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CA Final 2022 Suggested Answers · Paper 6C International Taxation (Old Scheme)

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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 2022-23, unless otherwise stated in the questions/case studies.

Case Study 1

IndoAm Ltd., a wholly-owned subsidiary of AmeriCo Inc.

AmeriCo Inc., a USA-headquartered company, is engaged in the business of manufacture and sale of printer inks. It has set up a wholly-owned subsidiary in India namely, IndoAm Ltd, primarily to import a standardized printer ink product (Product A) from its parent company and resale in the India market. The products are being sold by Indo Am Ltd. through a wholesale distribution network in India, and products are sold in the same form as imported without any customization or value-addition. For F.Y.2021-22, the Product A (with an MRP of INR 1,500 each) is sold by IndoAm Ltd to third party distributors at an average resale discount of 20%. Based on a TP benchmarking conducted by the Company, three independent comparable companies earn resale margin (gross profit over sales) of 14%, 22% and 19%, respectively from distribution/ resale of similar products in India.

Transfer pricing litigations and APA for IndoAm Ltd.

During transfer pricing audit for F.Y. 2018-19, IndoAm Ltd failed to furnish mandatory transfer pricing documents as required by TPO.

For AY 2014-15, the TPO made an adjustment of INR 1,10,00,000. The Company preferred an appeal with the Commissioner of Income Tax (Appeal) and recently received a favourable order that completely deletes the adjustment. Considering the uncertainty and exposure from TP litigations, the Company applied and obtained an Advance Pricing Agreement (APA). After signing the APA on 1 June 2022, the Company filed an income tax return for AY 2022-23, wherein an adjustment of INR 2,36,00,000 was computed in accordance with the APA terms, and the same was offered for tax (due date for ITR was 30 Nov 2022).

SingInk Co., a Singapore-based Company

SingInk Co is a Singapore based company and is engaged in supplying a specialty printing ink to customers in different geographies. AmeriCo Inc. has entered into a Master Agreement with SingInk Co. and supplies to all affiliates of AmeriCo Inc. is being made by Singink as per terms of this Master Agreement. Neither AmeriCo nor any of its affiliates, or SingInk participate directly or indirectly, in the management, control or capital of each other. IndoAm also imports comparable product (Product B) from SingInk Co. for resale in India. IndoAm makes a gross margin of 18% from resale of Product B.

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, 2021.

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AmeriCo Inc's India branch

AmeriCo Inc, also has a branch office in India. The branch office is engaged in procurement of raw material from Indian suppliers. Apart from the procurement activities, the branch has also developed an online platform which facilitates online sale of various material and products related to ink, colour pigments and printer accessories. During FY 21-22, the India branch charged a fee amounting to INR 65,00,000 from IndoAm Ltd for the use of the online platform. The India branch also charged fee from various other AmeriCo affiliates (non-resident in India) aggregating to INR 52,00,000 for the use of platform.

During FY 21-22, AmeriCo has allocated INR 67,00,000 to the branch office as the expenditure (pertaining to centralized general and administrative functions) incurred outside India. The branch has computed its adjusted total income for AY 2022-23 at INR 9,55,00,000. Further, its average adjusted total income for 3 assessment years prior to AY 2022-23 is computed as INR 8,90,00,000.

Sub Part (a) - Multiple Choice Questions:

Choose the correct alternative for the following MCQs: (5 x 2 = 10 Marks)

1.1 Whether IndoAm's import of Product B from Singink shall be subject to determination of an Arm's Length Price (ALP) under the relevant provisions of the Income-tax Act, 1961?

(A) Yes, as the transaction is an International Transaction between Associated Enterprises

(B) No, as IndoAm and SingInk are not associated enterprises

(C) Yes, as the transaction is a Deemed International Transaction

(D) No, as the price agreed between the two enterprises, is a price agreed between two independent parties.

1.2 What is the quantum of head office expenditure that AmeriCo Inc's India branch can claim in its income tax return for A.Y. 2022-23?

(A) INR 67,00,000

(B) INR 47,75,000

(C) INR 44,50,000

(D) INR 3,25,000

1.3 What is the quantum of penalty that the TPO can levy for Indo Am's failure to furnish the transfer pricing documentation?

(A) INR 5,00,000

(B) 2% of the value of international transaction

(C) INR 5,000 per day for every day of continuing failure

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

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1.4 What is the amount of Equalization levy that IndoAm Ltd. should deduct/ pay in relation to payment to be made to AmeriCo Inc's India branch for the use of the online platform?

(A) 3,90,000

(B) 1,30,000

(C) NIL

(D) 6,50,000

1.5 In case the online platform was rather provided directly by AmeriCo Inc. without any involvement of its India branch in such activities (other facts being same), who would be required to ensure payment of equalization levy before making the payment to AmeriCo Inc?

(A) All payers to Deduct Equalisation Levy @6%-

(B) All payers to Deduct Equalisation Levy @2%

(C) No action required as Equalisation levy is not applicable

(D) AmeriCo Inc to pay 2% equalization levy

Sub Part (b)- Questions other than MCQs:

1.6 Based on the details provided, which method would be the most appropriate method for determination of the Arm's Length Price (ALP) for IndoAm's import of Product A from AmeriCo and why? Also, compute the ALP per unit of Product A applying the most appropriate method. ***(6 Marks)***

1.7 Based on the details provided, whether the Primary adjustment of INR 2,36,00,000 offered by the Company in its income tax return require a "Secondary Adjustment"? In case the excess money is not repatriated into India, compute the secondary adjustment under the possible options as relevant for PY 22-23 (assume that international transaction is denominated in INR, and the SBI MCLR on 1 April 2022 is 4.2%). ***(6 Marks)***

1.8 What is the tax effect of the adjustment made by the TPO for AY 2014-15? Considering the tax effect, can the tax department file an appeal against the CIT(Appeal) order with the Income Tax Appellate Tribunal? Explain. ***(3 Marks)***

Solution to Case Study 1

Answers to Q.1.1 to Q.1.5

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

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Answer to Q.1.6

Resale Price Method is the most appropriate method for determination of the Arm's Length Price for IndoAm's import of Product A from AmeriCo since IndoAm sold Product A without any customization or value-addition. Resale Price Method is generally used to test transactions involving distribution function, i.e. when the tested party purchases products/ acquires services from related party and resells the same to independent parties. The use of RPM is appropriate where the reseller does not add substantially to the value of the product/ services.

Determination of ALP of transaction between IndoAm and Americo of Product A by Resale Price Method using three independent comparable resale margins -

Particulars	Amount per unit (in ₹)
MRP of Product A	1,500
Less: Discount by IndoAm Ltd to third party distributor (20%)	300
Resale price by IndoAm Ltd to third party distributor	1,200
Less: Resale margin comparable 1 (14% of sales)	168
Arm's Length Price using comparable 1	**1,032**
Resale price by IndoAm Ltd to third party distributor	1,200
Less: Resale margin comparable 2 (22% of sales)	264
Arm's Length Price using comparable 2	**936**
Resale price by IndoAm Ltd to third party distributor	1,200
Less: Resale margin comparable 3 (19% of sales)	228
Arm's Length Price using comparable 3	**972**
Since there are more than one ALP using Resale Price Method as the most appropriate method and dataset has less than 6 entries, Arithmetical mean of all the values would be the **Arm's length Price** [(1,032+936+972)/3]	**980**

Notes:

(1) The above solution is based on the assumption that the other comparable entities also provide similar discount, owing to which there is no need for any functional adjustment.

(2) It is possible to first compute the average i.e. 14% + 22% +19% / 3 = 18.33% and deduct ₹ 220, being 18.33% on ₹ 1200, in which case also ALP would be ₹ 980.

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Answer to Q.1.7

Yes, IndoAm Ltd. has to make a secondary adjustment since primary adjustment is determined by an advance pricing agreement entered into by the assessee under section 92CC on or after the 1.4.2017 and it exceeds ₹ 1 crore.

In case the excess money is not repatriated into India by IndoAm Ltd., IndoAm has two options

Option 1

Opts not to pay additional income-tax on such excess money not repatriated: In this case, since APA has been entered into on 1.6.2022 i.e., before the due date of filing return of income, the excess money of ₹ 2,36,00,000 available with the associated enterprise has to be repatriated to India within 90 days from the date of filing return of income. If it is not so repatriated, the same would be deemed as an advance made by IndoAm Ltd. to its associated enterprise.

Interest would be calculated on such advance at 7.45% [i.e., SBI MCLR as on 1st April 2022, i.e., 4.20% + 3.25%].

Such interest computed from the due date of filing of return i.e., 30.11.2022 to 31.3.2023 amounting to ₹ 5,82,855 [i.e., 121 days/365 days x 2,36,00,000 x 7.45%] would be added to its total income for A.Y.2023-24.

Option 2

Opts to pay additional income-tax on such excess money not repatriated: In such a case, IndoAm Ltd. has to pay additional income-tax @20.9664% (tax @18% *plus* surcharge @12% *plus* cess@4%) on ₹ 2,36,00,000, which amounts to ₹ 49,48,070.

Where additional income-tax is so paid by IndoAm Ltd., it will not be required to make secondary adjustment and compute interest from the date of payment of such tax.

Answer to Q.1.8

(i) Tax effect of the adjustment made by the TPO for the relevant assessment year would be 33.384% [30% tax + surcharge @7% (assuming the total income exceeds ₹ 1 crore but does not exceed ₹ 10 crores) + HEC@4%] of ₹ 1,10,00,000 = ₹ 36,72,240.

(or)

Tax effect of the adjustment made by the TPO for the relevant assessment year would be 34.944% [30% tax + surcharge @12% (assuming the total income exceeds ₹ 10 crore) + HEC@4%] of ₹ 1,10,00,000 = ₹ 38,43,840.

(ii) Departmental appeal may be filed before Income Tax Appellate Tribunal against the order of CIT (Appeals) if the tax effect exceeds the monetary limit of ₹ 50,00,000.

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(iii) In this case, since the tax effect does not exceed the monetary limit of ₹ 50,00,000, department cannot file an appeal before Income Tax Appellate Tribunal against the order of CIT (Appeal).

Note – *The relevant assessment year is A.Y.2014-15, for which the surcharge rate is 5% where the total income exceeds ₹ 1 crore but does not exceed ₹ 10 crore; and 10% where the total income exceeds ₹ 10 crore. Also, cess was levied@3%. However, students appearing in November, 2022 examination are not expected to be aware of the surcharge and cess rates for A.Y.2014-15. Accordingly, the rates for A.Y.2022-23 have been mentioned in the above answer. It may be noted that in every case, the fact and conclusion given in (ii) and (iii) in the above answer would not change.*

CASE STUDY 2

ABC Inc., USA

ABC Inc. USA is a US based company having Mr. X and Mrs. Y as its shareholders. Mr. X, a person of Indian origin, residing in USA holds 51% and Mrs. Y. an Indian citizen who is also residing in US, holds 49% shares of ABC Inc. Both the shareholders, Mr. X and Mrs. Y, are also director in ABC Inc. There are three more directors in ABC Inc. Two of these directors are Indian citizens residing in Mauritius and one director is a US citizen residing in USA.

The balance sheet of ABC Inc. for the year ended 31.12.2020 is as below:

Amount in USD (Millions)

Liabilities	***Amount***	***Assets***	***Amount***
Equity shares (including reserves and surplus)	*100*	*Investment in PQR LLC*	*80*
		Bank	*20*
	100		***100***

During the FY 2021-22, three out of four board meetings were held in India wherein directors residing in Mauritius and US physically participated, except Mr. X & Mrs. Y. They were paid sitting fees for the same. Board meetings held in India were attended by either of Mr. X and Mrs. Y, on video conferencing and decisions were made on majority basis by directors. ABC Inc. is not engaged in active business outside India. All major commercial decisions were made in board meetings conducted in India. The turnover for ABC Inc for year ended on 31st Dec 2020 was equivalent to INR 100 Crs.

Mr. X and Mrs. Y

Mr. X and Mrs. Y visited India in the month of March 2021 and got stuck due to COVID-19 pandemic and they were in India upto 31st October 2021. All the Board meeting during such period were held in India and either of Mr. X and Mrs. Y participated in board meetings virtually and took part in making all decisions, including decision for sale of shares by PQR LLC.

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PQR LLC, Mauritius

PQR LLC is a Mauritius based entity, wholly owned by ABC Inc. PQR LLC made investment in XYZ Pvt Ltd in India, on 1st April 2016. PQR LLC is not engaged in active business outside India.

Mauritius and India have a Double Taxation Avoidance Agreement which is identical to that of the provisions in UN Model Convention, however, changes as per exhibit A are made effective from 1st April 2017

On 1 November 2021, PQR LLC sold its 100% holding in XYZ Pvt Ltd to a Singapore based company, LMN LLC at a price of USD 100 MN. (1 USD = ₹ 70 on 1st Nov 2021)

USD exchange rate on 1st April 2016, 1 USD = ₹ 40.

The balance sheet of PQR LLC for the FY ended 31.03.2021

Amount in USD (Millions)

Liabilities	***Amount***	***Assets***	***Amount***
Equity shares (including Reserves and surplus)	*80*	*Investment in XYZ Pvt Ltd.*	*80*
	80		***80***

The balance sheet of XYZ private Ltd. for the FY ended 31.3.2021

Amount in USD (Millions)

Liabilities	***Amount***	***Assets***	***Amount***
Equity shares (including Reserves and surplus)	*80*	*Immovable Properties**	*90*
Loan for immovable Properties	*10*		
	90		***90***

**The fair market value of the Immovable Properties on the date of transfer is 100 Mn.*

LMN LLC.

The Singapore Company, LMN LLC were managed by two joint MDs, Mr. Raja and Mr. Ram, both are citizen of India, residing in Singapore for last 15 years. They made this as strategic investment in India.

The Board of LMN LLC wanted to infuse more funds to carry out operations in India but they don't want to do this by way of equity capital. As an alternate they inducted fund as loan of INR 800 Mn on 1st November 2021, to XYZ Pvt Ltd at an interest rate of 7% which is as per prime lending rate of State Bank of India. During the FY 2021-22, XYZ Pvt Ltd has earnings before interest, taxes, depreciation, and amortization INR 60 Mn. In the transfer pricing report, the transaction of interest payment was shown at Arm's Length Price. Out of total interest paid, XYZ Pvt Ltd failed to deduct tax on INR 13 Mn paid as interest to LMN LLC.

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Mr. Raja

Mr. Raja, one of the directors of LMN LLC Singapore, visited India to oversee the operations in India on 15th November 2021 and stayed in India upto 31st March 2022. During the FY 2021-22, Mr. Raja has earned following income:

Nature of Income	Amount (INR)
Dividend from a company listed in Singapore.	7,00,000
Rental Income from house property in India.	9,00,000
Interest income from NRE account in India.	2,00,000
Capital gain from transfer of shares of a company listed in India.	5,00,000

Exhibit- A

Article-13

- *3A- Gains from the alienation of shares acquired on or after 1st April 2017 in a company which is resident of a Contracting State may be taxed in that State.*
- *Gains from alienation of any property other than that referred to in paragraphs 1, 2, 3, 3A,. shall be taxable only in the contracting state of which the alienator is a resident.*

Choose the correct alternative for the following MCQs: (5 x 2 = 10 Marks)

2.1 Based on the facts, which one is correct statement about Place of Effective Management (POEM) of ABC Inc.?

(A) POEM is in India as the majority of board meetings of ABC Inc were held in India and major commercial decisions were made in these board meetings

(B) POEM is outside India as all directors have not visited India for board meetings held in India

(C) POEM is in India as the majority shareholders are citizen of India or person of Indian origin

(D) POEM is outside India as all the directors and shareholders are non-resident

2.2 Based on the facts of transfer of shares by PQR LLC, which one is a correct statement about accrual of Capital Gain which is chargeable to tax in India?

(A) Capital gain shall not accrue or arise in India as shares were sold by non-resident to another non-resident.

(B) Capital gain shall accrue or arise in India as shares of PQR LLC shall be deemed to be situated in India.

(C) Capital gain shall not accrue or arise in India as the shares of PQR LLC were held by US company.

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(D) Capital gain shall accrue or arise in India as the shareholders of the ultimate company are citizen of India.

2.3 Whether Mr. X and Mrs. Y who visited India in March 2021 become resident of India for FY 2021-22 as per the provisions of section 6 of the Income-tax Act, 1961?

(A) No, because if any person is stranded in India due to COVID 19 lockdown shall not be considered resident of India.

(B) Yes, as they are Indian Citizen or person of Indian Origin

(C) Yes, as their total stay in India during FY 2021-22 is more than 182 days.

(D) No, because even though they were in India, but they were managing the affairs of the foreign entity.

2.4 To determine the residency of Mr. Raja, the total income other than the income from foreign source, which one of the following is correct?

(A) All four sources of income should be included together.

(B) All sources, other than dividend income, shall be included together.

(C) All sources, other than interest income from NRE account in India and dividend from shares listed in Singapore, shall be included together.

(D) All sources, other than capital gain from transfer of shares of company listed in India shall be included together.

2.5 XYZ Pvt Ltd seeks your advice regarding the disallowance of interest payment to LMN LLC.

(A) Interest expenses shall be disallowed because tax has not been deducted on whole amount of such interest.

(B) Interest expenses of USD 13 Mn shall be disallowed and not the full amount shall be disallowed.

(C) Interest expenses deduction shall be restricted upto 30% of EBITDA, subject to fulfilment of conditions of tax deduction at source

(D) No disallowance because the transaction is at arm's length.

2.6 Considering the provisions of India Mauritius DTAA, whether capital gain of PQR LLC, arising from transfer of shares of XYZ Ltd is taxable in India. Whether your answer would be different if such shares are acquired on or after 1 April 2017. ***(6 Marks)***

2.7 ABC Inc. were contemplating the sale of shares of PQR LLC, as a part of their strategy to exit from Indian operations in the beginning of Financial Year 2021-22. In this regard, they are seeking an advice with respect to determination of the capital gain tax, if any, on the transfer of shares of PQR LLC.

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(a) *In this regard, briefly explain whether any capital gains shall accrue or arise in the hands of ABC Inc. on the transfer of shares of PQR LLC.* ***(5 Marks)***

(b) *Also explain how the fair market value of asset shall be determined in this case.* ***(4 Marks)***

Solution to Case Study 2

Answers to Q.2.1 to Q.2.5

MCQ No.	Correct Option
2.1	A
2.2	None of the options are correct
2.3	C
2.4	B or C
2.5	C

Answer to Q.2.6

(i) Where shares of XYZ Pvt. Ltd. are acquired by PQR LLC on 1.4.2016

The question states that India-Mauritius DTAA is identical to UN Model Convention.

As per Article 13(4) of UN Model Convention, gains derived by a resident of a Contracting State (i.e., Mauritius) from the alienation of shares may be taxed in the other Contracting State (i.e., India) if, at any time during the 365 days preceding the alienation, these shares derived more than 50% of their value directly or indirectly from immovable property situated in that other State (i.e., India).

In this case, PQR LLC, a Mauritius based company sold 100% holding in XYZ Pvt. Ltd, an Indian company which derives its value from immovable property situated in India.

Accordingly, capital gains of PQR LLC, arising from transfer of shares of XYZ Pvt. Ltd. may be taxed in India as per Article 13(4) of UN Model Convention.

Note – In the facts given in page 6, it is mentioned that the Mauritius and India have a DTAA identical to UN Model Convention with changes as per Exhibit A from 1.4.2017. A combined reading of both would be as follows -

Article of UN Model Convention

Gains derived by a resident of a Contracting State (Mauritius) from the alienation of shares may be taxed in the other Contracting State if, at any time during the 365 days preceding the alienation, these shares derived more than 50% of their value directly or indirectly from immovable property situated in that other State (Source State: India).

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Extract given in question

(3A) Gains from the alienation of shares acquired on or after 1.4.2017 in a company which is resident of a contracting state (India) may be taxed in that State.

Gains from alienation of any property other than that referred to in paragraphs 1,2,3,3A shall be taxable only in the contracting state of which the alienator is a resident (Mauritius).

As per combined reading of the above, it is interpreted that in case shares are acquired before 1.4.2017, it may be taxed in Source State (India) if shares derived more than 50% of their value directly or indirectly from immovable property situated in that Source State (India) and in case share are acquired on or after 1.4.2017, it may be taxed in Source State without 50% condition. The main answer has been given on this basis as per the requirement of the question.

However, as per India-Mauritius DTAA, capital gains on sale of shares of an Indian company by a resident of Mauritius is taxable only in Mauritius, if such shares were acquired before 1.4.2017. On 10.5.2016, the India-Mauritius tax treaty was amended and, it has been provided that gains from the alienation of shares acquired on or after 1.4.2017 in a company which is a resident of India may be taxed in India. The answer on the basis of India-Mauritius DTAA which has been discussed in the study material is given below as an Alternative Answer. It is this answer which correctly distinguishes the position prior to and after the amendment of India- Mauritius DTAA

Alternative Answer for part (i)

As per article 13(4) of the India-Mauritius DTAA, if such shares were acquired before 1.4.2017, gains derived by a resident of a Contracting State (Mauritius) from the alienation of the same shall be taxable only in that State (Mauritius).

Accordingly, capital gains on sale of shares of XYZ Pvt. Ltd., an Indian company, by PQR LLC, a Mauritius based company, would be taxable only in Mauritius, since such shares were acquired by PQR LLC on 1.4.2016 (i.e., before 1.4.2017)

(ii) If such shares are acquired on or after 1.4.2017

Article 13(3A) between India and Mauritius w.e.f. 01.04.2017 reads "Gains from the alienation of shares acquired on or after 1st April, 2017 in a company which is resident of a Contracting State (India) may be taxed in that State (India)".

As per Article 13(3A) given in the facts, gains from alienation of shares acquired on or after 1.4.2017 in a company (i.e., XYZ Pvt. Ltd.) which is resident of a Contracting State (i.e., India) may be taxed in that state (i.e., India).

Accordingly, if shares of XYZ Pvt. Ltd. are acquired on or after 1.4.2017, capital gains of PQR LLC, arising from transfer of shares of XYZ Pvt. Ltd. may be taxed in India.

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Answer to Q.2.7

(a) ABC Inc, USA, is resident in India for P.Y.2021-22, since its POEM is in India in that year on account of the following -

(i) It is not engaged in active business outside India

(ii) All major commercial decisions were made in board meetings conducted in India.

Hence, its global income would be taxable in India.

Capital gains on transfer of shares of PQR Inc. would be includible in the total income of ABC Inc. USA, whether or not, it accrues or arises in India.

Note - Since ABC Inc, USA, is resident due to its POEM being in India in the P.Y.2021-22, capital gains would become taxable in India irrespective of the place of accrual. However, since the question has been framed in a manner requiring application of indirect transfer provisions applicable to a non-resident, alternative answer has been given on this basis (assuming that if they exit from Indian operations in the beginning of F.Y.2021-22, the POEM would not be in India) –

Alternative Answer

Capital gain arising in the hands of ABC Inc. USA from transfer of a capital asset situated in India would be deemed to accrue or arise in India.

Shares of PQR LLC, Mauritius, shall be deemed to be situated in India if those shares derive directly or indirectly, its value substantially from assets located in India.

Shares of PQR LLC would be deemed to derive its value substantially from the assets located in India, if on the specified date, the value of Indian assets (without reduction of liabilities)

- exceeds ₹ 10 crore; and
- represents at least 50% of the value of all the assets owned by the PQR LLC.

Specified date would be the date on which the accounting period of the PQR LLC ends preceding the date of transfer of a share i.e., 31.3.2021.

Shares of PQR LLC derives its value substantially from assets located in India since the value of assets located in India (without reduction of liabilities) on 31.3.2021, being the specified date i.e., 10 crore USD

- exceeds ₹ 10 crore; and
- represents more than 50% of the value of assets of PQR LLC i.e., more than 50% of USD 8 crore

Since shares of PQR LLC, Mauritius derives its value substantially from assets located in India, it shall be deemed to be situated in India and capital gain arising in the hands of

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ABC Inc. USA from transfer of a capital asset situated in India would be deemed to accrue in India.

Answer to Q.2.7(b)

The fair market value of asset, tangible or intangible, as on the specified date, held directly or indirectly by a foreign company, for the purposes of section 9(1)(i), has to be computed in accordance with Rule 11UB.

Accordingly, where the asset is a share of an Indian company not listed on a recognised stock exchange on the specified date (share of XYZ P Ltd., in this case), the fair market value of the share shall be its fair market value on such date as determined by a merchant banker or an accountant in accordance with any internationally accepted valuation methodology for valuation of shares on arm's length basis as increased by the liability, if any, considered in such determination.

CASE STUDY 3

Heavy Business Ltd, a company incorporated in Mauritius, is dealing into various business segments involving heavy engineering expertise such as construction of bridges and dams, operation of aircrafts, exploration of mineral oils and shipping business in international waterways. Company is aggressively marketing in India to get some big projects in India as well as to take advantage of the Government policy for oil exploration and international aircraft to carry passengers and goods.

Construction of bridges and dams

On 1st September 2021, Government of India (GOI) awarded the contract for construction of a bridge for a contract value of USD 4,000,000,000. This is a joint agreement between India and Japan. It is agreed that 50% of the cost shall be borne by Japan Government. For execution of contract, M/s Heavy Business Ltd sub-contracted the same to an Indian Company Associate Ltd for a value of USD 2,000,000,000. Associate Ltd has 2 common directors with Heavy Business Ltd, out of total 4 directors. In the FY 2021-22, 25% work is completed and GOI made payment of USD 1,000,000,000. Heavy Business Ltd. made payment of USD 750,000,000 to Associate Ltd. Heavy Business Ltd has also incurred other expenses worth USD 200,000,000 on procurement of material being used in execution of project during FY 2021-22.

Associate Ltd. also hired an equipment from M/s Parrot LLC, based out of Singapore, for execution of contract and the lease rent of such equipment is USD 500,000,000 out of which lease rent of USD 200,000,000 relates to FY 2021-22.

Mr. Ram, a citizen and resident of Mauritius, is an engineer by qualification and employee of Heavy Business Ltd. M/s Heavy Business Ltd deputed Mr. Ram in India for this project and he visited India on 1st November 2021. His family was in Mauritius and his salary in Mauritius is 10000 USD per month and social security contribution by the employer in Mauritius is 1000 USD per month. The same amount is being deducted as his social security contribution from his salary. During his deputation in India, Ram's family was receiving salary every month.

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Operation of international aircraft

Heavy Business Ltd also got license from DGCA to operate international aircraft between India and Mauritius and after doing all the necessary formalities, the commercial flight operation started from 1st November 2021. For booking of air tickets, M/s Heavy Business Ltd started an online booking portal through which the air ticket booking can be done from anywhere. The collection details for the FY 2021-22 are as below:

Journey from	***India (In USD)***	***Mauritius (In USD)***
Ticket booking from		
India	*20.00Cr*	*30.00 Cr*
Mauritius	*40.00 Cr*	*50.00 Cr*
Amount received for advertisement on aircraft	*10.00 Cr*	*15.00 Cr*
Ticket booked for journey in FY 2022-23	*25.00 Cr*	*35.00 Cr*

Heavy Business Ltd. took 10 aircraft on lease from an Ireland based organization for a monthly rental of 5 MN USD. The company has also given contract to GMN Inc, a German company, for the maintenance of these aircrafts and paid 10 MN USD for FY 2021-22, however, no engineer visited India in FY 2021-22 and supported virtually. The German company also claimed that since they do not have any permanent establishment in India so no tax should be deducted on the payment made to them and accordingly Heavy Business Ltd had not deducted the tax.

(Assume India Ireland Treaty is based on UN Model convention, except the clauses provided as Exhibit at the end of Case Study)

Exploration of mineral oils

M/s KLM Ltd, a company registered in India got a contract from ONGC Ltd for exploration of mineral oils in high sea. For this purpose, they need helicopter for transportation of staff from the base station to the exploitation site. KLM Ltd contacted Heavy Business Ltd for the same and Heavy Business Ltd gave two helicopters on wet lease model for a monthly lease rent of 1 Cr. KLM Ltd also engaged YSR LLC of Singapore for providing food to the staff at the exploitation site and base station. For this purpose, YSR LLC had set up a kitchen for supply of food. For FY 2021-22, M/s KLM Ltd paid 9 Cr to YSR LLC, through banking channels and YSR LLC had also incurred all the expenses related to business through banking channels. YSR LLC maintained books of accounts and declared profit of 8% of the total revenue and filed the income tax return accordingly without audit of books of accounts u/s 44AB.

India - Ireland Tax Treaty

ARTICLE 12 ROYALTIES AND FEES FOR TECHNICAL SERVICES

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

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2. *However, such royalties or fees for technical services may also be taxed in the Contracting State in which they arise, and according to the laws of that State, but if the recipient is the beneficial owner of the royalties or fees for technical services, the tax so charged shall not exceed 10 percent of the gross amount of the royalties or fees for technical services.*

3. *(a) The term "royalties" as used in this Article means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematograph film or films or tapes for radio or television broadcasting, any patent, trade mark, design or model, plan, secret formula or process or for the use of or the right to use industrial, commercial or scientific equipment, other than an aircraft, or for information concerning industrial, commercial or scientific experience:*

   (b) The term "fees for technical services" means payment of any kind in consideration for the rendering of any managerial, technical or consultancy services including the provision of services by technical or other personnel but does not include payments for services mentioned in Articles 14 and 15 of this Convention.

4. *The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the royalties or fees for technical services, being a resident of a Contracting State, carries on business in the other Contracting State in which the royalties or fees for technical services arise through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the right or property in respect of which the royalties or fees for technical services are paid is effectively connected with such permanent establishment or fixed base. In such case the provisions of Article 7 or Article 14, as the case may be, shall apply.*

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

6. *Where, by reason of a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the royalties or fees for technical services, having regard to the use, right or information for which they are paid, exceeds the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In such case, the excess part of the payments shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of this Convention.*

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Choose the correct alternative for the following MCQs: (5 x 2 = 10 Marks)

3.1 Which of the following statement is correct about taxability of payment made by Associate Ltd to Parrot LLC for hiring of equipment?

(A) Payments are taxable in the hands of M/s Associate Ltd

(B) Income is not chargeable to tax in the absence of permanent establishment of Parrot LLC.

(C) Income is chargeable to tax at the rate of 40% on Gross receipts in the hands of Parrot LLC

(D) Income is chargeable to tax at the rate of 10% of the gross receipts in the hands of Parrot LLC.

3.2 Which of the following statement is correct about taxability of Salary Income of Mr. Ram in India?

(A) Not taxable in India as salary is received outside India.

(B) Not taxable in India as Ram is an employee of M/s Heavy Business Ltd Mauritius.

(C) Salary, received from 1st November 2021, is being accrued or arisen in India hence taxable in India irrespective of his residential status

(D) Ram is RNOR and Salary earned outside India is taxable in India.

3.3 Which of the following statement is correct about the income of YSR LLC Singapore?

(A) YSR LLC is correct in declaring 8% income on gross receipts without getting audit done u/s 44AB as all the receipts and expenses are through banking channel.

(B) YSR LLC can declare minimum 10% Income on Gross Receipts without getting the books audited u/s 44AB

(C) YSR LLC is required to get the books of accounts audited u/s 44AB as turnover exceeds 1 Crore

(D) Service provided by YSR LLC are not qualified for presumptive taxation.

3.4 Considering the India-Ireland tax treaty, the payment for lease of aircraft shall be taxed as:

(A) Royalty income because as defined in Section 9(1).

(B) Fees for technical services as defined in Section 9(1).

(C) Business Income, after applying India Ireland Tax treaty

(D) Not taxable after applying India Ireland Tax treaty

3.5 Which of the following statement is correct with respect to taxability of GMN Inc., German Company providing maintenance services to Heavy Business Ltd?

(A) Not taxable in the absence of permanent establishment

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(B) Taxable as Fee for technical services

(C) Not taxable as the transaction is between 2 foreign companies.

(D) Taxable as Significant Economic presence established digitally.

3.6 Determine the taxable turnover of M/s Heavy Business Ltd. for the A.Y. 2022-23 in respect of operation of aircraft only. Comment on the taxing rights of income from operation of aircrafts and availability of Foreign Tax Credit between Source and Residence State on the basis of UN Model Convention. ***(8 Marks)***

3.7 Compute the tax liability of M/s Heavy Business Ltd. for the AY 2022-23 in respect of construction of bridges and dam only and also mention the requirements to be complied with for presumptive taxation of this income. ***(7 Marks)***

Solution to Case Study 3

Answer to Q.3.1 to 3.5

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

Answer to Q.3.6

As per section 44BBA, profits and gains of the business of operation of aircraft in the case of non-residents would be the sum equal to 5% of the aggregate of the following amounts -

(a) paid or payable, whether in or out of India, to the assessee or to any person on his behalf on account of the carriage of passengers, livestock, mail or goods from any place in India; and

(b) received or deemed to be received in India by or on behalf of the assessee on account of the carriage of passengers, livestock, mail or goods from any place outside India.

Keeping in view the provisions of section 44BBA, the taxable turnover of M/s Heavy Business Ltd. for A.Y. 2022-23 would be as follows:

Computation of taxable turnover under section 44BBA	
Particulars	**(in USD)**
Tickets booked from India for journey from India	20 Cr.

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Tickets booked from India for journey from Mauritius	30 Cr.
Tickets booked from Mauritius for journey from India	40 Cr.
Tickets booked from Mauritius for journey from Mauritius	Not taxable
Tickets booked in advance for journey from India USD 25 Cr. (**taxable**, even if the amount paid or payable in or outside India for journey from India)	25 Cr.
Alternate Answer: If it is assumed that the same is included in the above figures, no further adjustment is required, in such a case, taxable turnover would be ₹ 90 Crore.	
Tickets booked in advance for journey from Mauritius USD 35 Crore (**not taxable** assuming tickets are also booked from Mauritius. No further adjustment is required, since tickets booked from Mauritius for journey from Mauritius are not included above).	-
Amount received for advertisement on aircraft [On plain reading of section 44BBA, amount received towards advertisement on aircraft **would not be included in taxable turnover**, for the purpose of computing presumptive income, since only the receipts on account of carriage of passengers, livestock, mail or goods forms part of receipts included for this purpose]	-
Total taxable turnover u/s 44BBA	**115 Cr.**

As per Article 8 of UN Model Convention, profits of an enterprise of a Contracting State from the operation of aircraft in international traffic shall be taxable only in that State.

In the present case, M/s Heavy Business Ltd. is a company incorporated in Mauritius. Accordingly, the profits arising from the operation of aircrafts would be taxable in Mauritius only; such income would not be taxable in India. Hence, no double taxation arises and no foreign tax credit would be available.

Note - As per Article 8, profits of Heavy Business Ltd would be taxable in Mauritius only. Hence, no foreign tax credit would be allowed by Mauritius, since the said income is taxable only in Mauritius.

However, since Article 8 is not covered in the syllabus, this question may be answered on the basis of the provisions of the Income-tax Act, 1961. Accordingly, such income would also be taxable in India in accordance with the provisions of section 44BBA of the Income-tax Act, 1961.

Foreign tax credit between Source and Residence State as per UN Model Convention.

As per para 1 of Article 23B of UN Model Convention, where a resident of a Contracting State derives income which may be taxed in the other Contracting State in accordance with the provisions of this convention, the first mentioned State (Mauritius, in this case) shall allow as a deduction from the tax on the income of that resident, an amount equal to the income-tax paid

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in that other State (India, in this case). Such deduction shall not, however, exceed that part of the income tax, as computed before the deduction is given, which is attributable, to the income which may be taxed in that other State.

Answer to Q.3.7

As per section 43CB, the profits and gains arising from a construction contract shall be computed on the basis of percentage of completion method (POCM) in accordance with the notified ICDS i.e., ICDS III: Construction Contracts. Accordingly, profits from construction contract would be computed in the following manner:

Particulars	Amount in USD
Contract revenue [USD 100,00,00,000, being 25% of the contract revenue] (As per ICDS III, under POCM method, contract revenue is recognised which can be attributed to the proportion of work completed. In the present case, 25% of the work is completed. Accordingly, 25% of contract revenue is recognised)	100,00,00,000
Less: Contract cost	50,00,00,000
- Payment to sub-contractor [since 25% of work is completed, payment to Associate Ltd. to the extent of 25% of total sub-contract value would be allowed as deduction. As per ICDS III, payment to sub-contractor in advance would not be included in contract cost]	
- Salary (11000 x 5)	55,000
- Cost on procurement of material	20,00,00,000
Profits from business/Total Income	**29,99,45,000**
Assuming the conversion rate as on 31.3.2022 to be ₹ 70, the profits and gains of business and profession (which constitutes total income) would be	**₹ 2099.615 crores**
Computation of Tax liability	**₹ in crores**
Tax @40%	839.846
Add: Surcharge@5% [since total income in Indian rupees exceed ₹ 10 crores]	41.992
	881.838
Add: Health and education cess @4%	35.274
Tax liability	**917.112**

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The option to pay tax as per presumptive provisions contained under section 44BBB is available only to foreign company engaged in the business of civil construction in connection with turnkey power projects approved by the Central Government.

In the present case, M/s Heavy Business Ltd. engaged in construction contact of a bridge awarded by the Government of India, such construction contract is not in connection with power project.

Thus, M/s Heavy Business Ltd. would not be eligible to opt for presumptive provisions contained under section 44BBB.

Note – *In the facts of the case study and in the question, the conversion rate for USD in Indian currency is not given. In the above solution, the business income has been computed assuming the conversion rate as on 31.3.2022 to be ₹ 70.*

CASE STUDY - 4

Style You (India)

Ms. Saroj is the promoter and the Chief Executive Officer of Style You (India) Private Limited (also referred as "Style You" or the "Company"). Saroj currently holds 32% equity shares of the Company. Origami Finance, a company based out of Country "A", holds 30%, Fashionista Ltd, company based out of Country "B" holds 29% of the equity. The rest of the equity is held by certain key managerial personnel of the company.

In FY 21-22, Style You has raised the following loans/borrowings:

(a) On 01 May 2021, raised a loan of INR 15 crores from Bank of Tokyo. India branch, at an interest rate of 7.6%. The loan is guaranteed by Origami Finance.

(b) On 01 June 2021, borrowed INR 65 crores from Fashionista Ltd at 7.9%. The loan is repayable over a period of 5 years.

The net profit of Style You for FY 2021-22 was INR 6.5 crores after debiting the interest on loans as mentioned above, depreciation of INR 1 crores and tax of 2.1 crores.

Holiday Home in Dubai

Ms. Saroj has been a frequent traveller to many places outside India to meet clients and participate in trade shows etc. In FY 2011-12, during one of her visits to Dubai, Saroj acquired time share interest in a Holiday Home. She paid AED 1.0 million as an upfront payment and AED 375,000 every year for the next 5 years to complete her acquisition of 25% share in the vacation property. She uses the same sparingly as she has been quite busy and taking very few personal days off. Given the availability of the holiday home and very little personal use of the same, in the recent years, Saroj allowed a real estate leasing company to use the holiday home to be rented off to vacationers and earn rental income from the same. The rental income was usually deposited by the real estate leasing company in a bank account maintained by Saroj locally in Dubai. As on 01 April 2021, the bank account had a total balance AED 1.01 million.

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During a recent assessment proceeding for AY 20-21, the Assessing officer came to know about the foreign assets and foreign bank account of Ms. Saroj as certain rental income from Holiday home was credited in her Indian bank account. Based thereon, a notice under Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 was issued to her on 30 December 2021. The market value of the timeshare in holiday home was AED 2.8 million as on 01.04.2021 and worth AED 2.7 million on 30.12.2021. The exchange rates of Indian currency per 1 AED on various dates were -

01-04-2021 =INR 20.86

30-12-2021 =INR 20.29

When enquired, Saroj could not provide any reasonable explanation on the sources of money she used to purchase her timeshare interest in the property. Further, she could not show any other rental income from the holiday home being offered in the Income Tax Return in India in any of the previous years.

Style You, Bangladesh

Style You (India) has set-up a wholly owned subsidiary in Bangladesh, with a key objective of procuring fabric and other raw material. During FY 21-22, the company derived all its income from procuring fabric and other raw material from third-party vendors locally in Bangladesh and selling the same to its parent Company in India, having gross receipts of INR 45 crores during the year. It had 10 local employees (based out of Bangladesh) on its payroll, and two Indian residents (quality assurance manager and Chief Operating Officer). Out of total payroll expenditure of 20 million, the total payroll expenditure for the QA Manager and the COO is 12 million. It has assets in the form of computer equipment, software, leasehold improvements, and furniture, all of which is located in its company's office in Bangladesh.

Fashionista Ltd.'s employees visit to India

During the FY 21-22, Fashionista Ltd sent its employees Frieda and Sylvia to India to render production efficiency and quality assurance related training to Style You India's employees, Frieda and Sylvia, both arrived in India on 01 May 2021 for the first time ever and left on 25 May 2021. After that Sylvia had to visit India again to oversee the quality assurance functions as several of Style You India's export consignment were getting rejected due to quality issues. She arrived on 25 Sept 2021 and left on 20 March 2022. For the services rendered by Frieda and Sylvia, Fashionista Ltd charged a lumpsum fee of INR 2.35 crores from Style You Ltd. Frieda received a per day additional allowance of INR 12,000 per day in addition to her salary of GBP 78,000 from Fashionista Ltd. Sylvia received a per day additional allowance of INR 10,000 per day in addition to her salary of GBP 65,000 from Fashionista Ltd.

Sub Part (a)- Multiple Choice Questions:

Choose the correct alternative for the following MCQs: (5 x 2 = 10 Marks)

4.1 With respect to the Holiday home and its rental income detected during the FY 21-22, which of the following statements is correct?

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(i) *Undisclosed foreign asset would be liable to tax in the previous year in which such asset comes to the notice of the Assessing officer.*

(ii) *The Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 does not apply to a non-resident person unless such person was resident in the year in which undisclosed asset located outside India was acquired.*

(iii) *No deduction is allowed from value of undisclosed asset located outside India unless the assessee can furnish evidence to the satisfaction of AO that asset has been acquired from the income which has been assessed or assessable to tax under the Act.*

(iv) *The undisclosed foreign income and asset of any previous year included under the Black Money and Imposition of Tax Act would also need to be included in the computation of total income under the Income-tax Act, 1961 for the same previous year.*

The most appropriate answer is-

(A) *(i), (iii) and (iv) above*

(B) *(ii), (iii) and (iv) above*

(C) *(i), (ii) and (iii) above*

(D) *All statements are correct*

4.2 *With respect to loans and borrowings made by Style You and deduction of Interest claimed in computation of taxable income during FY 21-22, which of the following would not be considered correct regarding Base Erosion Profit Shifting (BEPS) Action Item related to Interest Deduction and Other Financial Payment?*

(i) *The Action plan calls for development of recommendation for the design of rules to be incorporated in DTAAS (Double Taxation Avoidance Agreements) to prevent tax base erosion through use of interest expenses and other financial payments.*

(ii) *The OECD is concerned that MNC groups may locate third party debts in high tax countries so as to erode the tax base by way of interest expenses.*

(iii) *The BEPS Action Item report recommend a common approach to be adopted by countries that links an entity's net interest deduction to its EBIT (Earnings Before Interest and Tax).*

(iv) *The Common approach recommended by BEPS Action Item report includes three elements a fixed ratio rule, a Group ratio rule and Targeted rules.*

The most appropriate answer is-

(A) *(i) and (ii) above*

(B) *(ii) and (iii) above*

(C) *(ii) and (iv) above*

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(D) (i) and (iii) above

4.3 What is the residential status of Frieda and Sylvia for AY 22-23?

(A) Frieda and Sylvia both are Resident

(B) Frieda and Sylvia both are Non-Resident

(C) Frieda is Resident, and Sylvia is Resident but not ordinarily resident

(D) Frieda is Non-resident, and Sylvia is Resident but not ordinarily resident

4.4 Which of the following is correct regarding taxability of the incomes of Frieda and Sylvia, in India, for FY 21-22?

(i) The remuneration received by Frieda for the services she rendered in India would be exempt from tax if (a) Fashionista Ltd is not engaged in any business or trade in India, and (b) her remuneration is not liable to be deducted from the income of Fashionista Ltd chargeable under the Income-tax Act, 1961

(ii) The remuneration received by Sylvia would be taxable proportionately for the time she spent in India.

(iii) The remuneration received by Sylvia will not be taxable in India if she chooses to offer her entire salary for taxation in her home country.

(iv) The remuneration received by Frieda for the services she rendered in India would not be exempt from tax in India if Fashionista Ltd has a Permanent Establishment in India.

The most appropriate answer is-

(A) (i) and (iv) are correct

(B) (ii) and (iii) are correct

(C) (i) and (iii) are correct

(D) All statements are incorrect

4.5 Assuming that the payment made by Style You India is neither characterised as royalty nor as fee for technical services under the DTAA between India and Country B. In such a case, which of the following statement would be considered as correct?

(A) Style You India needs to withhold tax @ 40% if Fashionista Ltd. has a Permanent Establishment in India

(B) Style You India does not need to withhold any tax given that Fashionista Ltd. is a non-resident

(C) Style You India does not need to withhold taxes as the payment is neither royalty nor FTS

(D) Style You India need not withhold taxes unless BFAR orders for withholding taxes

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Sub Part (b) Questions other than MCQs

4.6 Discuss the applicability of the provisions of limitation of interest deduction to various borrowings of Style You India. Based on the same, determine the total interest deduction allowable to the Company for AY 2022-23. ***(6 Marks)***

4.7 Compute the value of undisclosed asset chargeable to tax in the hands of Saroj under the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015. ***(4 Marks)***

4.8 Examine whether Style You Bangladesh meets the ABOI (Active Business Outside India) test. What additional facts need to be examined to determine whether Style You Bangladesh has a Place of Effective Management in India? ***(5 Marks)***

Solution to Case Study 4

Answer to Q.4.1 to 4.5

MCQ No.	Correct Option
4.1	C
4.2	D
4.3	D
4.4	A
4.5	A

Answer to Q.4.6

Origami Finance (in Country A) and Fashionista Ltd. (in Country B) are deemed to be associated enterprises of StyleYou (India), an Indian company, since they each hold shares carrying 26% or more voting power in StyleYou (India).

StyleYou (India), an Indian company, being the borrower, has incurred interest expenditure in respect of debt issued by its non-resident associated enterprises (NRAE) and such interest exceeds ₹ 1 crore. Accordingly, the interest paid or payable by StyleYou (India) in excess of 30% of EBITDA or interest paid or payable to NRAE, whichever is lower, shall not be allowed as deduction as per section 94B. The provisions of section 94B would, therefore, be attracted in respect of interest on ₹ 65 crores borrowed from Fashionista, a NRAE.

Further, where the debt is issued by a lender which is not associated but an AE either provides an implicit or explicit guarantee to such lender, such debt shall be deemed to have been issued by an AE and limitation of interest deduction would be applicable.

However, a PE of a foreign company which is engaged in the business of banking is excluded from the application of section 94B.

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Accordingly, even though loan from Bank of Tokyo, India branch, is guaranteed by a non-resident AE, namely, Origami Finance, the same is excluded from the application of section 94B, since Indian branch of Bank of Tokyo is a PE of a foreign bank.

Computation of interest allowable as deduction to StyleYou (India) for A.Y.2022-23

Particulars	₹	₹
Net profit		6,50,00,000
Add: Interest already debited		
On loan from Bank of Tokyo = 7.6% of ₹ 15 crores x 11/12	1,04,50,000	
On loan from Fashionista = 7.9% of ₹ 65 crores x 10/12	4,27,91,667	
		5,32,41,667
Depreciation		1,00,00,000
Income tax		2,10,00,000
EBITDA		**14,92,41,667**
30% of EBITDA	4,47,72,500	
Interest paid or payable by Style You		5,32,41,667
Less: Excess interest – Lower of		
(i) Interest paid or payable to NRAE in excess of 30% of EBITDA		
Since ₹ 4,27,91,667 < ₹ 4,47,72,500 Nil		
(ii) Interest paid or payable to NRAE 4,27,91,667		Nil
Interest allowable as deduction		**5,32,41,667**

Note – In the above solution, interest has been calculated on the basis of number of months. On the basis of the number of days, the solution would be as follows -

Particulars	₹	₹
Net profit		6,50,00,000
Add: Interest already debited		
On loan from Bank of Tokyo=7.6% of ₹ 15 crs x 334/365 days	1,04,31,781	
On loan from Fashionista= 7.9% of ₹ 65 crs x 303/365 days	4,26,27,534	
		5,30,59,315
Depreciation		1,00,00,000
Income tax		2,10,00,000
EBITDA		**14,90,59,315**
30% of EBITDA	4,47,17,795	

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Interest paid or payable by Style You			5,30,59,315
Less: Excess interest – Lower of			
(i) Interest paid or payable to NRAE in excess of 30% of EBITDA			
Since ₹ 4,26,27,534 < ₹ 4,47,17,795	Nil		
(ii) Interest paid or payable to NRAE	4,26,27,534		**Nil**
Interest allowable as deduction			**5,30,59,315**

Note – The above solution has been worked out by computing excess interest as the difference between interest paid to NRAE and 30% of EBITDA, as per the intent expressed in section 94B(1) read with the Explanatory Memorandum to the Finance Bill, 2017. Excess interest can be computed by deducting 30% of EBITDA from total interest on the basis of plain reading of section 94B(2). If this view is taken, the workings would be modified as follows –

When interest is computed on the basis of number of months:

Particulars	₹	₹
Net Profit		6,50,00,000
Add: Interest already debited		
On loan from Bank of Tokyo = 7.6% of ₹ 15 crores x 11/12	1,04,50,000	
On loan from Fashionista = 7.9% of ₹ 65 crores x 10/12	4,27,91,667	
		5,32,41,667
Depreciation		1,00,00,000
Income-tax		2,10,00,000
EBITDA		**14,92,41,667**
30% of EBITDA	4,47,72,500	
Interest paid or payable by Style You		5,32,41,667
Less: Excess interest – Lower of		
(i) Total interest paid or payable in excess of 30% of EBITDA		
₹ 5,32,41,667 (-) ₹4,47,72,500	84,69,167	
(ii) Interest paid or payable to NRAE	4,27,91,667	84,69,167
Interest allowable as deduction		**4,47,72,500**

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When interest is calculated on the basis of number of days:

Particulars	₹	₹
Net Profit		6,50,00,000
Add: Interest already debited		
On loan from Bank of Tokyo=7.6% of ₹ 15 Cr x 334/365 days	1,04,31,781	
On loan from Fashionista = 7.9% of ₹ 65 Cr x 303/365 days	4,26,27,534	
		5,30,59,315
Depreciation		1,00,00,000
Income-tax		2,10,00,000
EBITDA		**14,90,59,315**
30% of EBITDA	4,47,17,795	
Interest paid or payable by Style You		5,30,59,315
Less: Excess interest – Lower of		
(i) Total interest paid or payable in excess of 30% of EBITDA		
₹ 5,30,59,315 (-) ₹4,47,17,795 83,41,520		
(ii) Interest paid or payable to NRAE 4,26,27,534		83,41,520
Interest allowable as deduction		**4,47,17,795**

Note - Though the question does not mention "per annum" or "p.a.", the interest has been computed considering the rates of 7.6% and 7.9% given therein as "rates per annum".

Answer to Q.4.7

Computation of value of undisclosed asset under BM Act, 2015

Particulars	₹ in lakhs
An Undisclosed asset located outside India shall be charged to tax on its value in the previous year in which such asset comes to notice of the Assessing Officer. Accordingly, value of bank account in Dubai and time share interest in holiday home in Dubai would be charged to tax in the A.Y.2022-23, since notice was issued by the Assessing Officer in December, 2021.	
Bank balance in Dubai (Sum of all deposits made in the bank since the date of opening account) on valuation date, being 1st April, 2021 [AED 1.01 million x 10 (for conversion into lakhs) x INR 20.86, conversion rate as on 1.4.2021]	210.686

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Value of time share interest in holiday home in Dubai	
Higher of,—	
(i) cost of acquisition [AED 10 lakhs + AED 18.75 lakhs (AED 3.75 lakhs x 5)] = AED 28.75 lakhs; and	
(ii) market value as on 1.4.2021 = AED 28 lakhs	
AED 28.75 lakhs x ₹ 20.86, conversion rate as on 1.4.2021	599.725
Value of Undisclosed Asset chargeable to tax in A.Y.2022-23	**810.411**

Answer to Q.4.8

A company shall be said to be engaged in "Active Business Outside India" (ABOI) for POEM, if -

(i) the passive income is not more than 50% of its total income; and

(ii) less than 50% of its total assets are situated in India; and

(iii) less than 50% of total number of employees are situated in India or are resident in India; and

(iv) the payroll expenses incurred on such employees is less than 50% of its total payroll expenditure.

StyleYou (Bangladesh) shall be regarded as a company engaged in active business outside India for P.Y.2021-22 for POEM purpose only if it satisfies **all** the four conditions **cumulatively**.

In this case,

(i) Income from procuring fabric and raw material from third-party vendors locally in Bangladesh and selling the same to its parent company in India does not constitute passive income. Only if both purchase and sale are from/to associated enterprises, income therefrom would be passive income. Therefore, condition (i) is satisfied.

(ii) Since all the assets are situated in Bangladesh, condition (ii) is satisfied.

(iii) Since only 2 out of 12 employees are resident in India or situated in India, which is 16.67% of total employees, condition (iii) is satisfied.

(iv) Total payroll expenditure is 20 million, out of which payroll for resident Indian employees is 12 million, which is 60% of total payroll expenditure. Therefore, StyleYou (Bangladesh) does not satisfy the condition that the payroll expenses incurred on employees situated in India or are resident in India is less than 50% of its total payroll expenditure

Accordingly, since condition (iv) is not satisfied, StyleYou (Bangladesh) does **not** satisfy the ABOI test.

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Additional facts required to determine whether StyleYou (Bangladesh) has a POEM in India

In order to determine whether StyleYou (Bangladesh) has a POEM in India, we need the information of persons who actually make the key management and commercial decision for conduct of the company's business as a whole and the place where the decisions are made.

(or)

The POEM guidelines are not applicable since gross receipts of Style You (Bangladesh) are less than ₹ 50 crores. Hence, there is no need to check any additional fact.

Note – *The question mentions that StyleYou (Bangladesh) derived all its income from procuring fabric and other raw material from third-party vendors locally in Bangladesh and selling the same to its parent company in India, having gross receipts of INR 45 crores during the year. From this statement, it can be inferred that since Style You (Bangladesh) derives all income from this source, its gross receipts also cannot exceed INR 45 crores, which is the figure of gross receipts of the parent company. In such a case, POEM guidelines would not apply to it, since its gross receipts are lower than INR 50 crores.*

CASE STUDY 5

Consult Ltd.

Consult Limited, a privately-held Indian company, provides business consulting services to small business owners worldwide. The company has also developed a technology platform that help clients onboard freelance local consultants directly based on their needs ("Direct Consult" business).

Most of the employees of the Company work in India and provide consulting services to their clients in India as well as outside India. Certain employees are deployed outside India to oversee the Direct Consult business. In the Direct Consult business, the freelance consultants get paid directly by their clients and in-turn pay Consult Limited a 10% commission in lieu of the right to use the technology platform owned by Consult Ltd. The Company avails technical services from PQR Inc. regarding regular upkeep and development of the Direct Consult software.

Maushmi, deployed outside India

Ms. Maushmi has been a long-standing employee of Consult Ltd. She has been deployed at various places outside India over the last 12 years. These past years, Maushmi has been visiting India on leave once every year from 20 Dec to 30 Jan to meet her parents. For the last many years including FY 21-22, she is liable to pay tax in Country A, where she is domiciled.

- *Maushmi owned a flat at Mumbai (acquired by her on 10.10.2011 for INR 35 lakhs). She sold it off for INR 95 lakhs on 18.10.2021 to Dinesh, an Indian resident. The stamp duty valuation of the same is INR 90 lakhs as on the date of the sale. Maushmi paid a brokerage of 95,000 to an Indian local real estate agent towards the same.*

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- *During FY 21-22, a total interest of INR 150,000 was credited to her Non-resident (External) bank account.*
- *Maushmi owns certain shares in listed stocks, which she sold off in FY 21-22 for INR 18 lacs. These shares were acquired in FY 2009-10 for INR 550,000 and earned a dividend income of INR 21,000 during FY 21-22. The fair market value of the shares on 31st January 2018 is INR 18.10 lacs.*
- *Maushimi currently owns an apartment in Detroit, USA. Because she is currently not staying in Detroit, she has let out the same at rent of USD 900 per month in Detroit. (TTBR INR 58/1 USD as on 31 March 2022 and TTSR INR 62/1 USD on 31 March 2022).*
- *The cost inflation index for FY 2009-10 is 148, for FY 11-12 is 184, for FY 2021-22 is 317.*

Permanent Establishment in Country "B"

For FY 16-17 and FY 17-18, Consult Ltd had earned certain income from Direct Consult business from freelances in Country B. Further, Maushmi has travelled to Country B twice for 10 business days each in the 2 years to interview the freelancers as well as to meet the clients. The tax authorities in Country B have alleged that Consult Ltd has a Fixed Place PE in that country as Maushmi has routinely used the office of the clients for her disposal. The tax authorities have got the Company to pay INR 58 lakhs as the tax due on profit attributed by them on the PE. Consult Ltd. is considering invoking Mutual Agreement Procedure on this issue.

Sub Part (a) Multiple Choice Questions

Choose the correct alternative for the following MCQs: (5 x 2 = 10 Marks)

5.1 What does the tax paid by Consult Ltd in Country B related to the Permanent Establishment issue indicates?

(A) Juridical Double Taxation.

(B) Economic Double Taxation.

(C) No double taxation as Consult Ltd can claim Foreign Tax Credit of the taxes it paid in Country B against the PE allegations.

(D) No double taxation as Consult Ltd can claim relief in a MAP proceeding.

5.2 Which of the following statement regarding taxability of interest income earned by Maushmi is correct?

(A) Interest earned on credit balance maintained in a Non-resident (Ordinary) Account is exempt

(B) Interest earned on credit balance maintained in a Non-resident (External) Account is exempt

(C) Interest earned on credit balance maintained in a Foreign Currency Non-resident Account is exempt

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(D) *Interest from any type of bank account maintained by a Non-resident individual with any bank in India is taxable*

5.3 *What is the nature of payment made by freelance consultants to Consult Ltd (assume applicable DTAA between India and respective Country is in line with the OECD Model Tax Convention)?*

(A) *Fee for Technical Services*

(B) *Sales commission*

(C) *Royalty*

(D) *Other Income*

5.4 *Dinesh wants to understand whether he needs to deduct tax at source on payment to be made to Maushmi for purchase of the apartment. Which of the following is incorrect in this regard?*

(A) *There is a requirement to deduct tax at source before making payment to a non-resident*

(B) *Requirement to deduct tax at source would not have been if Dinesh was a non-resident himself*

(C) *Persons responsible for paying any sums to non-resident are required to furnish information related to payment of such sums in prescribed form as per Rule 37BB*

(D) *The tax is to be deducted at source at the time of credit of such income to the account of payee or at the time of payment, whichever is earlier*

5.5 *Mutual Agreement Procedure (MAP) helps dispute resolution through bilateral negotiation. Which of the following does not work towards facilitating MAP/making MAP more effective?*

(A) *Section 90/90A of the Income Tax Act, 1961*

(B) *TIEA (Tax Information Exchange Agreement)*

(C) *Article 25 of the applicable DTAA*

(D) *BEPS Action Plan 14*

Sub Part (b)-Questions other than MCQs

5.6 *What is the residential status of Maushmi for FY 21-22 from India tax perspective? Which all income would be taxable given her residential status? Compute her taxable income and tax liability for AY 22-23.* ***(8 Marks)***

5.7 *If Consult Ltd. were to file for a Mutual Agreement Procedure (MAP), would it need to file application with Competent Authority (CA) of India or CA of Country B? Explain legal provision supporting your answer. Under which situations can the access of MAP be denied to Consult Ltd?* ***(7 Marks)***

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Solution to Case Study 5

Answer to Q.5.1 to 5.5

MCQ No.	Correct Option
5.1	A
5.2	B
5.3	None of the options are correct
5.4	B
5.5	B

Answer to Q.5.6

Ms. Maushmi would be non-resident in India, since her stay in India during the previous year 2021-22 is only for 42 days, which is less than 182 days

Accordingly, income which accrues or arises in India, income which is received in India and income which is deemed to accrue or arise in India alone would be taxable in her hands in India for the P.Y.2021-22.

Computation of taxable income and tax liability for the A.Y. 2022-23

Particulars	(₹)	(₹)
Income from house property		
Rental Income from an apartment in Detroit, USA [Not taxable in India, since property is situated outside India and income accrues, arises and is received outside India].		**Nil**
Capital Gains		
Capital Gains on transfer of flat at Mumbai [Capital gains arising on transfer of flat at Mumbai would be deemed to accrue or arise in India, since such flat is situated in India. Hence, such capital gain is taxable in her hands]		
Full value of consideration [Actual sales consideration, since stamp duty value is less than actual sales consideration]	95,00,000	
Less: Brokerage	95,000	
Net Consideration	94,05,000	
Less: Indexed cost of acquisition [₹ 35 lakhs x 317/184]	60,29,891	
Long-term capital gains [since flat held for a period of more than 24 months]		33,75,109

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Capital Gains on transfer of listed equity shares [Taxable in her hands, since shares are situated in India]		
Full value of consideration	18,00,000	
Less: Cost of acquisition	18,00,000	
Higher of -		
Cost of acquisition ₹ 5,50,000 and ₹ 18,00,000, being the lower of -		
(i) FMV as on 31.1.2018 – ₹ 18.10 lakhs; and		
(ii) Sale consideration – ₹ 18 lakhs		
Long term capital gain, since shares held for more than 12 months		Nil
Income from Other Sources		
Dividend Income from Indian Company [Taxable in India, since such shares are situated in India]	21,000	
Interest in Non-resident (External) bank A/c [Exempt as per section 10(4)(ii)]	Nil	
		21,000
Gross Total Income/Total Income		**33,96,109**
Gross Total Income/Total Income (rounded off)		33,96,110

Tax liability	**(₹)**
Tax on dividend income u/s 115A@20% of ₹ 21,000	4,200
Tax on long-term capital gains under section 112 @20% of ₹ 33,75,110	6,75,022
Ms. Maushmi cannot adjust the basic exemption limit against long-term capital gains taxable u/s 112, since she is a non-resident.	
	6,79,222
Add: Health and Education cess @4%	27,169
Tax liability	**7,06,391**
Tax liability (rounded off)	7,06,390

Answer to Q.5.7

Consult Ltd. has to file for a Mutual Agreement Procedure (MAP) with the Competent Authority of India.

As per Rule 44G(1), an assessee, being a resident of India, aggrieved by any action of the tax authorities outside India, in case the action of tax authorities of any other country is not in accordance with the terms of the agreement (DTAA) with such other country or specified territory, may make an application to the Competent Authority in India seeking to invoke the

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mutual agreement procedure, if provided in such agreement.

The Competent Authority of India can deny access to MAP to Consult Ltd. in the following situations:

(1) **Delayed MAP Applications** - If Consult Ltd. makes a MAP application to the Competent Authority of India after the expiry of the time period specified in the Article relating to MAP of the relevant DTAAs, the Competent Authorities of India would not provide access to MAP.

(2) **Taxpayer's Objection Not Justified** – If the Competent Authorities of India come to a conclusion that the objection raised by Consult Ltd. on the action taken by tax authorities is not justified, they can deny access to MAP.

(3) **Incomplete MAP Applications/ Documents/ Information** – When an Indian taxpayer makes a MAP application in India in Form No. 34F, it is expected to be complete in all respects. If the Competent Authorities of India point out some errors or defects in the application or ask for additional information/documents, Consult Ltd. should remedy the errors/defects and should provide the information/documents within a reasonable time period.

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