 but was appointed as CFO position by Albert Ltd. w.e.f. 1st November, 2022.

Kishore gifted a vacant land at Jaipur to his sister Sujata (non-resident) residing in Singapore, on 05.03.2023. The circle rate (stamp duty valuation) of the vacant land on the date of gift was ₹ 25 lakhs. On 14th January, 2023, he made a cash gift of ₹ 9 lakhs through online transfer to his friend Hardik (non-resident) who resides in Dubai on the occasion of Hardik's 50th birthday.

Kishore has the following incomes for the financial year 2022-23:

- (i) Salary from Brita Ltd. up to 30.06.2022 at USD 12,000 per month.
- (ii) House property in Country K was let out throughout the financial year 2022-23 for USD 1,000 p.m. Assume that there is no deduction in Country K similar to section 24 of the Income-tax Act, 1961.
- (iii) Dividend from Indian companies (gross) ₹ 1,08,000. All the shares were acquired in April, 2014 when he was resident in India.
- (iv) Dividend from companies in Country K (net) received USD 4,000 in March 2023. Assume the rate of TDS on dividend @ 20%.
- (v) Salary income (computed) from Albert Ltd. ₹ 15,00,000.

Note: TT buying rate on the date of receipt of dividend 1 USD = ₹ 81; on 28.02.2023 1 USD = ₹ 80; and on 31.03.2023 1 USD = 82.

Kishore paid income-tax in Country K @ 20% and there is no basic exemption limit. He has opted for the provisions of section 115BAC in India,

There is no DTAA between India and Country K.

REQUIRED

Choose the most appropriate alternative for the following MCQs:

5.1 What would be the quantum of penalty leviable on Albert Ltd. (being the reporting entity of international group by name Pele Ltd.) for the delay in filing the CbC report for the year ended 31st March, 2022?

- (A) ₹ 45,000
- (B) ₹ 1,35,000

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- (C) ₹ 50,000
(D) ₹ 40,000
- 5.2 How much is the amount liable towards tax deduction at source (TDS) or payable by way of equalization levy (EL) by Albert Ltd. for the online advertisement space obtained from Hendricks Ltd., UK?
- (A) EL, 14,000
(B) TDS ₹ 72,800
(C) EL ₹ 42,000
(D) ₹ 19,600
- 5.3 How much of income is chargeable to tax in the hands of Chennai branch of Pele Ltd. in respect of mobile handsets directly supplied by Pele Ltd. from Country J to the customers in India? Assume that there is DTAA between India and Country J as per UN Model Convention.
- (A) No income would be chargeable to tax in the hands of Chennai branch of Pele Ltd. since the supply was made directly from outside India and the branch had no role to play in such supply.
(B) Since the goods supplied directly were not similar to those sold through the Chennai branch, the force of attraction rule would not apply. Therefore, no income arising thereon is chargeable to tax in India.
(C) By applying Force of Attraction Rule, the gross profit mark-up @20% on total supplies of ₹ 210 lakhs, being ₹ 42 lakhs, would be deemed to be the income of Pele Ltd. accruing in India and would be taxed in the hands of Chennai branch.
(D) The overall gross profit ratio of Pele Ltd. would be adopted for the purpose of computing the income earned in respect of supplies made in India and it would be chargeable to tax as income of foreign company separately.
- 5.4 How much of the gift received by Sujata and Hardik from Kishore is chargeable to Income-tax in India?
- (A) As both the recipients of gift are non-residents, no income would accrue in India.
(B) Sujata being relative of Kishore, no income would accrue in India for the gift of vacant land at Jaipur. In the hands of Hardik, ₹ 9 lakhs would be chargeable to income-tax in India.
(C) ₹ 25 lakhs is chargeable to tax as income in the hands of Sujata as the subject matter of gift viz. vacant land is located in India. The cash gift of ₹ 9 lakhs received by Hardik (from non-relative) is chargeable to tax in India.

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- (D) ₹25 lakhs is chargeable to tax as income in the hands of Sujata as the subject matter of gift is located in India. The cash gift of ₹9 lakhs received by Hardik though from non-relative is not chargeable to tax as the amount was received through online transfer outside India.
- 5.5 How much will be added to the total income of Albert Ltd. after considering the comparable and data set constructed and furnished in the Case Study?
- (A) ₹4.80 crores
(B) ₹3.60 crores
(C) ₹4.485 crores
(D) No addition to the total income is required because of ALP adjustment.

(5 x 2 = 10 Marks)**DESCRIPTIVE QUESTIONS****You are required to answer the following descriptive questions:**

- 5.6 Compute the total income of Kishore for the assessment year 2023-24 after determining his residential status. **(6 Marks)**
- 5.7 State the legal position as to when Albert Ltd. is not obliged to furnish CbC report of the international group in India. **(5 Marks)**
- 5.8 Briefly state the assessment years for which APA and the rollback provisions would apply for Albert Ltd., indicating whether the rollback benefit can be availed for each of such years involved. **(4 Marks)**

Solution to Case Study 5**Answers to Q.5.1 to Q.5.5**

MCQ No.	Correct Option
5.1	A
5.2	C
5.3	B
5.4	B
5.5	A

Answer to 5.6**Determination of Residential Status of Kishore for the PY 2022-23**

During the P.Y. 2022-23, Kishore permanently shifted to India and stayed for 274 days in India. Since he stayed in India for 182 days or more during the P.Y. 2022-23, he would be resident in

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India for the A.Y. 2023-24.

An individual is said to be "Resident but not ordinarily resident [RNOR]" in India in any previous year, if he satisfies any one of the following conditions:

- He is a non-resident in at least 9 out of 10 previous years preceding the relevant previous year; or
- His stay in India in the last 7 years preceding the relevant previous year is 729 days or less.

His stay in India in the last 7 years preceding the P.Y.2022-23 is only 280 days (40 days x 7 years). Since Kishore satisfies the second condition, he would be **resident but not ordinarily resident in India for P.Y.2022-23**.

Accordingly, the following income would be taxable in his hands in India for the P.Y.2022-23 –

- i. Income which accrues or arises in India,
- ii. Income which is deemed to accrue or arise in India,
- iii. Income which is received or deemed to be received in India and
- iv. Income which accrues or arises outside India but is derived from a business controlled in or profession set up in India

Computation of total income of Kishore for the A.Y. 2023-24 under section 115BAC

Particulars	Amount (₹)
<u>Salaries</u>	
Salary from Brita Ltd., Country K [Not taxable in India, since income accrues or arises outside India and is not deemed to accrue or arise in India since services are not rendered in India.]	-
Salary from Albert Ltd. (Computed) [Taxable in India, since services are rendered in India]	15,00,000
<u>Income from house property</u>	
Rental Income from house property in Country K [Not taxable in India, since property is situated outside India and income accrues, arises, and is received outside India]	-
<u>Income from Other Sources</u>	
Dividend Income from Indian Company (gross) [Taxable in India, since such shares, being a capital asset is situated in India]	1,08,000

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Dividend from companies in Country K [Not taxable in India, since such shares are not situated in India. Such income accrues, arises and is received outside India]	-
Gross Total Income/Total Income	<u>16,08,000</u>

Answer to 5.7

Circumstances when Albert Ltd., being a constituent entity resident in India, is not required to file CbC report in India

As per section 286(5), if an international group, having parent entity which is not resident in India i.e., Pele Ltd., Country J, had designated an alternate entity for filing its report with the tax jurisdiction in which the alternate entity is resident, then, the entities of such group operating in India i.e., Albert Ltd. would not be obliged to furnish report if the following conditions are satisfied-

- such alternate entity has furnished CbC report with the tax authority of the country or territory in which such entity is resident on or before the date specified by that country or territory;
- the CbC report is required to be furnished under the law for the time being in said country or territory;
- the said country or territory has entered into an agreement with India providing for exchange of the said report;
- the prescribed authority has not conveyed any systemic failure in respect of the said country or territory to any constituent entity of the group that is resident in India;
- the said country or territory has been informed in writing by the constituent entity that is the alternative reporting entity on behalf of the international group and
- the same has been informed to the prescribed authority by the constituent entity resident in India i.e., Albert Ltd. in accordance with section 286(1).

Answer to 5.8

The application for advance pricing agreement may be filed at any time before the first day of the previous year relevant to the first assessment year for which the application is made, in respect of transactions which are of a continuing nature from dealings that are already occurring; or before undertaking the transaction in respect of remaining transactions.

Roll back year means any previous year, falling within the period not exceeding four previous years, preceding the first of the five consecutive previous years for which advance pricing agreement is valid.

In the present case, since Albert Ltd. has applied for APA and also opted for rollback provisions, the APA is apparently in respect of international transactions which are of continuing nature. Accordingly, the APA application filed in June, 2022 would be in respect of five previous years beginning with P.Y. 2023-24 relevant to the A.Y. 2024-25.

Consequently, Albert Ltd. made an application for roll back. Roll back provisions would be applicable for four previous years immediately preceding P.Y.2023-24 i.e., P.Y.2022-23 (A.Y. 2023-24), P.Y.2021-22 (A.Y. 2022-23), P.Y.2020-21 (A.Y. 2021-22) and P.Y.2019-20 (A.Y. 2020-21).

In respect of A.Y. 2023-24 and A.Y. 2022-23, benefit of rollback can be availed if the return of income of those years has been furnished on or before the due date specified u/s 139(1).

Since the return of income for A.Y. 2021-22 was filed belatedly u/s 139(4), benefit of rollback cannot be given for A.Y. 2021-22.

In respect of A.Y. 2020-21, even if the dispute was contested before CIT(A) and decided against the assessee, benefit of rollback can be availed, since the prohibition is only in respect of a dispute contested before Tribunal and decided against the assessee. Modified return has to be filed in respect of A.Y.2020-21.

Benefit of rollback cannot be availed in respect of A.Y. 2019-20 since it falls beyond the four year period.