

ELECTIVE PAPER 6C: INTERNATIONAL TAXATION

SOLUTION TO CASE STUDY 1

ANSWERS TO MCQs

1. (d)
2. (b)
3. (a)
4. (d)
5. (b)

ANSWERS TO DESCRIPTIVE QUESTIONS

Answer to Q.1:

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

Second stage: In this case, considering that Shyam is an agent exclusively for Athena Ltd., he is a dependent agent. A dependent agent in India does not automatically constitute a PE for Athena Ltd. unless he satisfies the requirements of Article 5(5). As per Article 5(5) of the DTAA with Country A, a dependent agent in India would constitute a PE for Athena Ltd. only if it is shown that he habitually concludes contracts in the name of Athena Ltd. or habitually plays the principal role leading to the conclusion of contracts that are concluded without material modification by Athena Ltd. In this case, it can be seen that the agent can only engage in preliminary negotiations and the desired terms of relationship would be subject to the independent detailed consideration, confirmation and final approval of Athena Ltd. Due to these reasons, the agent in India does not constitute a PE for Athena Ltd., even though he works solely for Athena Ltd.

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

Furthermore, a warehouse in India would **not** constitute a PE as per Article 5(4) of the India-Country A DTAA, if the same is used solely for the purpose of storage, display and delivery of goods or merchandise belonging to the enterprise, if it is of preparatory or auxiliary character.

Since no PE is constituted in the first three stages, profits of Athena Ltd. for P.Y.2020-21 would not be taxable in India.

Fourth stage – In this stage, Athena Ltd. sets up a branch in Mumbai in April, 2021, which constitutes a PE in India as per Article 5(1)/(2) of the India-Country A DTAA. Accordingly, profits of Athena Ltd. as are attributable to the PE in India for P.Y.2021-22 would be liable to tax in India.

Answer to Q.2

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

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

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

Only when all the four conditions are cumulatively satisfied, Athena Ltd. would be said to have active business outside India.

(1) Particulars	(2) Country A	(3) Country B	(4) India	(5) Total	(6) % of (4) to total in (5)
Value of assets	Rs.400 lakhs	Rs.100 lakhs	Rs.210 lakhs	Rs.710 lakhs	29.58%
Number of employees	30	10	20	60	33.33%
Payroll expenses on employees	Rs.160 lakhs	Rs.35 lakhs	Rs.65 lakhs	260	25.00%

It can be seen that the value of assets in India is only 29.58% of the total assets of the company, the number of employees in India is only 33.33% of the total number of employees and the payroll expenses incurred on such employees is only 25% of its total payroll expenditure. Thus, three out of four conditions for active business outside India are met. However, the passive income test has also to be met for active business to be outside India.

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

Percentage of passive income to total income = $145/250 \times 100 = 58\%$

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

If the total income of Athena Ltd. is Rs.300 lakhs, then, percentage of passive income to total income would be 48.33% [$145/300 \times 100$]. In this case, the passive income is not more than 50% of the company's total income. Since all the four conditions are cumulatively satisfied, Athena Ltd. can be said to have active business outside India.

Solution to Case Study 2

Answers to MCQs

Q. No.	Answer
1	(c)
2	(a)
3	(c)
4	(c)
5	(d)

Answers to Descriptive Questions

1. Determination of residential status of Mrs. Varsha

Under section 6(1), an individual is said to be resident in India in any previous year, if she satisfies any one of the following conditions:

- (i) She has been in India during the previous year for a total period of 182 days or more, or
- (ii) She has been in India during the 4 years immediately preceding the previous year for a total period of 365 days or more and has been in India for at least 60 days in the relevant previous year.

If the individual satisfies any one of the conditions mentioned above, she is a resident.

However, the following categories of individuals will be treated as resident in India only if the period of their stay during the relevant previous year amounts to atleast 182 days. In other words, even if such persons were in India for 60 days or more (but less than 182 days) in the relevant previous year, they will not be treated as resident due to the reason that their stay in India was for 365 days or more during the 4 immediately preceding years.

- (1) Indian citizen, who leaves India during the relevant previous year as a member of the crew of an Indian ship or for purposes of employment outside India, or
- (2) Indian citizen or person of Indian origin who, being outside India, comes on a visit to India during the relevant previous year.

However, an Indian citizen or person of Indian origin having total income, other than the income from foreign sources (i.e., income which accrues or arises outside India except income from a business controlled from or profession set up in India), exceeding Rs. 15 lakhs during the previous year will be treated as resident in India if

- the period of her stay during the relevant previous year amounts to 182 days or more, or
- she has been in India during the 4 years immediately preceding the previous year for a total period of 365 days or more and has been in India for at least 120 days in the previous year.

Mrs. Varsha's stay in India in the P.Y.2020-21 – $31+31+28+31 = 121$ days

Her stay in India in the four preceding PYs = $92 \times 4 = 368$ days

Total income (excluding income from foreign sources) > Rs.15 lakhs [See Working below]

Since Mrs. Varsha is a person of Indian origin whose total income (excluding income from foreign sources) is greater than Rs.15 lakhs, she is resident in India for A.Y. 2021-22 since she stays in India for a period exceeding 120 days in the P.Y.2020-21 and more than 365 days in the four immediately preceding previous years. Since she is a resident on account of application of this special provision, she would by default be a resident but not ordinarily resident as per section 6(6).

Computation of total income of Mrs. Varsha for A.Y.2021-22

	Particulars	Rs.	Rs.
I	Income from house property		
	Gross Annual Value [Rs.60,000 x 12]	7,20,000	
	Less: Municipal Taxes [not allowable, since paid by tenant]	-	
		7,20,000	
	Less: Deduction@30% u/s 24(a)	2,16,000	
			5,04,000

II Profits and gains of business or profession		
Income from performances in India	6,00,000	
Country A [US \$ 4,000 x Rs. 70.70 – Rule 115] [Taxable, since the same is from a profession set up by her in India]	<u>2,82,800</u>	8,82,800
III Income from Other Sources		
Interest on fixed deposits with Indian Bank	8,00,000	
Interest on bonds issued by Country A company [not taxable since she is resident but not ordinarily resident and the income accrues outside India and is received outside India]	<u>-</u>	<u>8,00,000</u>
Gross Total Income		21,86,800
Less: Deductions under Chapter VI-A		
Deduction u/s 80C – Contribution to PPF	1,50,000	
Deduction u/s 80G – Donation to PM Cares Fund – 100% of amount contributed	<u>2,00,000</u>	
		<u>3,50,000</u>
Total Income		<u>18,36,800</u>

Computation of tax liability of Mrs. Varsha for A.Y.2021-22

Particulars	Rs.
Tax on total income of Rs.18,36,800	3,63,540
[Rs.12,500 + Rs.1,00,000 + Rs.2,51,040 (being 30% of Rs.8,36,800)]	
Add: Health and education cess@4%	<u>14,542</u>
Total tax liability	<u>3,78,082</u>

Note – If she opts for section 115BAC, she would not be entitled for deduction of Rs.3,50,000 under Chapter VI-A. Her total income would be Rs.21,86,800 and her tax liability would be Rs. 4,09,280 (working shown below), which is higher than the tax liability computed as per the regular provisions of the Act. Hence, she would not opt for section 115BAC.

Particulars	Rs.
Upto Rs. 2,50,000	Nil
Rs. 2,50,001 – Rs. 5,00,000 [Rs. 2,50,000@5%]	12,500
Rs. 5,00,001 – Rs. 7,50,000 [Rs. 2,50,000@10%]	25,000
Rs. 7,50,001 – Rs. 10,00,000 [Rs. 2,50,000@15%]	37,500
Rs. 10,00,001 – Rs. 12,50,000 [Rs. 2,50,000@20%]	50,000
Rs. 12,50,001 – Rs. 15,00,000 [Rs. 2,50,000@25%]	62,500
Rs. 15,00,001 – Rs. 21,86,800 [Rs. 6,86,800@30%]	<u>2,06,040</u>
	<u>3,93,540</u>

Add: HEC@4%	<u>15,742</u>
Total tax liability	<u>4,09,282</u>
Total tax liability (rounded off)	4,09,280

2. **Computation of total income of Ms. Anjana for A.Y.2021-22**

	Particulars	Rs.	Rs.
I	Salaries		
	Deloitte, Mumbai [Rs.2,00,000 x 5 + Rs.1,00,000]	11,00,000	
	Boston Consultancy, California		
	October 2020 [\$ 10,000 x Rs.69]	6,90,000	
	Nov 2020 [\$ 10,000 x Rs.69.30]	6,93,000	
	Dec 2020 [\$ 10,000 x Rs.69.50]	6,95,000	
	Jan 2021 [\$ 10,000 x Rs.69.90]	6,99,000	
	Feb 2021 [\$ 10,000 x Rs.70.10]	7,01,000	
	March 2021 [\$ 10,000 x Rs.70.30]	<u>7,03,000</u>	
		<u>41,81,000</u>	
	Gross Salary	52,81,000	
	Less: Standard deduction u/s 16(i)	<u>50,000</u>	
			52,31,000
III	Income from Other Sources		
	Interest on fixed deposits with ICICI bank	50,000	
	Interest on fixed deposits with Citibank, California [\$ 600 x Rs.70.70 – Rule 115]	42,420	
	Dividend from shares of US based company [\$ 750 x Rs.69.90 – Rule 115]	<u>52,425</u>	
			1,44,845
	Gross Total Income		53,75,845
	Less: Deductions under Chapter VI-A		Nil
	Total Income		53,75,845
	Total Income (rounded off)		53,75,850

Computation of tax liability of Ms. Anjana for A.Y.2021-22

Particulars	Rs.
Tax on total income of Rs.53,75,850	14,25,255
[Rs.12,500 + Rs.1,00,000 + Rs.13,12,755 (being 30% of Rs.43,75,850)]	
Add: Surcharge@10%	<u>1,42,526</u>
	15,67,781
Add: Health and education cess@4%	<u>62,711</u>

Total tax liability	<u>16,30,492</u>
Tax liability (Rounded off)	<u>16,30,490</u>

If she opts for section 115BAC, she would not be entitled to standard deduction of Rs. 50,000 under 16(i) while computing her salary income. Her total income would be Rs.54,25,850 and her tax liability would be Rs. 15,61,850 (working shown below), which is lower than the tax liability computed as per the regular provisions of the Act. Hence, she should opt for section 115BAC for A.Y.2021-22.

Particulars	Rs.
Upto Rs. 2,50,000	Nil
Rs. 2,50,001 – Rs. 5,00,000 [Rs. 2,50,000@5%]	12,500
Rs. 5,00,001 – Rs. 7,50,000 [Rs. 2,50,000@10%]	25,000
Rs. 7,50,001 – Rs. 10,00,000 [Rs. 2,50,000@15%]	37,500
Rs. 10,00,001 – Rs. 12,50,000 [Rs. 2,50,000@20%]	50,000
Rs. 12,50,001 – Rs. 15,00,000 [Rs. 2,50,000@25%]	62,500
Rs. 15,00,001 – Rs. 54,25,850 [Rs. 39,25,850@30%]	<u>11,77,755</u>
	13,65,255
Add: Surcharge@10%	<u>1,36,526</u>
	15,01,781
Add: HEC@4%	<u>60,071</u>
Total tax liability	<u>15,61,852</u>
Total tax liability (rounded off)	15,61,850

Computation of total income of Ms. Manasi for A.Y.2021-22

	Particulars	Rs.	Rs.
I	Salaries		
	Publishing house in New York [Not taxable, since she is a non-resident and salary is earned and received outside India]	-	
	Penguin Publishing House, New Delhi [Rs.2,97,600 x 27/31 + Rs.2,97,600 x3]	11,52,000	
	Gross Salary	11,52,000	
	Less: Standard deduction u/s 16(i)	<u>50,000</u>	
			11,02,000
III	Income from Other Sources		
	Interest on savings account with HDFC bank, New Delhi	12,500	
	Winnings from lotteries	2,50,000	
	Income from bonds of US company (not taxable since she is non-resident and the income accrues and is received outside India)	<u>-</u>	
			2,62,500

Gross Total Income	13,64,500
Less: Deductions under Chapter VI-A	
Deduction u/s 80TTA – Interest on savings bank account	10,000
Total Income	13,54,500

Computation of tax liability of Ms. Manasi for A.Y.2021-22

Particulars	Rs.
Tax on total income of Rs.13,54,500	
Tax on lottery income of Rs.2,50,000@30%	75,000
Tax on balance income of Rs.11,04,500 [Rs.12,500 + Rs.1,00,000 + Rs.31,350 (being 30% of Rs.1,04,500)]	1,43,850
	2,18,850
Add: Health and education cess@4%	8,754
Total tax liability	<u>2,27,604</u>
Total tax liability (rounded off)	2,27,600

If she opts for section 115BAC, she would not be entitled to standard deduction of Rs. 50,000 under 16(i) while computing her salary income and deduction of Rs.10,000 under section 80TTA. Her total income would be Rs.14,14,500 and her tax liability would be Rs. 1,90,220 (working shown below), which is lower than the tax liability computed as per the regular provisions of the Act. Hence, she should opt for section 115BAC for A.Y.2021-22.

Particulars	Rs.
Tax on lottery income of Rs.2,50,000@30%	75,000
Tax on other income of Rs.11,64,500	
Upto Rs. 2,50,000	Nil
Rs. 2,50,001 – Rs. 5,00,000 [Rs. 2,50,000@5%]	12,500
Rs. 5,00,001 – Rs. 7,50,000 [Rs. 2,50,000@10%]	25,000
Rs. 7,50,001 – Rs. 10,00,000 [Rs. 2,50,000@15%]	37,500
Rs. 10,00,001 – Rs. 11,64,500 [Rs. 1,64,500@20%]	32,900
	1,82,900
Add: HEC@4%	7,316
Total tax liability	<u>1,90,216</u>
Total tax liability (rounded off)	1,90,220

Notes –

- (1) Since Ms. Anjana is a resident and ordinarily resident, her global income is taxable in India under the provisions of the Income-tax Act, 1961. However, Manasi is a non-resident, owing to which only income which accrues or arises or is received in India is taxable in her hands in India.

- (2) As per Rule 115, the TTBR on the last date of the month immediately preceding the month in which salary is due or paid is to be considered for conversion. Likewise, for dividend, the TTBR on the last day of the month immediately preceding the month in which the dividend is declared, distributed or paid is to be considered. In this case, since the dividend was paid in January, 2021, the TTBR on 31.12.2020 has to be considered. For interest on fixed deposits, the TTBR on the last day of the previous year (i.e., on 31.3.2021) has to be considered.
- (3) Both Ms. Anjana and Ms. Manasi have the option to compute total income and pay tax as per section 115BAC. Since the tax liability as per section 115BAC is lower for both of them, they should opt to pay tax under the special provisions.

Solution to Case Study 3

Answers to MCQs

Q. No.	Answers to MCQs
1	A
2	A
3	D
4	A
5	C

Descriptive Questions:

Answer to Q.1:

Ashirwad Industry's contract with Chi Kyon Ltd. was divided into 2 phases, phase 1 covering the supply of machineries by Chi Kyon on F.O.B. basis. Phase II of the contract dealt with the installation of the machinery, training for operating the machinery, commissioning and supervision for erection of machinery. The consideration for the entire contract was Rs. 100 crores which was divided between Phase I [Rs.70 crores] and Phase II [Rs.30 crores].

With regard to the phase I of the contract, the delivery of the equipment or machinery took place on F.O.B basis. Therefore, the sale of the machinery was concluded outside India as the title in goods and the risks and rewards were passed on to the buyer outside India. Therefore, there was no business connection in India as per Section 9(1)(i). Also, Chi Kyon did not have any fixed place of business in India through which its business was being carried on. Therefore, the offshore supply of machinery would not be taxable in India.

Under Phase II of the contract, installation of machines in India, training, commissioning, assembly etc. would constitute business connection in India as per the provisions of section 9(1)(i). Moreover, under Article 5(3) of the India-Country M DTAA, the furnishing of services, including consultancy services, by Chi Kyon Ltd. through its employees would constitute a PE in India, since activity of that nature continues for a period of more than 183 days i.e., 190 days in this case, in the F.Y. 2020-21. As per Article 7 of India-Country M DTAA, profit of Chi Kyon Ltd. may be taxed in India but only so much of them as is attributable to (a) PE; (b) sales in India of goods or merchandise of the same or similar kind as those sold through that PE or (c) other business activities carried on in India of the same or similar kind as those effected through that PE.

Answer to Q.2

- (i) Country N company is carrying on the systematic activity of construction in India. Therefore, it is carrying on the business in India and the income arising from the business connection shall be deemed to accrue or arise in India as per section 9(1)(i). As per clause (a) to *Explanation 1* of Section 9(1)(i) of Income-tax Act, 1961, in the case of a business of which all the operations are not carried out in India, the income of the

business deemed under this clause to accrue or arise in India shall be only such part of the income as is reasonably attributable to the operations carried out in India.

Further, it is carrying on the construction activity for more than 6 months in India and therefore, it is deemed to have a construction PE in India as per Article 5(3)(a) of the UN Model.

- (ii) As per Article 5(3) of OECD Model Convention, a building site or construction or installation project constitutes PE only if it lasts more than twelve months. Thus, construction project of Country N would not constitute PE in India, since the said project was only for 200 days.

Answer to Q.3:

As per Article 7(1) "Business Profits" of UN Model Convention, 2017, the profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on or has carried on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to *inter alia* that permanent establishment.

Para 3 to Article 7 provides that in determination of the profits of a permanent establishment, there shall be allowed deduction in respect of certain expenses which are incurred for the purposes of the business of the permanent establishment with a list of certain disallowances. Accordingly, Profits attributable to the PE would be computed in the following manner:

Particulars	Rs.
Profits and Gains from Business or Profession	
Contract Revenue	150 lakhs
Less: Expenses incurred for the PE	
- Salary and administration expenses	65 lakhs
- General HO expenses incurred for the Indian construction project	3 lakhs
- Interest on loan (not allowable)	-
- Reimbursement of salaries to H.O.	15 lakhs
- Technical fees paid (not allowable)	-
Net profit attributable to PE in India	67 lakhs

SOLUTION TO CASE STUDY 4

I. ANSWERS TO MCQs

- (b)
- (c)
- (a)
- (a)
- (c)

II. ANSWERS TO DESCRIPTIVE QUESTIONS

Answer to Q.1

- (i) The eligibility of partnership firms for tax treaty benefits have been a controversial area and is a classic case of economic double taxation. Tax treaties by and large address only juridical double taxation issues and not

economic double taxation. This is due to the fact that each country has its own methodology to tax partnership firms. For instance, India taxes the income of a partnership in the firm's hands, but the Contracting State, in this case, Country Y and Country Z, taxes such income in the hands of the partner directly, treating the partnership as "fiscally transparent entity". In both cases, the income is subject to tax in both countries albeit in the hands of different persons i.e., in the hands of the partners in the country of residence and in the hands of the firm in the source country, namely, India.

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

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

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

As per Article 2 of the India-Country Y DTAA, the scope of the DTAA extends to both income-tax and trade tax as may be levied under the laws of Country Y. Since trade tax is being levied on the Gryffindors Y partnership firm, it can be held that the firm is "liable to tax" and therefore the requirement in Article 4 gets satisfied. Accordingly, Gryffindors Y partnership firm shall be eligible to access the India-Country Y DTAA based on this line of reasoning.

- (b) As per Article 3(1)(d) of the India-Country Z DTAA, the term 'person' includes any other entity which is taxable under the laws in force in the either Contracting States.

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

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

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

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

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

Answer to Q.2

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

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

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

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

Solution to Case study 5

Answers to MCQs

MCQ No.	Answer
1	A
2	B
3	C
4	C
5	A

Answer to Q.1

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

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

- exceeds the amount of Rs. 10 crores; and
- represents at least 50% of the value of all assets owned by the company, or entity, as the case may be

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

However, in case the book value of the assets of the company or entity (i.e., the intermediary company/entity, whose shares are held by the transferor company) on the date of transfer exceeds by the book value of the assets as on the last balance sheet date preceding the date of transfer by at least 15%, the date of transfer shall be the specified date.

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

1. Determining the “Specified date” on which 50% threshold is to be tested – *Explanation 6* to section 9(1)(i) of the Income-tax Act, 1961

Book value of assets of Grapes Ltd as on previous accounting year end date i.e. on 31st December, 2019	2500 crores
Book value of assets of Grapes Ltd as on the date of transfer i.e. on 1st September, 2020	2000 crores
Is there an increase in book value of asset by 15%	No. In fact, there is decrease in book value of asset
Specified date	31st December 2019

2. Determining whether 50% threshold is met on the specified date

FMV of all assets of Grapes Ltd as on specified date i.e. 31 st December 2019	5000 crores
FMV of India assets as on specified date i.e. 31 December 2019 (Since Mango Ltd. is its 100% subsidiary)	3000 crores
Percentage of India asset as compared to all assets of Grapes Ltd	60%
Whether <i>Explanation 5</i> to section 9(1)(i) is triggered?	Yes

Since, the value of Indian assets-exceeds the amount of Rs. 10 crores; and represents 60% of the value of all assets owned by Grapes Ltd., the shares of Grapes Ltd. shall be deemed to derive its value substantially from the assets located in India.

3. Determination of capital gain taxable in India

Rule 11UC of Income-tax Rules, 1962, provides that the income from transfer outside India of a share of, or interest in, a company or an entity referred to section 9(1)(i), attributable to assets located in India, shall be determined in accordance with the following formula, namely:—

Where;

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

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

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

Thus, while A is to be computed under the provisions of the Income-tax Act, 1961 as if the shares of Grapes Ltd is situated in India, B and C is to be computed based on the formula provided under Rule 11UB. In the present case, while B and C are already given in the question, we have to determine A.

Computation of capital gain and tax liability

Particulars	Amount in crores
Full Value of Consideration [See Note 1]	2100
Less: Cost of Acquisition	
Indexation benefit not available [Section 112(1)(c)(iii)]	<u>1000</u>
Capital gain	<u>1100</u>
Amount taxable in India as per Rule 11UC	660
1100*(3000/5000)	
<u>Computation of tax liability:</u>	
Tax@10% under section 112(1)(c)(iii)	66.00
Add: Surcharge@5%	<u>3.30</u>
	69.30
Add: Health and education cess@4%	<u>2.77</u>
	<u>72.07</u>

Note 1

As the transfers are at book value, the full value of consideration has to be determined under section 50CA read with Rule 11UA

Value of Mango Ltd [Rule 11UA]

Particulars	Amount in crores
Other assets	700
Investment (assuming not in shares and securities)	300
Immovable property (stamp duty value)	<u>500</u>
Total Assets	1500
Less: Liabilities	<u>400</u>
Value of investment	<u>1100</u>

Value of Grapes Ltd [Rule 11UA]

Particulars	Amount in crores
Other assets	500
Investment in Mango Ltd – 11UA value	1100
Investment value in China, Sri Lanka and Taiwan (assuming it is at fair market value as per Rule 11UA as no data is given to determine Rule 11UA value of these companies)	<u>500</u>
Total Assets	2100
Less: Liabilities	<u>Nil</u>
Value of investment [Rule 11UA]	<u>2100</u>

Answer to Q.2

Mr. Win stayed in India for 31 days in the P.Y.2020-21, hence, he would be a non-resident in India for A.Y.2021-22.

Mr. Hope, brother of Mr. Win, has also stayed in India for 31 days in the P.Y.2020-21, hence, he would also be non-resident in India for A.Y.2021-22.

Computation of tax liability of Mr. Win for the A.Y.2021-22		
Particulars	Rs.	Rs.
Income taxable under section 115BBA		
Income from participation in football matches in India [Taxable u/s 115BBA, since Mr. Win is a non-resident sports person and not a citizen of India] [No expenditure is allowed]	25,00,000	
Income received from contribution of articles in a sports magazine	<u>2,00,000</u>	
		27,00,000
Income taxable under section 115BB		
Winnings from lottery		3,00,000
Gross Total Income/ Total Income		30,00,000
Computation of tax liability		
Tax@ 20% under section 115BBA on Rs. 27,00,000		5,40,000
Tax@ 30% under section 115BB on Rs. 3,00,000		90,000
		6,30,000
Add: Health & Education cess@4%		25,200
Total tax liability of Mr. Win for the A.Y.2021-22		6,55,200

The total income of Mr. Hope is Rs. 4,00,000, which comprises entirely of his income from pop music events in India [Taxable @20% u/s 115BBA, since Mr. Hope is a non-resident entertainer and not a citizen of India]

Computation of tax liability of Mr. Hope for the A.Y.2021-22	
Particulars	Rs.
Tax@ 20% on Rs. 4,00,000	80,000
Add: Health & education cess@4%	3,200
Total tax liability of Mr. Hope for the A.Y.2021-22	83,200