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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 2021-22, unless otherwise stated in the questions/case studies.

Case Study 1**Triveni (P) Ltd., Bhilwara, Rajasthan**

Triveni (P) Ltd. (the 'company') is engaged in manufacture of garments. Various kinds of garments were sold to Toho Inc. of New York, USA (who has 30% voting power in Triveni (P) Ltd. and to other unrelated parties. The Company sold 3 lakh units of shirt @ USD 5 per unit to Toho Inc. Identical shirts were sold to other unrelated parties @USD 6 per unit. (Assume the rate of exchange as 1 USD = ₹ 70.). however, the terms of sales to Toho Inc. included provision of guarantee by Toho Inc. to SBI, on a loan of ₹ 25 crores availed by the Company from SBI; and providing the Company access to Toho Inc's database on market trends in Europe. The interest paid by Triveni (P) Ltd. on the SBI loan for the financial year ended March 31st 2021 (FY2020-21) amounts to ₹ 200 lakhs. Triveni (P) Ltd. paid a fee @ 1% to Toho Inc. for providing the guarantee on the loan from SBI. The market rate for availing guarantee for a similar transaction is 2%. Triveni (P) Ltd. also paid ₹ 5 lakhs to Toho Inc. towards the cost incurred in providing access to its database. If the Company had obtained similar database from an unrelated party, the cost would have been ₹ 15 lakhs.

Toho Inc. markets apparels globally under its brand name. It sells in many countries including India through e-commerce operators at a price, which is generally marked-up at 50% on its cost of purchase. During the F.Y. 2020-21, its sales in India was ₹ 20 Crores through e-commerce operator viz., Talc e-Com Ltd., United Kingdom, in which Toho Inc. has 40% voting power. Leveraging their combined knowledge and experience, Triveni (P) Ltd. and Toho Inc. provided their know-how on the supply chain of textile industry to an unrelated party viz., Trueman Inc., USA, a new company manufacturing garments from recycled plastics.

Triveni (P) Ltd. bought a plant from Marshal Pte. Ltd., Singapore, on lease for an annual payment of ₹ 100 lakhs. The plant if imported would have costed ₹ 5 crores. The DTAA between India and Singapore provides for withholding tax @ 15% on royalty paid. For the A.Y. 2021-22, the POEM of Marshal Pte. Ltd. is in India.

The EBITDA of Triveni (P) Ltd. for the AY 2021-22 amount to ₹ 440 lakhs and profit after tax (computed) is at ₹ 144.36 lakhs (tax rate 27.82%).

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, 2020.

For the AY 2018-19, the total income of Triveni (P) Ltd. was enhanced by ₹ 210 lakhs by the Assessing Officer ('AO'), in conformity with the Arm's Length Price ('ALP') determined by the Transfer Pricing Officer ('TPO'). The assessment order is dated 15.11.2020. The Company decided to accept the adjustment made in the assessment order.

Dr. Richards -Ex-director of Triveni (P) Ltd.

Dr. Richards was Director (Research and Development) of Triveni(P) Ltd. up to 31.03.2016. He authored a book on textile technology, which was published by a reputed book publishing company in India. The first edition was written in the year 2010 when he was employed at Triveni (P) Ltd., He left India and went back to his home country in April, 2016. He visits India every year for giving final touches to the revised edition of the book and stays in India for 45 days. In the FY 2020-21, he earned royalty income of ₹ 12 lakhs and incurred expenditure of ₹ 3 lakhs towards travel and stay in India. He used to retain 50 percent of the gross royalty due to him at the publisher, on which he earned interest @12 percent per annum. His interest income on the cumulative balance with the publisher for the AY 2021-22 amounts to ₹ 5 lakhs. He donated ₹ 50,000 to PM CARES Fund in August 2020.

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

- 1.1 At what rate Triveni (P) Ltd. would withhold tax on the amount paid to Marshal Pte. Ltd., Singapore?
- (A) 40%
- (B) 15%
- (C) 10%
- (D) 30%
- 1.2 What would be the most appropriate method for determination of ALP in respect of the transactions between Triveni (P) Ltd., and Toho Inc., who together undertook market research for Trueman Inc. of USA?
- (A) Comparable Uncontrolled Price method
- (B) Transaction Net Margin Method
- (C) Profit Split Method
- (D) Cost Plus method
- 1.3 How much is the total income of Triveni (P) Ltd., after ALP adjustment for the supplies made to Toho Inc and interest paid to SBI based on the guarantee provided by Toho Inc.?
- (A) ₹ 319.36 lakhs

- (B) ₹ 375 lakhs
(C) ₹ 402.5 lakhs
(D) ₹ 410 lakhs
- 1.4 For the AY 2018-19, in case Triveni (P) Ltd. is not able to repatriate the excess money form Toho Inc., what is the additional income-tax it should pay, so that there is no secondary adjustment?
- (A) 58,28,659
(B) 37,80,000
(C) 39,31,200
(D) 44,02,944
- 1.5 What is the 'due date' by which Triveni (P) Ltd. must receive the excess money consequent to ALP adjustment made in the assessment order for AY 2018-19?
- (A) 31.12.2020
(B) 28.02.2021
(C) 13.02.2021
(D) 31.03.2021

Based on the information provided, you are required to answer the following issues:

- 1.6 Compute the transfer pricing adjustments (primary and secondary) to be made to the transfer price in respect of goods supplied by Triveni (P) Ltd. to Toho Inc. for the AY 2021-22. **(5 Marks)**
- 1.7 Compute the total income and tax liability of Dr. Richards under the Income-tax Act, 1961, on the assumption that there is no DTAA between India and his home country. Determine the amount of tax deductible at source by the publisher from the royalty and interest paid/payable to Dr. Richards. Is Dr. Richards required to file his income tax return (ITR) in India? **(5 Marks)**
- 1.8 What is the tax liability to Toho Inc India on sale of goods in India through the e-commerce operator? In case Toho Inc. makes direct supply of goods by obtaining the data from Talc e-Com Ltd., United Kingdom, what would be your answer? Will your answer be different if Talc e-Com Ltd. is an Indian company located in Mumbai? Do consider the provision relating to significant economic presence of a non-resident in India in your answer. **(5 Marks)**

Solution to Case Study 1**Answer to MCQs**

Q. No.	Answer
1.1	(B)
1.2	(C)
1.3	(B)
1.4	(D)
1.5	(C)

Answer to Q.1.6

As per section 92A, Toho Inc., USA and Triveni (P) Ltd., an Indian company would be deemed to be associate enterprises, since Toho Inc., USA holds shares carrying not less than 26% (30%, in the present case) of the voting power in Triveni (P) Ltd.

As per section 92B, the transactions entered into between Triveni (P) Ltd., an Indian company, and Toho Inc., USA, being associated enterprises, for sale of shirts would be international transaction.

Triveni (P) Ltd. is also selling shirts to unrelated parties, which would be the comparable uncontrolled transaction in this case. The selling price for unrelated customers has to be adjusted by taking into consideration the functional differences existing between the transactions of Triveni (P) Ltd., with associated enterprise (Toho Inc.) and other unrelated parties.

Accordingly, the arm's length price for sales of shirts has to be computed for working out the impact on assessable value as per CUP method.

Computation of transfer pricing adjustment to be made	
Particulars	Amount (in ₹)
Selling price of shirts to unrelated parties by Triveni (P) Ltd. [3 lakhs x \$ 6 per unit x 70]	12,60,00,000
Adjustments for functional differences	
Less: Guarantee fee [Toho Inc. provided guarantee to SBI on a loan of ₹ 25 crores availed by Triveni (P) Ltd. for a fee @1% while market rate for availing guarantee for similar transaction is 2%. Therefore, guarantee fee @1% on ₹ 25 crores shall be adjusted]	25,00,000
Less: Cost for accessing the database [Triveni (P) Ltd. paid ₹ 5 lakhs to Toho Inc for providing access to its database on markets trend while similar database is available from unrelated party at a cost of ₹ 15 lakhs.	

Therefore, adjustment for cost of such database has to be carried out]	<u>10,00,000</u>
Arm's length price	12,25,00,000
Sale price of shirts to Toho Inc. (associated enterprise) [3 lakhs x \$ 5 per unit x 70]	<u>10,50,00,000</u>
Amount to be added to its total income	<u>1,75,00,000</u>

In this case, secondary adjustment has to be made under section 92CE, since –

- (1) The primary adjustment is in respect of A.Y.2021-22; and
- (2) The primary adjustment exceeds Rs 100 lakhs.

Secondary adjustment means an adjustment in the books of account of Triveni (P) Ltd. and Toho Inc., its associated enterprise, to reflect that the actual allocation of profits between Triveni (P) Ltd. and Toho Inc. are consistent with the transfer price determined as a result of primary adjustment, thereby removing the imbalance between cash account and actual profit of Triveni (P) Ltd.

If the excess money (i.e., ₹ 175 lakhs) available with Toho Inc. is not repatriated to India within 90 days from the due date of filing of return (where primary adjustment is made suo moto by Triveni (P) Ltd)/ 90 days from the date of the order of the Assessing Officer (where he makes the primary adjustment and the same is accepted by the company), the same would be deemed as an advance made by the Triveni (P) Ltd. to its associated enterprise, Toho Inc. and interest would be calculated on such advance from the due date of filing of return/date of order of the Assessing Officer, as the case may be, and added to its total income of that year.

In case, Triveni (P) Ltd. opts to pay additional income-tax @ 20.9664% (tax @18% plus surcharge @12% plus cess@4%) on ₹ 175 lakhs, it will not be required to make secondary adjustment and compute interest from the date of payment of such tax.

Answer to Q.1.7

Dr. Richards would be a non-resident in India for A.Y. 2021-22 since he has stayed in India only for 45 days during the P.Y. 2020-21.

As per section 5(1), in the case of a non-resident, income which accrues or arises or which is deemed to accrue or arise to him in India or which is received or is deemed to be received in India would be includible in his total income.

Computation of total income and tax liability of Dr. Richards for A.Y. 2021-22	
Particulars	Amount (₹)
Royalty income in respect of book on textile technology [No deduction in respect of any expenditure would be allowed as per section 115A(3)]	12,00,000
Interest income	<u>5,00,000</u>
Gross Total Income	17,00,000

Less: Deduction under section 80G PM CARES Fund	<u>50,000</u>
Total Income	<u>16,50,000</u>

Computation of tax liability:	Amount (₹)
Tax @10% on royalty on books u/s 115A ¹	1,20,000
Tax on other income of ₹ 4.50 lakhs	<u>10,000</u>
	1,30,000
Add: Health and education cess@4%	<u>5,200</u>
Tax Liability	<u>1,35,200</u>

It is not beneficial for Dr. Richards to opt for section 115BAC as in that case deduction under section 80G would not be available to him and his tax liability would be more.

Determination of tax deductible at source:

Any person responsible for paying interest or any other sum chargeable to tax (other than salaries) to a non-corporate non-resident or to a foreign company is liable to deduct tax at source at the rates prescribed by the relevant Finance Act.

The publisher is required to deduct tax at source on royalty and interest paid/payable to Dr. Richards @10% and 30%, respectively. Further, since Dr. Richards is a non-resident, health and education cess @ 4% on TDS would also be added.

So, the publisher is required to deduct tax ₹ 1,24,800 i.e., @10.4% on ₹ 12 lakhs, being the royalty income and ₹ 1,56,000 i.e., @ 31.2% on ₹ 5 lakhs, being the interest income.

Requirement for filing ITR:

Section 115A(5) provides that if the total income of the non-resident comprises of only income referred to in section 115A and tax deductible at source has been fully deducted and the rate of such deduction is not less than the rate specified therein, it shall not be necessary for him to file his return of income.

However, in this case, Dr. Richards has interest income as well. Therefore, he cannot avail the benefit of exemption from filing of return of income as contained in section 115A. Hence, he would be liable to file his return of income for A.Y.2021-22.

¹In respect of royalty on books which are on a subject which are permitted, according to the Import Trade Control Policy of the Government of India for the period commencing from the 1st day of April, 1977, and ending with the 31st day of March, 1978, to be imported into India under an Open General Licence, the condition of approval of Central Government is not applicable. Hence, the condition of approval of Central Government is not applicable for availing benefit of concessional rate of tax@10% u/s 115A on royalty income in respect of book on textile technology.

Note – In ITR-3, income chargeable to tax u/s 115A is taxable @10% without any deduction under Chapter VI-A. Accordingly, deduction under section 80G has not been availed against royalty referred to in section 115A(b) in the above solution but has been availed against interest income chargeable under the regular provisions of the Act.

Section 115A(4) of the Income-tax Act, 1961 provides that in case of a non-resident, where the gross total income includes any income i.e., dividend or interest referred to in clause (a) of section 115A, the gross total income shall be reduced by the amount of such income and the deduction under Chapter VI-A shall be allowed as if the gross total income as so reduced were the gross total income of the assessee. As per the plain reading of the Act, the section puts restriction on allowability of deductions under Chapter VI-A from dividend or interest income referred to in section 115A(a) and not from royalty or FTS referred to in section 115A(b). Hence, there is no express prohibition in section 115A of the Act regarding claiming deduction under Chapter VI-A in relation to royalty and FTS taxable thereunder.

On this basis, deduction under Chapter VI-A can be claimed in respect of royalty income chargeable to tax @10% u/s 115A. The tax liability in such case would be ₹ 1,15,000 + ₹ 12,500 = ₹ 1,27,500 plus HEC@4% ₹ 5,100 = ₹ 1,32,600.

Answer to Q.1.8

As per section 9(1)(i), business profits of a non-resident would be deemed to accrue or arise in India, if such income accrues or arises through or from any business connection in India. In such a case, such income would be taxable in the hands of the non-resident in India.

Further, as per *Explanation 1* to section 9(1)(i), in case of a business, of which all operations are not carried out in India, the income of the business which is deemed to accrue or arise in India due to business connection in India shall be only such part of the income as is reasonably attributable to the operations carried out in India.

Explanation 3A to section 9(1)(i) provides that income attributable to operations in India for establishing business connection would include income from, *inter alia*, -

- (i) sale of data collected from a person who resides in India or from a person who uses internet protocol address located in India; and
- (ii) sale of goods and services using data collected from a person who resides in India or from a person who uses internet protocol address located in India.

In this case, profits earned by Toho Inc., a foreign company, from sale of goods through Talc e-Com Ltd., UK does not arise through or from business connection in India, since Talc e-Com Ltd., UK is not a dependent agent who acts wholly and exclusively or mainly for Toho Inc.

The concept of “significant economic presence” is **not** applicable for A.Y.2021-22.

Therefore, there is no specific provision in the Income-tax Act, 1961 for bringing such income within the ambit of business connection.

Section 194-O, which is a TDS provision, would also apply only if Toho Inc., the e-commerce participant, is resident in India, which is not so in this case.

Direct supply of goods:

In case Toho Inc. makes direct supply of goods by obtaining the data from Talc e-Com Ltd., UK, profits earned by Toho Inc. from such sales does not arise through or from business connection in India, because the data is not collected from a person who resides in India or from a person who uses internet protocol address located in India. It is collected from a UK based company.

If Talc e-Com Ltd is an Indian company

If Talc e-Com Ltd. is an Indian company located in India, profits earned by Toho Inc. from sale of goods directly to customers in India making use of data obtained from Talc e-Com Ltd., an Indian company, would be deemed to accrue or arise in India and income attributable to such sales would be taxable in India since the data is collected from a person who resides in India.

CASE STUDY 2

Smart Advisors LLP is a boutique tax advisory firm. You are a Partner in the international tax consultancy division of the firm and are requested to advise on the following client issues:

Sanjeev (P) Ltd., Baroda

Sanjeev (P) Ltd., Baroda has been supplying goods to its Associate Enterprise (AE) in foreign country and the report in respect of its international transactions with AE has been furnished for all years. It has applied for Advance Pricing Agreement ('APA') in respect of the transactions with its AE. Application for APA was filed on 15th March, 2020 and the APA was signed on 2nd June, 2020. It applied for APA rollback in July, 2020 which was signed on 20th November, 2020. The details of the status of open income tax assessments are as follows:

- *Assessment Year (AY) 2014-15 – reassessment under section 148 of the Income tax Act ('Act') is pending and it is in respect of the ALP determination, which was alleged by Revenue as wrongly computed in the original assessment;*
- *AY 2015-16 – the matter is pending before High Court with regard to acquisition of a company by the assessee and the dispute is about set off of loss of the erstwhile company;*
- *AYs 2016-17 and 2017-18 – there is no dispute and the assessments have been completed;*
- *AY 2018-19 - notice u/s 143(2) of the Act was issued and the assessment is pending;*
- *AY 2019-20 - the income tax return ('ITR') was filed on 20th March, 2020; and*
- *AY 2020-21 – the ITR was filed on 20th September, 2020.*

Dexter (P) Ltd., Kanpur

Harish, the ex-CEO of Dexter (P) Ltd., was in India up to 31st March, 2014. He received secret commission from the overseas suppliers to the extent of USD 5,00,000 in a bank account outside India. Out of the said amount, he acquired an apartment in Singapore in June, 2013 for USD 3,00,000 and spent the balance amount in a destination wedding in Mauritius, for his daughter in August, 2018. Based on the documents recovered under Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 ('Black Money Act' or 'BM Act') and Income-tax Act ('IT Act') were initiated. Notice under the BM Act and IT Act was issued to Harish on 20th September, 2019. The fair market value of the Singapore apartment as on 01.04.2019 was USD 5,00,000 and as on 01.04.2020, it was USD 5,10,000.

Dexter (P) Ltd. availed certain technical services from Delta Co. Ltd. of Country 'L' for USD 1 (one) lakh. India and Country 'L' signed Multi-Lateral Instrument ('MLI') on 25.07.2020 and both submitted the instrument of ratification to OECD depository on 27th August, 2020.

Martin SPA of Belgium has 12% shareholding in Dexter (P) Ltd. Martin SPA is engaged in manufacture of glass utensils and portable power generators. It has a branch office at Kolkata for sale and service of its generators (manufactured in Germany). Martin SPA wants to do direct sale of glass utensils (manufactured in Belgium) to a large retail chain in India.

Vijay

Vijay (age 40 years) was employed as marketing manager at Dexter (P) Ltd. He resigned his job on 10th November, 2020 and joined a foreign company headquartered in Sharjah, UAE, as General Manager (Marketing) on 1st December, 2020, at a salary of USD 10,000 per month. The salary of every month is due on the 1st day of the next calendar month. There is no income tax in the country where he is employed outside India. In India, Vijay paid interest on housing loan amounting to ₹ 3,00,000; repaid housing loan principal of ₹ 6,00,000; and paid life insurance premium of ₹ 1,20,000. His income consists of (i) salary income in India ₹ 21,00,000 (computed after standard deduction) up to 10th November, 2020; and (ii) Bank fixed deposit interest ₹ 1,50,000. His family resides in the own house, for which he has paid the interest and principal mentioned above.

Ajay brother of Vijay is employed at a US branch office of a software company, which has its headquarters located in Bengaluru, India. The software company has 15 branches in various countries and all the branches are controlled from India. Ajay had never visited India during the last 10 years and came to India on 20th November, 2020 and stayed in India till 15th April, 2021. He inherited a commercial building of his parents which yielded annual income of ₹ 25 lakhs (computed). Vijay was his power of attorney holder till he left for employment outside India in November, 2020. Salary income of Ajay up to November, 2020 amounts to ₹ 36 lakhs (computed) and he worked from home when he was in India and his salary income from

December, 2020 to March, 2021 was ₹ 28 lakhs (computed).

The TT buying rates of 1 USD on various dates are as under:

1st April, 2019 to 30th November, 2020 = ₹ 70; and on 1st December, 2020 to 1st April 2021 = ₹ 71.

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

- 2.1 What is the time limit for completion of assessment in the case of Harish under the Black Money Act?
- (A) 31.03.2021
 - (B) 31.03.2022
 - (C) 31.03.2023
 - (D) 30.09.2020
- 2.2 What is the date of entry into force of MLI between India and Country 'L'?
- (A) 01.04.2021
 - (B) 01.01.2021
 - (C) 01.02.2020
 - (D) 27.11.2020
- 2.3 Which of the following is valid under the UN Model Convention in respect of Martin SPA for the income earned by it?
- (A) Both the profits earned by direct supply and through the branch are taxable by applying Force of Attraction Rule.
 - (B) Only profit of the branch is taxable. Profit from direct supply is not taxable as Force of Attraction Rule would not apply.
 - (C) Both the profits are not taxable as the company's activities are preparatory in nature and actual operations are carried outside India.
 - (D) Both the profits earned are exempt by applying Bright Line Test.
- 2.4 What is the residential status of Ajay for the AY 2021-22? Ignore relaxations given for Covid-19.
- (A) Resident and ordinarily resident
 - (B) Resident but not ordinarily resident
 - (C) Non-resident
 - (D) Deemed Resident

- 2.5 In which of the following cases, the sale of goods by Martin SPA in India would not be taxable under UN Model?
- (A) By appointing Mr. Suresh, a relative of the Promoters of Dexter(P) Ltd., as a part - time agent in India for sale of goods.
- (B) By appointing an exclusive agent (unrelated) in India, who secures order mainly for it.
- (C) By establishing a liaison office for storage and delivery of goods
- (D) By opening a liaison office just to secure and process customers' order and supplying goods directly from Belgium.

Based on the information provided, you are required to answer the following issues:

- 2.6 Discuss briefly the applicability of rollback agreement for various assessment years to Sanjeev (P) Ltd. Further, briefly state about the applicability of annual compliance audit for all the years covered by the APA signed. **(6 Marks)**
- 2.7 Decide the validity of notice issued under Black Money Act, 2015 and Income-tax Act, 1961 for taxation of undisclosed asset and income in the hands of Harish. Further, determine the tax liability, if any, under the Black Money Act and Income tax Act. **(4 Marks)**
- 2.8 Determine the residential status and compute total income of Vijay for the A.Y. 2021-22. What would be the impact if his salary payable outside India is credited directly to his bank account in Mumbai? What would be your answer in case the business outside India is owned by an Indian resident and controlled from India in both the above said situations? **(5 Marks)**

Solution to Case Study 2

Answer to MCQs 2.1 to 2.5

Q. No.	Answer
2.1	(B)
2.2	(C)
2.3	(B)
2.4	(C)
2.5	²

² None of the options are correct.

Answer to Q.2.6

Roll back year means any previous year, falling within the period not exceeding four previous years, preceding P.Y.2020-21, being the first of the five consecutive previous years specified in the APA. Since P.Y.2013-14, P.Y.2014-15 and P.Y.2015-16 fall beyond the said four year period, Sanjeev (P) Ltd. cannot avail roll back benefit in respect of those years.

It can avail roll back benefit for P.Y.2016-17 (A.Y.2017-18), in respect of which assessment has been completed and for P.Y.2017-18 (A.Y.2018-19) in respect of which assessment is pending, assuming that the return of income for these years have been filed on or before the due date u/s 139(1). These years fall within the four year period.

However, roll back benefit cannot be availed in respect of P.Y.2018-19 (A.Y.2019-20), even though it falls within the four year period, since the return was filed belatedly u/s 139(4) on 20.3.2020.

It can avail roll back benefit in respect of P.Y.2019-20 (A.Y.2020-21), since the return has been filed u/s 139(1) on 20.9.2020.

Annual Compliance Report:

The company has to furnish an annual compliance report to the DGIT (International Taxation) for each year covered in the APA, within 30 days of the due date of filing income-tax return for that year, or within 90 days of entering into an APA, whichever is later.

Compliance Audit of the agreement

The Transfer Pricing Officer has to furnish the compliance audit report within 6 months from the end of the month in which the Annual Compliance Report for each year covered in the APA is received by him.

The TPO shall carry out the compliance audit of the agreement for each of the year covered in the agreement. For this purpose the TPO may require -

- (i) the assessee to substantiate compliance with the terms of the agreement, including satisfaction of the critical assumption, correctness of the supporting data or information and consistency of the application of the transfer pricing method;
- (ii) the assessee to submit any information, or document, to establish that the terms of the agreement has been complied with;

Answer to Q.2.7

Under the Income-tax Act, 1961, as per section 153A, where a search is initiated under section 132, the Assessing Officer shall assess/reassess the total income of each of the six assessment years immediately preceding the assessment year relevant to the previous year in which search is conducted.

In this case, search is conducted in the premises of Dexter (P) Ltd. in July, 2019, wherein documents relating to secret commission received by Harish were found. Therefore, the documents have to be handed over to the Assessing Officer having jurisdiction over Mr. Harish,

who can assess/reassess total income of Mr. Harish for six assessment years prior to A.Y.2020-21, relevant to P.Y.2019-20, when search was conducted.

Thus, notice under the Income-tax Act, 1961 can be issued for assessing/reassessing total income of Mr. Harish from A.Y.2014-15 to A.Y.2019-20.³

Under the Black Money Law, the Assessing Officer can serve notice on Mr. Harish for assessing his undisclosed foreign asset (apartment in Singapore), even though he is a non-resident now, since he was resident in the P.Y.2013-14, when the foreign asset was acquired. However, he cannot serve notice to assess undisclosed foreign income (secret commission) earned up to 31.3.2014, since the Black Money Act is effective only from A.Y.2016-17 (P.Y.2015-16).

Thus, the Income-tax Act, 1961 and the Black Money Law contains enabling provisions for issue of notice under the respective Acts to assess undisclosed income and/or asset. However, there cannot be simultaneous proceedings under both laws in respect of the same income/asset.

Computation of tax liability

Under the Income-tax Act, 1961, the tax liability computed u/s 115BBE would be ₹ 2,73,00,000, being 78% of unexplained money/expenditure of ₹ 3.50 crores (USD 5 lakh x ₹ 70).

Alternatively, if the Assessing Officer proceeds under the Black Money Law, which specifically brings to tax undisclosed foreign asset, tax liability under the black money law would be 30% of US \$ 5,00,000 (value of Singapore Apartment as on 1.4.2019, since the same is higher than the cost) x ₹ 70 = 30% of ₹ 3,50,00,000 = ₹ 1,05,00,000.

Answer to Q.2.8

Mr. Vijay would be a resident for A.Y.2021-22 since his stay in India during the P.Y.2020-21 is for 224 days⁴ which exceeds 182 days, being the minimum period of stay in India required for being treated as a resident in India in case of an Individual, being an Indian citizen leaving India for the purposes of employment during the year.

Further, as per the information given in the question, he has been employed with Dexter (P) Ltd. till 10th November, 2020. He joined a foreign company in Sharjah, UAE only on 1st December, 2020. In the absence of information indicating otherwise in the question, it is apparent that prior to November, 2020, he has always been in India. Accordingly, he would satisfy the condition of being resident in India in at least 2 previous years out of 10 previous years immediately preceding P.Y.2020-21 as well as the condition of being present in India for 730 days or more during the 7 immediately preceding previous years.

Accordingly, his residential status for A.Y.2021-22 would be Resident and Ordinarily Resident and his global income would be taxable in India.

³ It may be noted that an extended time limit of 16 years is available for issue of notice under section 148 where income in relation to a foreign asset chargeable to tax has escaped assessment. The extended time limit can be invoked by the Assessing Officer, in this case, if required.

⁴even if we consider that he left India on 11th November, 2020, after resigning his job at Dexter (P) Ltd. India on 10th November, 2020

Computation of total income of Mr. Vijay for A.Y.2021-22		
Particulars	Amount (₹)	Amount (₹)
Income from Salaries		
Salary in India (before standard deduction)	21,50,000	
Salary in Sharjah, UAE		
December 2020 to March 2021 = USD 10,000 p.m. x 4 months x ₹ 71 (conversion rate)	28,40,000	
[Since Salary falls due on 1 st of next month, conversion rate of 31 st December has to be considered for the salary for the month of December which falls due on 1 st Jan; Likewise, conversion rate on 31 st Jan, 28 th Feb and 31 st March to be considered for salary of Jan, Feb and March which fall due on 1 st Feb, 1 st March and 1 st April, respectively. Therefore, the conversion rate of ₹ 71 per USD applicable from 1 st December, 2020 to 1 st April,2021 will apply for conversion of salary of all four months.		
	49,90,000	
Less: Standard deduction u/s 16(ia)	50,000	
		49,40,000
Income from house property		
Annual Value (since the property is self-occupied)	Nil	
Less: Deduction u/s 24		
Interest on housing loan ₹ 3 lakh, restricted to	(2,00,000)	
Loss from house property (set-off against salary income)		(2,00,000)
		47,40,000
Income from Other Sources		
Interest on bank fixed deposit		<u>1,50,000</u>
Gross Total Income		48,90,000
Less: Deductions under Chapter VI-A		
Under section 80C		
– Life insurance premium paid	1,20,000	
- Principal repayment of housing loan ⁵	<u>6,00,000</u>	
	7,20,000	
Restricted to		<u>1,50,000</u>
Total Income		<u>47,40,000</u>

⁵ Assumed to have been paid to bank or other approved entities

Note – It would not be beneficial for Vijay to opt for section 115BAC. This is for the reason that when he opts for section 115BAC he would not be able to avail benefit of standard deduction of ₹ 50,000 while computing income from salaries, interest deduction of ₹ 2 lakh u/s 24 while computing income from house property and deduction of ₹ 1.50 lakhs u/s 80C from gross total income.

Direct credit in bank account in India

In the case of a resident and ordinarily resident, since global income is being subjected to tax in India, salary payable outside India would be taxable in India, whether or not it is credited to his bank account in Mumbai. Hence, there would be no change in Vijay's total income on this account.

Business outside India owned by an Indian resident and controlled from India

Likewise, there would be no change in the answer if the business outside India is owned by an Indian resident and controlled from India in both the above said situations.

CASE STUDY 3

Jones Ltd., Jaipur

Jones Ltd., Jaipur is engaged in manufacture of electrical cables. 60% of its shareholding are held by Jupiter Ltd., U.K. 40% of Jupiter Ltd. is in turn held by Lewis Inc. of USA. Based on the guarantee of Lewis Inc., Bank of Abu Dhabi, UAE advanced ₹ 150 crores to Jones Ltd. For the FY 2020-21, the EBITDA of Jones Ltd. is ₹ 21 crores and interest payable on the said loan amounts to ₹ 7.4 crores.

Jones Ltd. along with Lewis Inc. is bidding for a large Government EPC contract in India. Jones Ltd. wants to obtain an advance ruling regarding the tax liability arising from the transactions with Lewis Inc.

Jones Ltd. is contemplating an agreement with Motors Corp. of South Korea. The agreement would give exclusive distribution right throughout India to Jones Ltd. for the goods manufactured and supplied by Motors Corp. Jones Ltd. would leverage on its existing sales network to sell goods supplied by Motors Corp., without any value addition or rebranding.

Jones Ltd. started online advertising of its products on the portal EV online.com, Japan, from 01.06.2020. During the FY 2020-21, Jones Ltd. paid ₹ 6 lakhs to EVOnline.Com towards online advertisements.

Jones Ltd. declared dividend in January 2021. Henry LLC, a company incorporated in Country X and a minority shareholder in Jones Ltd., is to receive dividend of ₹ 5,50,000. The protocol to the tax treaty ('DTAA') between India and Country X contains the Most Favored Nation (MFN) clause. As per the DTAA between India and Country X, the rate of tax on the dividend income in the source country is 20%. In a subsequent DTAA between India and Country Y, the rate of tax on dividend is provided at @10%.

Mr. Mahesh, an expat on deputation to Jones Ltd.

Jones Ltd. has obtained technology to manufacture cables for the defense industry from Sun LLC of United States and acquired machineries for manufacture from Randall Pte. Ltd., Singapore ('Randall'). The agreement with Randall envisaged that it would depute its staff for any difficulty in operation / production encountered by Jones Ltd. Jones Ltd. could not get output as per its standard of quality specifications and therefore sought technical assistance from Randall, who deputed Mr. Mahesh (VP-Operations) to provide the necessary expertise in operating the machineries.

Mahesh came to India on 30th November, 2020 and immediately got to work at the factory of Jones Ltd. from 1st December, 2020. As per agreement, the salary of Mahesh during his stay in India has to be borne by Jones Ltd. Mahesh's salary is USD 10,000 per month and is to be paid on the first day of next calendar month. The salary has to be credited directly to his bank account held outside India.

The TT buying rates of 1 USD in Indian Rupee are given below:

30.11.2020 = ₹ 69	31.12.2020 = ₹ 70
31.01.2021 = ₹ 71	28.02.2021 = ₹ 72
31.03.2021 = ₹ 73	30.04.2021 = ₹ 74

Ravinder, MD, Jones Ltd.

Jones Ltd. is associated enterprise of Moon Ltd. of Country 'Z'. Ravinder, a person of Indian origin and citizen of Country 'Z', is employed at Moon Ltd. As his parents living in India are getting old and unwell, Ravinder wished to come and stay in India with them. As Ravinder was a high performing employee of the international group, he was appointed as Managing Director of Jones Ltd. in the year 2018 for a period of 3 years (to end by 30.06.2021). During this period, he resides with his parents in India and regularly visits Country Z, where his family (wife and kids) continue to reside. His salary income from Jones Ltd. for the FY 2020-21 is ₹ 48 lakhs. Ravinder owns house property both in India and Country 'Z', both of which are self-occupied by him and his family. Ravinder has a passion towards farming and has income from an organic farm owned by him in Country 'Z'. He plans to retire in 5 years and do farming. As per domestic law of India and Country 'Z', the residential status of Ravinder is resident in the respective countries.

Choose the correct alternative for the following MCQs:

(2 x 5 =10 Marks)

3.1 How much of interest paid to Bank of Abu Dhabi based on the guarantee provided by Lewis Ins., is liable for disallowance under section 94B?

- (A) ₹ 7.40 crores
- (B) Nil as interest is not paid to AE
- (C) ₹ 1.10 crores

- (D) Nil, as the loan provided cannot be deemed to be issued by an AE
- 3.2 What would you call when the dividend declared by Jones Ltd. is taxable both in India and in the foreign State of which Henry LLC is a resident (i.e., Country X)?
- (A) Economic double taxation
(B) Juridical double taxation
(C) Non-exclusive single taxation
(D) Mutual double taxation
- 3.3 At what rate Henry LLC, by virtue of MFN clause, is liable to pay tax on the dividend received from Jones Ltd.?
- (A) 20%
(B) 10%
(C) At the regular rate applicable to foreign companies
(D) 10% plus applicable surcharge and education cess
- 3.4 The AAR ruling on the application of Jones Ltd. in respect of the transactions with Lewis Inc., may be binding on which of the following?
- (i) Applicant i.e., Jones Ltd.;
(ii) Lewis Inc., USA;
(iii) Transaction in respect of which it is sought;
(iv) PCIT or CIT in respect of said transaction;
(v) The Appellate Tribunal for forming an opinion.
- The options are as under:
- (A) (i),(ii),(iii) and (iv)
(B) (i),(iii),(iv) and (v)
(C) (i),(iii) and (iv)
(D) (i),(ii),(iv) and (v)
- 3.5 Assuming Motors Corp is deemed to be an AE of Jones Ltd., which would be the most appropriate method for determination of ALP in respect of goods purchased from Motors Corp Ltd. for distribution in India?
- (A) Cost Plus method
(B) Resale Price Method
(C) Profit Split method
(D) Comparable Uncontrolled Price Method

You are required to answer the following issues:

- 3.6 Analyse the chargeability and determine the quantum of tax deductible at source on salary payment made to Mahesh. Assume, the salary is paid by Randall outside India by direct credit to his bank account in Singapore and later adjusted between Jones Ltd. and Randall in their business transactions. Would such arrangement have any tax consequences for Mahesh? (Assume the relevant article of India-Singapore DTAA is based on the UN Model Convention) **(5 Marks)**
- 3.7 Discuss briefly the provisions relating to determination of the residential status of Ravinder. Assume the DTAA between India and Country 'Z' provides for tie-breaker rule. Will your answer be different if Ravinder's appointment in India is not with specific timelines, and his wife has shifted to India and the organic farm is in Malaysia? **(5 Marks)**
- 3.8 Determine whether Jones Ltd. is liable for equalization levy for the payments made to EVOnline.com. Will your answer be different, if EVOnline.com has a branch office in Bengaluru for its India business? What are the tax implications in India on the payment for online advertisement made by Moon Ltd., U.K to EVOnline.com, Japan? **(5 Marks)**

Solution to Case Study 3

Answer to MCQs 3.1 to 3.5

Q. No.	Answer
3.1	(D)
3.2	(B)
3.3	(B)
3.4	(C)
3.5	(B)

Answer to Q.3.6

Determination of residential status and taxability of salary income earned in India

Mahesh would be a non-resident in India for the previous year 2020-21, since he does not stay in India for 182 days or more during the previous year 2020-21 or for 60 days during the previous year 2020-21 and 365 days or more in four years preceding the previous year 2020-21. In the case of a non-resident, income *inter alia* deemed to accrue or arise in India, would only be taxable in India.

As per section 9(1)(ii), income, which falls under the head "Salaries", would be deemed to accrue or arise in India, if it is earned in India. Salary payable for service rendered in India would be treated as earned in India.

In the present case, salary received by Mahesh would be deemed to accrue or arise in India since it is earned in India as it is payable for services rendered in India. Thus, such income would be taxable in the hands of Mahesh in India as per Income-tax Act, 1961, even if it is credited directly to his bank account held outside India.

Determination of quantum of tax deductible at source on salary income

The employer has to deduct tax at source under section 192(6) which deals with the provisions of deduction of tax in case of salary payable in foreign currency. The amount of tax to be deducted is to be calculated after converting the salary payable into Indian currency at the TT buying rate as adopted by SBI as on the date on which tax is required to be deducted at source under Chapter XVIIIB by the person responsible for paying such income.

Month	Salary is due on	USD	Exchange rate INR	Amount in ₹
Dec.2020	01.01.2021	10,000	70	7,00,000
Jan.2021	01.02.2021	10,000	71	7,10,000
Feb.2021	01.03.2021	10,000	72	7,20,000
Mar.2021	01.04.2021	10,000	73	<u>7,30,000</u>
Total Salary				<u>28,60,000</u>
Tax on the above U/s.115BAC (since it is more beneficial to Mahesh, assuming he has intimated to the employer of his intention to opt for section 115BAC)				5,95,500
Add: HEC @ 4%				<u>23,820</u>
Total tax deductible by Jones Ltd				<u>6,19,320</u>

Impact in the hands of Mahesh because of adjustment in business transactions between Jones Ltd and Randall

Even in case salary is paid by Randall outside India by direct credit to his bank account in Singapore, and later adjusted between Jones Ltd. and Randall in their business transactions, the taxability of salary received by Mahesh would remain same.

Note : The topic "Overview of Model Tax Conventions" is included in the syllabus of this paper. The Study Material, accordingly, discusses only select significant articles of the OECD and UN Model Tax Conventions. Article 15: Dependent Personal Services is not included in the Study Material. Nor is an extract of the said article given in the question paper. Accordingly, the above solution is based only on the basis of the provisions of Income-tax Act, 1961, in which case tax would be deductible at source under section 192 in respect of salary payment to Mahesh.

Answer to Q.3.7

As per the domestic tax laws of India and Country “Z”, Ravinder is resident of India as well as of Country “Z”. Hence, the tie-breaker rule provided in India-Country “Z” DTAA has to be applied to determine the residential status of Ravinder.

Tie-breaker rule provides that where an individual is a resident of both the countries, he shall be deemed to be resident of that country in which he has a permanent home; and if he has a permanent home in both the countries, he will be considered to be resident of that country, where his centre of his vital interests lie i.e., the country with which he has closer personal and economic relations.

Ravinder owns house property both in India and Country Z, and both of which are self-occupied by him and his family, he has a permanent home in both the countries. Since he has a permanent home both in India and Country “Z”, the next test is to analyse the country with which he has closer personal and economic relations.

Ravinder is in employment with Moon Ltd. of Country Z and only for a period of 3 years, he is appointed as managing director of Jones Ltd., India. His family (wife and kids) is residing in Country Z. He earns income from an organic farm which he owns in Country Z. Moreover, he also has interest in farming, and he is planning to do farming after retirement.

From these facts, it is evident that Ravinder has personal and economic relations closer to Country Z. Since his centre of vital interest lies in Country Z, he will be considered as resident of Country Z.

In such a case, the fact that he is a resident of India to be taxed in terms of sections 4 and 5 of the Income-tax Act, 1961 would become irrelevant, since the DTAA prevails over sections 4 and 5.

In case if his appointment in India is not with specific timelines and his wife has shifted to India and the organic farm is in Malaysia, his personal and economic relation or centre of vital interest would lie in India, since he has his family and occupation is in India. In such a case, he would be considered as resident in India.

Answer to Q. 3.8

Equalization levy @ 6% is attracted on the amount of consideration for “specified services” received or receivable by a non-resident not having PE in India from a resident in India who carries on business or profession; or from a non-resident having PE in India.

“Specified services” include online advertisement and any provision for digital advertising space or any other facility or service for the purpose of online advertisement.

In the present case, Jones Ltd. is required to deduct equalization levy @6% on ₹ 6,00,000 paid towards online advertisement of its product on the portal of EVOnline.com.

However, in case EVOnline.com has a branch office in Bengaluru for its India business, Jones Ltd. is not required to deduct equalization levy, since such levy is attracted only where such payment is made to a non-resident not having a permanent establishment in India.

However, such payment is liable for deduction of tax at source under Chapter XVII-B of the Income-tax Act, 1961.

In respect of payment for online advertisement made by Moon Ltd., UK to EVOnline.com, no equalization levy u/s 165 would be attracted, if Moon Ltd., UK, a non-resident company, does not have a PE in India.

However, if Moon Ltd., UK, has a PE in India, then, it would also be liable to deduct equalization levy @6% on the payment for online advertisement services to EVOnline.com, Japan.

CASE STUDY 4

Emsun Ltd.

Emsun Ltd. engaged in manufacture of semi-finished goods and exporting the same to its parent company Apollo Inc. of Australia. It also completes the full process of manufacturing and exports the finished goods in its brand name to European countries. The tax assessment of Emsun Ltd. for assessment year 2019-20 is pending as at 31.03.2021, as the Assessing Officer made reference to Transfer Pricing Officer (TPO) in September, 2020.

For the year ended 31.03.2021, the net income of Emsun Ltd. is computed by the assessee at ₹ 500 lakhs after adjusting for the following:

- (i) Depreciation of ₹ 260 lakhs;*
- (ii) Interest on moneys borrowed is ₹ 850 lakhs. The interest includes ₹ 600 lakhs paid to parent company Apollo Inc. The assessee while determining the ALP in respect of interest on loan from parent company, suo moto, added back ₹ 105 lakhs to its total income;*
- (iii) amortization of preliminary expenses under section 35D of ₹ 60 lakhs (on the capital employed of ₹ 50 cores).*

Emsun Ltd. bought shares for ₹ 30 crores from a Foreign Institutional Investor (FII). All the shares are listed in recognized stock exchanges in India. The purchase of shares resulted in long-term capital gain of ₹ 2 crores (computed) and short-term capital gain of ₹ 5 crores (computed) to the FII.

Emsun Ltd. carried out certain transactions with its parent company Apollo Inc. during the FY 2020-21 which the Assessing Officer considers necessary to declare as impermissible arrangement lacking commercial substance. He made reference to the Commissioner and it was

subsequently referred to Approving Panel on 23.09.2020 and the reference was received by the Approving Panel on 03.10.2020.

Mr. Rajesh, NRI, living in Singapore

Apollo Inc. Australia besides investment in Emsun Ltd. is engaged in manufacture of toys and dolls. Apollo Inc. solicited the services of Mr. Rajesh a NRI presently living in Singapore. Rajesh visited India every year during Durga Pooja to Diwali (say from September to November) and secured orders from Indian buyers for supply of toys and dolls by Apollo Inc.

The functional responsibility of Mr. Rajesh included timely dispatch of goods by Apollo Inc., and safe receipt of delivery by Indian customers and remittance of amounts by Indian customers to Apollo Inc. Apollo Inc. decides the itinerary of Mr. Rajesh as regards date, time and place to be visited by him. He usually stayed for more than 120 days during every previous year. For the previous year 2020-21, Rajesh was paid ₹ 15 lakhs (equivalent in US dollars) as commission by Apollo Inc. by crediting directly his bank account in Singapore. The total amount of purchases made by Indian customers from Apollo Inc. by placing orders through Rajesh amounted to ₹ 300 lakhs. The normal profit that would have been earned by Apollo Inc. is @ 10% on sale price.

Mr. Anand (age 40 years), brother of Mr. Rajesh, is a non-resident Indian based out of UK. He left India for the first time on 10.04.2012 for employment outside India. Wife of Mr. Anand is a physician (doctor) running a hospital as a partnership firm along with group of doctors in UK. She visited India on behalf of the firm to treat the patients in various hospitals in India and stayed for 180 days during the previous year 2020-21. The income arising from her services were paid to the bank account of the firm in UK.

Mr. Anand gives you the following information for the year ended 31.03.2021:

- (i) Dividend from foreign companies credited to his bank account in India is ₹ 3,61,000.
- (ii) Anand sold shares of Ellora Pharma Ltd. (Listed) which were subscribed in convertible foreign exchange. Cost of acquisition on 30.04.2015 was ₹ 4 lakhs and sold on 11.08.2020 for ₹ 7 lakhs. STT @0.1% paid on acquisition and sale of shares.

Bonus shares were issued by Ellora Pharma Ltd. in December 2017, which were also sold in October 2020 for ₹ 3,50,000.

The fair market value of Ellora pharma Ltd. as on 31.01.2018 was ₹ 5,40,000 for original shares and ₹ 2,10,000 for bonus shares.

- (iii) Anand had acquired 100 shares in an unlisted company on 10.07.2010 for ₹ 1,67,000. These shares were sold on 25.02.2021 for ₹ 6,40,000.
- (iv) He made investment of ₹ 6,00,000 by way of deposit in an Indian company on 05.03.2021.
- (v) He paid ₹ 40,000 towards health insurance premium of his father being a senior citizen and non-resident Indian.

The Cost Inflation Index is as follows: F.Y. 2010-11:167; F.Y 2015-16 : 254, FY 2020-21:301

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

- 4.1 What would be the most appropriate method applicable for determination of ALP for Emsun Ltd. for manufacturing and supplying semi-finished goods to Apollo Inc.?
- (A) Cost Plus Method
 - (B) Profit Split Method
 - (C) Resale Price Method
 - (D) Comparable Uncontrolled Price Method
- 4.2 If the payment made by Apollo Inc. to Mr. Rajesh is not covered by any of the specific clauses of UN Model of convention, in which country the commission income would be taxed? (Ignore DTAA between India and Singapore)
- (A) In the State of residence i.e. Singapore
 - (B) In the State of source i.e. India.
 - (C) In both the countries
 - (D) In neither countries. It is tax-free
- 4.3 How much Emsun Ltd. should deduct tax at source out of the payments made to FII for the purchase of listed shares?
- (A) ₹ 98.80 Lakhs
 - (B) ₹ 72.80 lakhs
 - (C) ₹ 180.336 lakhs
 - (D) NIL
- 4.4 When wife of Mr. Anand came to India and rendered services on behalf of the partnership firm running a hospital in UK, the income so earned is covered by which article of the tax treaty as per UN Model?
- (A) Business profit - Article 7
 - (B) Fees for technical services - Article 12A
 - (C) Independent personal services - Article 14.
 - (D) Dependent personal services - Article 15

4.5 What is the time limit within which the Approving Panel must give direction to the Commissioner as regards invoking or otherwise of GAAR provisions in the assessment of Emsun Ltd.?

- (A) 30.04.2021
 (B) 31.03.2021
 (C) 28.02.2021
 (D) 31.03.2022

You are required to answer the following issues:

4.6 Compute the amount of interest liable for disallowance for the AY 2021-22 and time limit for repatriation of excess interest by Apollo Inc. Also, state the impact of secondary adjustment in the hands of Emsun Ltd. as regards interest deduction and carry forward to future assessment years. **(4 Marks)**

4.7 Is the commission income of Mr. Rajesh, chargeable to income-tax in India? Can the Assessing Officer issue notice for taxing the income earned in India by Apollo Inc., from selling goods in India? **(5 Marks)**

4.8 Compute the total income and tax liability of Mr. Anand for the AY 2021-22 with brief reasons for treatment of each item. **(6 Marks)**

Solution to Case Study 4

Answer to MCQs 4.1 to 4.5

Q. No.	Answer
4.1	(A)
4.2	(C)
4.3	(D)
4.4	(C)
4.5	(A)

Answer to Q.4.6

Computation of Excess interest to be disallowed u/s 94B		
Particulars	₹ in lakhs	₹ in lakhs
Computation of EBITDA		
Net income		500
Add: Depreciation	260	
Interest	850	

Amortisation of preliminary expenses	<u>60</u>	1170
EBITDA		<u>1670</u>
30% of EBITDA = 30% of ₹ 1670 lakhs		501
<u>Disallowance u/s 94B</u>		
Lower of -		
- Interest paid to Apollo Inc., a non-resident AE	600	
- Interest paid to Apollo Inc. ₹ 600 lakhs		
Less: 30% of EBITDA ₹ 501 lakhs		
	99	
Therefore, disallowance u/s 94B would be		99
However, since arm's length adjustment has been made by the assessee <i>suo moto</i> for ₹ 105 lakhs, which is higher than ₹ 99 lakhs, no adjustment is required u/s 94B.		

Note - On a plain reading of provisions of section 94B(2), it appears that the "excess amount" has to be computed by taking—

- total interest paid or payable by the borrower in excess of 30% of earnings before interest, taxes, depreciation and amortization (EBITDA) of the borrower in the previous year or
 - interest paid or payable to associated enterprises for that previous year,
- whichever is less.

Accordingly, the alternative computation on the basis of plain reading of section 94B(2) is given below.

<u>Disallowance u/s 94B</u>	₹ in lakhs	₹ in lakhs
Lower of -		
- Interest paid to Apollo Inc., a non-resident AE	600	
- Total Interest on money borrowed ₹ 850 lakhs		
Less: 30% of EBITDA ₹ 501 lakhs		
	<u>349</u>	
Lower of the above		349
Less: Arm's length adjustment made <i>suo moto</i>		<u>105</u>
<u>Disallowance u/s 94B</u>		<u>244</u>

Such excess interest of ₹ 244 lakhs can be carried forward for 8 assessment years and claimed as deduction against business income to the extent of maximum allowable interest expenditure (30% of EBITDA).

If it is assumed that adjustment of Rs.105 lakhs has already been made while computing income, then the solution would be worked out as follows based on both the views mentioned above -

Computation of excess interest to be disallowed under section 94B				
Particulars	Considering interest paid to NR AE		Considering total interest	
	₹ In lakhs	₹ in lakhs	₹ in lakhs	₹ in lakhs
Net Income		500.00		500.00
Add: Depreciation	260.00		260.00	
Interest (₹ 850 lakhs less ₹ 105 lakhs, assuming that the adjustment of the said amount has already been made while computing income)	745.00		745.00	
Amortisation of preliminary expenses	<u>60.00</u>		<u>60.00</u>	
		<u>1065.00</u>		<u>1065.00</u>
EBITDA		<u>1565.00</u>		<u>1565.00</u>
30% of EBITDA = 30% of ₹ 1565 lakhs		469.50		469.50
Disallowance under section 94B				
Lower of -				
Interest paid to Apollo Inc., a non-resident AE		600.00		600.00
Interest paid to Apollo Inc./Total interest paid	600.00		850.00	
Less: 30% of EBITDA	<u>469.50</u>	130.50	<u>469.50</u>	380.50
Lower of the above		130.50		380.50
Less: Arm's length adjustment made <i>suo moto</i> by the assessee		<u>105.00</u>		<u>105.00</u>
Disallowance of excess interest u/s 94B		<u>25.50</u>		<u>275.50</u>

Such excess interest of ₹ 25.50 lakhs/₹ 275.50 lakhs can be carried forward for 8 assessment years and claimed as deduction against business income to the extent of maximum allowable interest expenditure (30% of EBITDA).

Secondary adjustment to be made by Emsun Ltd.

The excess money on account of primary adjustment (ALP) i.e., ₹ 105 lakhs has to be repatriated by Apollo Inc. on or before 28th February, 2022 (i.e., 90 days from the due date of filing of return 30.11.2021).

If it is not so repatriated on or before 28th February, 2022, then, interest would be chargeable on ₹ 105 lakhs from 30.11.2021 @ SBI lending rate as on 1.4.2021 + 3.25%, where the international transaction is denominated in Indian rupees and @ LIBOR as on 30.9.2021 + 3%, where the international transaction is denominated in foreign currency.

Alternatively, in lieu of repatriation, Emsun Ltd. can pay additional income-tax of ₹ 22.01472 lakhs i.e., 20.9664% on ₹ 105 lakhs, in which case, Emsun Ltd. need not make secondary adjustment and repatriate the excess money.

Answer to Q. 4.7

In this case, the agent, Rajesh comes and stays in India to secure orders from Indian buyers. Hence, the services are rendered in India and accordingly, the source of income is in India. Therefore, since the source of income is in India, commission is taxable in the hands of Mr. Rajesh, though the same is not received in India but has been directly credited to his bank account in Singapore.

As regards the second part of the question, business connection is required to be established for taxing the income earned in India by Apollo Inc. from selling goods in India.

Explanation 2 to section 9(1)(i) says that business connection shall include activity carried out through a person acting on behalf of non-resident, when a person habitually procures orders in India, mainly or wholly for the non-resident. In this case agent Mr. Rajesh habitually secures orders in India wholly for Apollo Inc. Therefore, Mr. Rajesh is not an independent agent.

Accordingly, the profit of ₹ 30 lakhs (10% of ₹ 300 lakhs) attributable to operations in India is deemed to accrue or arise in India u/s 9(1)(i) and would be chargeable to tax in India in the hands of Apollo Inc. Therefore, the Assessing Officer can issue notice for taxing the income of ₹ 30 lakhs earned by Apollo Inc., from selling goods in India.

Answer to Q.4.8

Mr. Anand left India for the first time on 10.4.2012 and settled in UK. Since he was not present in India at any time during the P.Y.2020-21, he would be a non-resident in India for A.Y.2021-22. He, being a non-resident, is chargeable to tax in respect of income received or deemed to be received in India and income which accrues or arises or is deemed to accrue or arise to him in India.

Long-term capital gains from shares in an Indian company (an asset situated in India) is deemed to accrue or arise in India. Dividend from foreign company is taxable in India since the same is credited to his bank account in India. Since he is a non-resident Indian, he is eligible to declare income under Chapter XII-A.

Computation of total income and tax liability of Mr. Anand for A.Y.2021-22 under Chapter XII-A

Particulars	Amount (₹)	
Long-term capital gains (from foreign exchange asset)⁶		
Original Shares (Listed shares of Ellora Pharma Ltd. subscribed in convertible foreign exchange)		
Sale consideration	7,00,000	
Less: Cost of acquisition	<u>5,40,000</u>	1,60,000
Higher of -		
(i) Actual cost	₹ 4,00,000	
(ii) Lower of -	₹ 5,40,000	
FMV as on 31.1.2018	₹ 5,40,000	
Sale consideration	₹ 7,00,000	
Bonus Shares (Listed shares of Ellora Pharma Ltd.)		
Sale consideration	3,50,000	
Less: Cost of acquisition	<u>2,10,000</u>	
Higher of -		
(i) Actual cost	Nil	
(ii) Lower of	₹ 2,10,000	
FMV as on 31.1.2018	₹ 2,10,000	
Sale consideration	₹ 3,50,000	
		<u>1,40,000</u>
		3,00,000
Less: Deduction under section 115F		
Deposit in an Indian company ⁷		
[Benefit can be availed only in respect of long-term capital gain on sale of bonus shares ⁸ , in respect of which the six month period has not expired on the date of deposit. Since the deposit exceeds the sale consideration of bonus shares, deduction would be available for the entire capital gains of ₹ 1,40,000 from sale of bonus shares]		<u>1,40,000</u>
		<u>1,60,000</u>

⁶ Since the conversion rates are not mentioned in the question, the calculation has been made in Indian rupees, based on figures given in the question.

⁷ Assuming that it is not a private company.

⁸ It is a foreign exchange asset [CIT v. Sham L Chellaram (2015) 373 ITR 292]

Unlisted shares⁹(not a foreign exchange asset)		
Sale Consideration	6,40,000	
Less: Indexed Cost of acquisition [₹ 1,67,000 x 301/167]	<u>3,01,000</u>	
		<u>3,39,000</u>
Long-term capital gains		4,99,000
Income from Other Sources		
Dividend from foreign companies credited to his bank account in India		3,61,000
Gross Total Income		8,60,000
Less: Deduction under Chapter VI-A		
Deduction under section 80D in respect of Medclaim premium of his father to the extent of ₹ 25,000 (as his father is a non-resident) is not allowable since all income of Mr. Anand are chargeable to tax at special rates contained in Chapter XII-A, section 115A and section 112; and deduction under Chapter VI-A is not permissible while computing income under these provisions.		Nil
Total Income		8,60,000
Computation of tax liability		
Tax on LTCG on FEA i.e., ₹ 1,60,000@10% u/s 115E		16,000
Tax on LTCG on unlisted shares i.e., @10% u/s 112 on ₹ 4,73,000 i.e., capital gain computed without indexation benefit (₹ 6,40,000 – ₹ 1,67,000)		47,300
Tax on dividend income of ₹ 3,61,000@20% u/s 115A		<u>72,200</u>
		1,35,500
Add: Health & Education Cess@4%		<u>5,420</u>
Tax liability		1,40,920

Computation of total income and tax liability of Mr. Anand for A.Y.2021-22 under regular provisions of the Act

Particulars	Amount (₹)	
Long-term capital gains		
Original Shares (Listed shares of Ellora Pharma Ltd.)		
Sale consideration	7,00,000	
Less: Cost of acquisition	<u>5,40,000</u>	
Higher of -		
(i) Actual cost	₹ 4,00,000	

⁹ Assumed to be of an Indian company

(ii) Lower of -	₹ 5,40,000	
FMV as on 31.1.2018	₹ 5,40,000	
Sale consideration	₹ 7,00,000	
		1,60,000
Bonus Shares (Listed shares of Ellora Pharma Ltd.)		
Sale consideration		3,50,000
Less: Cost of acquisition		<u>2,10,000</u>
Higher of -		
(i) Actual cost	Nil	
(ii) ₹ 2,10,000, being lower of	₹ 2,10,000	
FMV as on 31.1.2018	₹ 2,10,000	
Sale consideration	₹ 3,50,000	
		<u>1,40,000</u>
		3,00,000
Unlisted shares		
Sale Consideration		6,40,000
Less: Indexed cost of acquisition [₹ 1,67,000 x 301/167]		<u>3,01,000</u>
		<u>3,39,000</u>
		6,39,000
Long-term capital gains		
Income from Other Sources		
Dividend from foreign companies credited to his bank account in India		<u>3,61,000</u>
		10,00,000
Gross Total Income/Total Income		
Less: Deduction under Chapter VI-A		
Deduction under section 80D in respect of Mediclaim premium of his father to the extent of ₹ 25,000 (as his father is a non-resident) is not allowable since all income of Mr. Anand are chargeable to tax at special rates contained in section 112A, section 115A and section 112; and deduction under Chapter VI-A is not permissible while computing income under these provisions.		<u>Nil</u>
		10,00,000
Total Income		
Computation of tax liability		
Tax on LTCG of ₹ 3,00,000 i.e., @10% on ₹ 2,00,000 u/s 112A		20,000

Tax on LTCG on unlisted shares i.e., @10% u/s 112 on ₹ 4,73,000 i.e., capital gain computed without indexation benefit (₹ 6,40,000 – ₹ 1,67,000)	47,300
Tax on dividend income of ₹ 3,61,000@20% u/s 115A	<u>72,200</u>
	1,39,500
Add: Health & Education Cess@4%	<u>5,580</u>
Tax liability	<u>1,45,080</u>
Since the tax computed under Chapter XII-A is lower than the tax computed under the regular provisions of the Income-tax Act, 1961, Mr. Anand should opt for the special provisions under Chapter XII-A. His tax liability would be ₹ 1,40,920.	

CASE STUDY 5

Silver Ltd., Kolkata

Silver Ltd. is a constituent of Bradman Ltd. of UK. Silver Ltd. is engaged in manufacture of perfumes with the brand "Gold Silver". It contested the tax assessment of the AY 2018-19. The disputes relate to certain clauses of DTAA between India and foreign country which resulted in enhancement of income and consequent tax liability. The tax head of Group consulted a legal counsel in UK viz., Mr. Simon for advice. Mr. Simon cited some UK court decisions for interpretation of DTAA and which could be used to benefit of the assessee in appeal. He also opined that any term not defined in the Indian tax law but defined subsequently could be used for interpreting the DTAA and that would benefit the assessee.

Silver Ltd. paid ₹ 3.50 lakhs for online digital advertisement space to Diggy Corp of Malaysia in the FY 2020-21. Diggy Corp has no permanent establishment in India. A further sum of ₹ 2.30 lakhs is payable for the year to Diggy Corp for the digital advertisement space used by Silver Ltd.

Silver Ltd. entered into a contractual agreement with VK Ltd. Of Country 'M' for availing project installation services in India. The term of the contract would span more than 12 months. To avoid constituting a PE in India, VK Ltd. resorted to splitting the contract into 3 contracts of shorter of shorter duration. Further, VK Ltd. wants to route the contract through its subsidiary in Country N. The DTAA between India and Country N provides a period of 12 months for an installation project to constitute a PE. Since Country N has a low tax rate, VK Ltd. wants to assume key risks in its subsidiary there, so that significant residual profits are allocated to Country N.

Silver Ltd. had to pay royalty to Jasmine GmbH of Germany for using the brand name owned by the foreign company. As per agreement, the India tax liability on royalty payable to Jasmine GmbH had to be borne by Silver Ltd., The DTAA between India and Germany provides for withholding tax@10%. Silver Ltd., however, had deducted tax @20% on the royalty of ₹ 400 lakhs payable to Jasmine GmbH.

Alfred (P) Ltd., Cochin is subsidiary of Silver Ltd. It is engaged in the activity of manufacture and sale of electronic components to Sumitzu Corp. of Japan. It expects some interpretational disputes in certain articles of the DTAA between India and Japan.

Narain, CEO of Silver Ltd.

Narain (Age 50 years) is the CEO of Silver Ltd. since 01.04.2016. His income in India consists of salary (before standard deduction) of ₹ 23 lakhs; loss from self-occupied property ₹ 3 lakhs and interest on bank deposits ₹ 1,60,000. He was outside India in Country 'P' from 01.04.2004 to 31.03.2015 and has the following incomes for the year ended 31st March, 2021. (i) Income from business in Country P = USD 25,000; (ii) Dividend from shares held in Country 'P' where dividend was declared and paid in March, 2021 = USD 10,000; (iii) Capital gain of USD 5,000 on sale of shares of companies registered in Country 'P' and sale proceeds were credited in bank account outside India on 28.03.2021.

India has DTAA with Country 'P' and the tax paid in Country 'P' is eligible for tax credit in India. The fiscal year for income-tax is the same both in India and Country 'P'. Rate of tax is 20% in Country 'P' in respect of all incomes. Income-tax was paid by Narain on 25.05.2021 for the incomes of the year ended 31st March, 2021.

Ravi and Prem are brothers of Narain. Ravi is a US citizen but resident in India for the AY 2021-22. Prem is also a foreign national and non-resident for the AY 2021-22.

Lotus Inc., USA

Lotus Inc. of USA is one of the constituents of Bradman Ltd. of UK.

Lotus Inc. USA has 55 lakh equity shares in Rose Inc. Canada which has PE in India. Lotus Inc. sold 11 lakh equity shares in Rose Inc. to Jasmine Pte. Ltd. of Singapore for USD 22 lakh on 25th November, 2020. The entire shareholding in Rose Inc. was acquired by Lotus Inc. in one instalment for USD 50 lakhs on 25.04.2011.

The details of assets and liabilities of Rose Inc. are as under:

	Canada		India	
	31.03.2021 ¹⁰	31.10.2021 ¹¹	31.03.2021 ¹²	31.10.2021 ¹³
	₹ in crores			
Fair market value of assets	4.00	8.00	20.00	24.00
Book value of assets	3.00	7.00	18.00	22.00
Liabilities	3.00	4.00	10.00	15.00

¹⁰ To be read as 31.3.2020

¹¹ To be read as 25.11.2020

¹² To be read as 31.3.2020

¹³ To be read as 25.11.2020

Note:

The TT buying rate of 1 USD on various dates: 25.04.2011 = ₹ 60; 31.03.2020 = ₹ 70; 31.10.2020 = ₹ 71; 25.11.2020 = ₹ 72; 28.02.2021 = ₹ 70; 28.03.2021 = ₹ 70.50; 31.03.2021 = ₹ 71; 30.04.2021 = ₹ 72; and 25.05.2021 = ₹ 73.

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

- 5.1 Can Silver Ltd. claim refund of tax excessively deducted by it on royalty paid to Jasmine GmbH?
- (A) No. Silver Ltd. cannot claim refund therefore the amount eligible for refund does not arise.
- (B) Jasmine GmbH can only claim refund of excess 10% deducted being ₹ 47.47 lakhs.
- (C) Jasmine GmbH cannot claim refund as the tax deducted is far less than 40% payable on its income in the capacity of foreign company.
- (D) Yes, Silver Ltd. can claim refund.
- 5.2 Which of the following would help Alfred (P) Ltd. in resolving the interpretational disputes in certain articles of the DTAA between India and Japan?
- (A) Dispute Resolution Panel
- (B) Mutual Agreement Procedure
- (C) Multi-Lateral Instrument
- (D) Advance Pricing Agreement
- 5.3 Which of the BEPS Action Plan ('AP') is intended to curb the approaches being adopted by VK Ltd. to reduce the tax liability in India?
- (A) AP-5, AP-6, AP-7, and AP-8-10.
- (B) AP-5, AP-6, and AP-7
- (C) AP-2, AP-3, AP-5 and AP-6.
- (D) AP-3, AP-5, AP-6 and AP-7.
- 5.4 Assuming Narain, Ravi and Prem have similar and equal source of some income in India, which of the following statement is valid as per Article 24 of the UN Model?
- (A) All the three of them are taxable equally and there is no room for discrimination in charging income-tax for the same income among them.
- (B) Narain and Ravi are the same (i.e., resident) but not Prem who is a non-resident. Therefore, tax on Prem could be more than the tax on Narain and Ravi.

- (C) Ravi and Prem are same since they are foreign nationals but not Narain who is an Indian national. Therefore, tax on Ravi and Prem could be more than the tax chargeable on Narain's income as Narain is both a resident and Indian national.
- (D) Narain and Prem are same but not Ravi who is a foreign national. Therefore, tax on Ravi could be more than tax levied on Narain and Prem.
- 5.5 How much is payable by Silver Ltd. by way of equalization levy for the digital advertisement space used from Diggy Corp?
- (A) ₹ 35,496
- (B) ₹ 21,000
- (C) ₹ 34,800
- (D) ₹ 46,800

You are required to answer the following issues:

- 5.6 Discuss briefly the tax consequence of the sale of shares of Rose Inc. by Lotus Inc. and compute tax liability in India, if any arising from sale of shares in the hands of Lotus Inc.

(6 Marks)

- 5.7 Compute the total income of Narain for the AY 2021-22 with final tax liability after deduction of foreign tax credit. Will your answer be different, if there is no DTAA between India and Country P, as regards the net tax liability of Narain for the AY 2021-22.

Note: Narain opts for tax under section 115BAC.

(6 Marks)

- 5.8 Do you agree with the approach suggested by Mr. Simon, legal counsel in UK, of defending the case in appeal in India by citing UK court decisions? Further, is it valid to interpret DTAA entered by India (based on OECD MC) by adopting ambulatory approach? **(3 Marks)**

Solution to Case Study 5

Answer to MCQs 5.1 to 5.5

Q. No.	Answer
5.1	(D)
5.2	(B)
5.3	(A)
5.4	(B)
5.5	(C)

Answer to Q.5.6

Capital gain arising in the hands of Lotus Inc. of USA from transfer of a capital asset situated in India is deemed to accrue in India. Shares of Rose Inc. Canada, a foreign company, shall be deemed to be situated in India if those shares derive directly or indirectly, its value substantially from the assets located in India.

Shares of Rose Inc. 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 Rose Inc.

Specified date would be the date on which the accounting period of the Rose Inc. ends preceding the date of transfer of a share or an interest i.e., 31.3.2020.

However, in case the book value of the assets of the Rose Inc. on the date of transfer i.e., 25.11.2020 exceeds the book value of the assets as on 31.3.2020 by at least 15%, the date of transfer i.e., 25.11.2020 would be the specified date.

In the instant case, specified date would be 25.11.2020 since book value of the assets of Rose Inc. on the date of transfer i.e., 25.11.2020 is ₹ 29 crores (₹ 7 crore + ₹ 22 crore) which exceeds the book value of the assets as on 31.3.2020 i.e., ₹ 21 crore (₹ 3 crore + ₹ 18 crore) by more than 15%.

Shares of Rose Inc. derives its value substantially from assets located in India since the value of assets located in India (without reduction of liabilities) on 25.11.2020, being the specified date i.e., ₹ 24 crores,

- ◆ exceeds ₹ 10 crores and
- ◆ represents 75% of the value of assets of Rose Inc. $[24/32 \times 100]$.

Computation of long term capital gains attributable to assets located in India	
Particulars	₹ in lakhs
Full value of consideration for transfer of shares of Rose Inc.	\$ 22
Less: Cost of acquisition of shares of Rose Inc. (\$ 50 lakhs x 11/55)	<u>\$ 10</u>
Long term capital gains [Since the shares of Rose Inc. have been held for more than 24 months]	<u>\$ 12</u>
Long term capital gains in Rupees [₹ 12 lakhs x 71, being the TTBR on 31.10.2020, being the last day of the month immediately preceding the month in which the capital asset was transferred, as per Rule 115 [A]	852
Fair Market value of assets of Rose Inc. located in India on 25.11.2020 [B]	2400

Fair Market value of all assets of Rose Inc. on 25.11.2020 [C] [₹ 800 lakhs + ₹ 2400 lakhs]	3200
Long term capital gains attributed to assets located in India [A x B/C]	639
Computation of tax liability of Lotus Inc.	
Particulars	₹ in lakhs
Tax@10% u/s 112 (without indexation and currency fluctuation benefit)	63.90000
Add: Surcharge@2% (Since the long term capital gain exceeds ₹ 1 crore but does not exceed ₹ 10 crores)	<u>1.27800</u>
	65.17800
Add: Health and education cess@4%	<u>2.60712</u>
Tax liability	<u>67.78512</u>

Answer to Q.5.7

Computation of total income of Mr. Narain for A.Y. 2021-22 as per section 115BAC		
Since Mr. Narain is resident in India for the P.Y.2020-21, his global income would be subject to tax in India. Therefore, income earned by him in Country P would be taxable in India.		
Particulars	Amount (₹)	Amount (₹)
Salaries		
Salary from Silver Ltd. [Standard deduction u/s 16(ia) not allowable, since Mr. Narain opts for section 115BAC]		23,00,000
Income from house property		
Loss from self-occupied property [Interest u/s 24(b) is not allowable in respect of self-occupied property, since Mr. Narain opts for section 115BAC]	-	-
Profits and gains from business or profession		
Income from business in Country P [\$ 25,000 x 71, being the last day of previous year i.e., 31.3.2021 as per Rule 115]		17,75,000
Capital Gains		
Capital gains on sale of shares of companies registered in Country P [\$ 5,000 x 70, being the last day of the month immediately preceding the month in which the shares are transferred i.e., 28.2.2021 as per Rule 115]		3,50,000

Income from Other Sources		
Interest on bank deposits	1,60,000	
Dividend from shares held in Country P [\$ 10,000 x 70, being the last day of the month immediately preceding the month in which the dividend is declared i.e., 28.2.2021 as per Rule 115]	<u>7,00,000</u>	
		<u>8,60,000</u>
Gross Total Income/Total Income		<u>52,85,000</u>

Computation of tax liability of Narain for A.Y.2021-22

Particulars		Amount
Upto ₹ 2,50,000	Nil	
₹ 2,50,001 – ₹ 5,00,000 [i.e., ₹ 2,50,000@5%]	12,500	
₹ 5,00,001 – ₹ 7,50,000 [i.e., ₹ 2,50,000@10%]	25,000	
₹ 7,50,001 – ₹ 10,00,000 [i.e., ₹ 2,50,000@15%]	37,500	
₹ 10,00,001 – ₹ 12,50,000 [i.e., ₹ 2,50,000@20%]	50,000	
₹ 12,50,001 – ₹ 15,00,000 [i.e., ₹ 2,50,000@25%]	62,500	
₹ 15,00,001 – ₹ 52,85,000 [i.e., ₹ 37,85,000@30%]	<u>11,35,500</u>	
		13,23,000
<i>Add: Surcharge@10% [Since, the total income exceeds ₹ 50 lakhs but does not exceed ₹ 1 crores]</i>		<u>1,32,300</u>
		14,55,300
<i>Add: Health & Education Cess@4%</i>		<u>58,212</u>
		<u>15,13,512</u>
<i>Less: Deduction in respect of tax paid in Country P</i>		
- Tax payable in India @28.638% on ₹ 28,25,000, being business income of ₹ 17,75,000 plus capital gains of ₹ 3,50,000 plus dividend income of ₹ 7,00,000 [i.e., ₹ 15,13,512 / ₹ 52,85,000 x 100] = 28.638%	8,09,024	
- Tax paid in Country P@20% [\$ 40,000 @20% x ₹ 72, being the rate on 30.4.2021, being the last day of the month immediately preceding the month in which tax is paid, i.e., May, 2021]	5,76,000	
Lower of the above		<u>5,76,000</u>
Tax Payable		<u>9,37,512</u>
Tax Payable (Rounded off)		<u>9,37,510</u>

If there is no DTAA between India and Country P, Mr. Narain would be entitled to deduction under section 91, since all conditions under section 91 are satisfied.

In such a case, there would be no change in the net tax liability of Mr. Narain after deduction of foreign tax credit.

Notes –

- (1) *In the absence of information, it is assumed that the capital gain arising to Narain from sale of shares of companies registered in Country P is short term capital gains taxable at normal rates of tax. Alternatively, it may be assumed that such capital gains is long term capital gains taxable@20%.*
- (2) *The second part of the question requires to compute the net tax liability of Narain if there is no DTAA between India and Country P. Rule 128 - Foreign tax credit of Income-tax Rules, 1962 covers –*
 - (i) *in respect of a foreign country with which India has a DTAA - the tax covered in DTAA; and*
 - (ii) *in respect of a foreign country with which India has no DTAA - tax payable in that country.*

Rule 128 prescribes the manner of computation of credit of foreign tax which is lower of tax payable under Income-tax Act, 1961 on income and the foreign tax paid on such income. The above answer has been given by applying the foreign tax credit Rule 128.

However, section 91 of the Income-tax Act provides the deduction in respect of doubly taxed income at the lower of Indian rate of tax or the rate of tax paid in country outside India. On the basis of the provisions of section 91, deduction would be ₹ 5,65,000 ,i.e., 20%, being the lower of Indian rate of tax and tax rate in Country P, applied on ₹ 28,25,000, being the doubly taxed income. Accordingly, the net tax liability would be ₹ 9,48,510 (rounded off).

Answer to Q.5.8

In *CIT v. Vishakhapatnam Port Trust's case [1983] 144 ITR 146*, the Andhra Pradesh High Court observed that, in view of the standard OECD Models which are being used in various countries, a new area of genuine 'international tax law' is now in the process of developing. Any person interpreting a tax treaty must now consider decisions and rulings worldwide relating to similar treaties. The maintenance of uniformity in the interpretation of a rule after its international adoption is just as important as the initial removal of divergences. Therefore, the judgments rendered by courts in other countries or rulings given by other tax authorities would be relevant.

Accordingly, the approach suggested by Mr. Simon, Legal counsel in UK, of defending the case in appeal in India by citing UK court decisions is valid.

Validity of interpreting DTAA (based on OECD MC) by adopting ambulatory approach :

Article 3(2) of the OECD Model Convention provides that meaning of a term not defined in the treaty shall be interpreted in accordance with the provisions of the tax laws of the Contracting State that may be applying the Convention.

The current position under the domestic law or the latest version of the commentary should be resorted to if that interpretation provides a suitable meaning of the term and clarifies the term in a better way.

Therefore, it is valid to interpret DTAA entered by India by adopting ambulatory approach.

However, this provision is subject to one caveat and that is if the context requires interpreting the term 'otherwise', then the meaning should be assigned accordingly. Therefore, the reference to the domestic tax law is not automatic if the term is not defined under the treaty. The term is to be first interpreted in light of the context provided under the treaty and if the context does not provide the meaning, then the domestic tax law meaning may be resorted to.