MOCK TEST PAPER 1

FINAL (NEW) COURSE: GROUP II

ELECTIVE PAPER 6C: INTERNATIONAL TAXATION

SOLUTION TO CASE STUDY 1

I. ANSWERS TO MCQs (Most appropriate answers)

1. (d)

2. (b)

3. (d)

4. (c)

5. (a)

II. ANSWERS TO DESCRIPTIVE QUESTIONS

Answer to Q.1:

(i) Section 194A requiring deduction of tax at source on any income by way of interest, other than interest on securities credited or paid to a resident, excludes from its scope, income credited or paid by a firm to its partner. However, section 195 which requires tax deduction at source on payment to non-residents, does not provide for any exclusion in respect of payment of interest by firm to its non-resident partner. Therefore, tax has to be deducted under section 195 @30%, being the rate in force in respect of Interest on capital paid to Mr. Manan.

As per section 10(2A), share of profit received by partner from the total income of firm is exempt from tax. Therefore, the share of profit paid to non-resident Indian is not liable for tax deduction at source.

However, section 195(6) provides that the person responsible for paying any sum, whether or not chargeable to tax, to a non-corporate non-resident or to a foreign company shall be required to furnish the information relating to payment of such sum in the form and manner prescribed under Rule 37BB.

(ii) The CBDT has, vide Circular No.7/2007 dated 23.10.2007, laid down the procedure for refund of tax deducted at source under section 195 of the Income-tax Act, 1961 to the person deducting tax at source from the payment to a non-resident. The said Circular allowed refund to the person making payment under section 195, *inter alia*, when there occurs payment of tax at a higher rate under the Income-tax Act, 1961 while a lower rate is prescribed in the relevant double taxation avoidance treaty entered into by India.

Hence, M/s Lily& Co., India can claim tax refund of excess tax deducted at source under section 195 where tax has been deducted at source at the rate of 30% provided under the Income-tax Act, 1961 while a lower rate i.e., 10% is prescribed under the DTAA with Country 'X'.

Answer to Q.2:

Computation of Total Income of Mr. Manan for A.Y. 2020-21

Particulars	INR	INR	INR
Profits & Gains of Business & Profession			
Income from partnership firm M/s Lily& Co., India			
- Interest on Capital *[See Note (ii)]*		5,00,000	
- Share of Profit	4,00,000		

Less: Exempt under section 10(2A)	(4,00,000)	-	
Fees for technical services received from TPO Ltd., India		10,00,000	
Fees for technical services received from Government of Country "Y"*[See Note (iii)]*		-	15,00,000
Capital Gains*[See Working Note]*			
Short-term capital gain on sale of shares of -			
- PQ Pvt. Ltd.	1,500		
- HL Pvt. Ltd	1,80,000	1,81,500	
Long- term capital gain on sale of shares of			
- PQ Pvt. Ltd.	Nil		
- PR Pvt. Ltd.	72,500	72,500	2,54,000
Income from Other Sources			
Interest earned on deposits:			
- Interest earned on NRO saving deposits		4,000	
- Interest earned on fixed deposits		5,000	
- Interest on NRE savings account [Exempt u/s 10(4)(ii)] *[See Note (v)]*		-	9,000
Gross Total Income			17,63,000
***Less:* Deductions under Chapter VI-A**			
Deduction under section 80C *[See Note (viii)]*			
Term deposit [Five year term deposit]	60,000		
Repayment of housing loan borrowed for construction of residential house	-	1,10,000	
Deduction under section 80D [*See Note (ix)]*			
Health insurance of self and spouse	20,000		
Health insurance of mother	25,000	45,000	
Deduction u/s 80TTA*[See Note (x)]*		4,000	1,59,000
Total Income			**16,04,000**

Computation of Tax Liability of Mr. Manan for A.Y. 2020-21

Particulars	INR	INR
Tax@10% on fee for technical services under section 115A		1,00,000
Tax@10% on long-term capital gain on sale of foreign exchange assets under section 115E[1]		7,250
Tax on balance income of INR 5,31,500 (i.e., INR 6,90,500- INR 1,59,000)		18,800
		1,26,050

[1] *Since the question specifies that the Manan has opted for Chapter XII-A, the resultant long-term capital gains would be taxable @10%, after providing for proportional exemption under section 115F, which is available in respect of investment of net consideration in another specified asset, shares of a private company in this case. It would have been more beneficial for Manan to have not opted for Chapter XII-A, as he could have claimed exemption of the entire capital gain of INR 5,80,000 under section 54F, since the amount invested in construction of house at Pune exceeds the net sale consideration of INR 12 lakhs on sale of shares of PR Pvt. Ltd.*

Add: Health and education cess @4%		5,042
Tax liability		**1,31,092**
Tax liability (rounded off)		**1,31,090**

Working Note:

Computation of Capital Gain on sale of shares purchased in convertible foreign currency

Particulars	INR
LTCG on sale of shares of PR Pvt. Ltd., since held for more than 24 months	
(As per the provisions of Chapter XII-A, long term capital gain, on sale of any specified asset in foreign currency, shall be calculated at flat rate of 10% without indexation. Shares of PR Pvt. Ltd fall under the category of "specified assets")	
Sale Consideration	12,00,000
Less: Cost of Acquisition	(6,20,000)
Long term capital gain	5,80,000
Less: Exemption under section 115F	
[5,80,000*10,50,000/12,00,000]	(5,07,500)
Long-term capital gain as per Chapter XII-A	**72,500**
*(**Note** - Since within a period of six months after the date of transfer of a long term foreign exchange asset, Mr. Manan has invested part of the net consideration in any specified asset, namely shares of CR Pvt. Ltd., he is eligible to claim proportionate deduction as per section 115F)*	
STCG on sale of shares of HL Pvt. Ltd., since held for less than 24 months	
Sale Consideration	9,30,000
Less: Cost of Acquisition	(7,50,000)
Short term capital gain	**1,80,000**
(Provisions of Chapter XII-A are only applicable in respect of long term capital gain from transfer of foreign exchange assets.)	

Computation of Capital Gain on sale of shares of PQ Pvt. Ltd.

Particulars	INR
LTCG on sale of 1500 shares acquired on October 1, 2017	
(As per section 2(42A), share of an unlisted company, if sold after period of 24 months from the acquisition date will be considered as long-term capital asset)	
Sale Consideration [1,500 x INR 15]	22,500
Less: Cost of Acquisition [1,500 x INR 10]	(15,000)
Long term capital gain	**7,500**
Less: Exemption u/s 54F [since the amount invested in construction of house at Pune exceeds the net sale consideration of INR 22,500 on sale of shares, the entire capital gain would be exempt. The construction of the house in Pune was completed within the prescribed time i.e., within three years after the date of transfer]	7,500
	Nil
STCG on sale of 500 shares acquired on October 31, 2018	
Sale Consideration [500 x INR 15]	7,500

Less: Cost of Acquisition [500 x INR 12]	(6,000)
Short term capital gain	**1,500**

Notes:

(i) Mr. Manan is a person who, staying outside India, comes on a visit to India every year. Hence, the minimum period of stay in India for Mr. Manan to be treated as a resident is 182 days in any previous year. For A.Y.2020-21, Mr. Manan is a non-resident since his stay in India in the P.Y.2019-20 is less than 182 days. In case of a non-resident, only income which accrues or arises or is deemed to accrue or arise in India or is received or is deemed to be received in India is taxable in India. Income which accrues or arises outside India is not taxable in India. Rental income from property in Country 'X' received there and subsequently brought to India is not taxable in India in the hands of Mr. Manan, since it neither accrues to him in India nor is it received by him in India.

(ii) Interest on capital paid by the partnership firm is includible as business income in the hands of the partner, only to the extent the interest is allowed as deduction in the hands of firm. In this case, the entire interest of INR 5 lakhs is included in the income of Mr. Manan since the same is as per the partnership deed and would has been fully allowed as deduction in the hands of firm.

(iii) Fees for technical services received from TPO Ltd., an Indian company, would be chargeable to tax under the head "Profits and gains of business or profession" in the hands of Mr. Manan. Since Mr. Manan is a resident of a country 'X' with which India has no DTAA, such fees for technical services would be taxable @10% as per section 115A.

However, fees for technical services received in foreign currency by Mr. Manan from the Government of Country "Y" would not be taxable in India, since such income has neither accrued in India nor is the same received in India.

(iv) As per section 9(1)(v)(c), interest payable by a non-resident would be deemed to accrue or arise in India, where the interest is payable on any debt incurred, or money borrowed and used, for the purpose of a business or profession carried on by such non-resident in India. In the present case, Mr. Fadnis, a non-resident had purchased bonds of XYZ Ltd., an Indian company out of the money borrowed. Consequently, the interest received by Mr. Manan in foreign currency equivalent to INR 1,95,000 will not be taxable in India, since such interest is neither received nor is it deemed to accrue or arise in India. Mr. Fadnis is a non-resident in India for A.Y.2020-21 since his stay in India during the P.Y.2020-21 is only 36 days.

(v) As per section 10(4)(ii), in case of an individual, any income by way of interest on moneys standing to his credit in Non-resident External Account (NRE A/c) would be exempt, provided the individual is a person resident outside India, as defined in Foreign Exchange Management Act (FEMA), 1999. Here, it is assumed that Mr. Manan qualifies to be person resident outside India as per FEMA, 1999 and hence, interest of INR 9,000 from NRE A/c is exempt from tax in his hands.

(vi) Transfer outside India of Rupee denominated bonds of an Indian company issued outside India and Government Securities through an intermediary dealing settlement of securities by Mr. Manan, a non-resident, to Mr. James, another non-resident, would not be regarded as a transfer under section 47 for levy of capital gains tax. Mr. James is a non-resident since he has stayed in India only for 100 days in the P.Y.2019-20. Being a citizen of India residing in Country "X", he has to come and stay in India for at least 182 days in a year to be treated as a resident.

(vii) As per section 64(1A), all income accruing to minor child is includible in the hands of the parent, whose total income before including minor's income is higher, after providing deduction of INR 1,500 per child under section 10(32). However, if minor child has earned the income because of his skill or talent then

it will not be included in the hand of parents. Hence, income generated by Mr. Manan's minor son, Krishan, by winning Science Olympiad shall not be clubbed with Mr. Manan's income.

(viii) Under section 80C, deduction is allowed for life insurance premium paid for self or spouse or any child, even though such premium is paid outside India. It is assumed that the annual premium is not more than 10% of actual capital sum assured. However, deduction in respect of tuition fees paid by individual to any university, college, school or other educational institution for full time education of his two children would be allowed only if, such institution is situated in India. Thus, payment for life insurance premium paid by Mr. Manan is fully allowable as deduction but no deduction would be allowed for annual tuition fees, since it is for education abroad. Further, no deduction is allowable under section 80C for A.Y.2020-21 in respect of repayment of housing loan, since the property in Pune is under-construction and no amount is chargeable to tax as income from house property, during the previous year 2019-20.

(ix) Mr. Manan is eligible for deduction of INR 20,000 in respect of health insurance premium of self and spouse, since the same is less than INR 25,000. He is also eligible for deduction in respect of premium paid for insuring the health of his mother, subject to a maximum of INR 25,000. However, he would not be eligible for claiming higher deduction of upto INR 50,000 under section 80D, as applicable to senior citizen, for the insurance on the health of his mother, since she is non-resident. Further, he is not eligible for any deduction in respect of the premium paid to insure the health of his sister, Ms. Shweta, since sister is not included within the definition of "family".

(x) As per section 80TTA, deduction in respect of interest earned on savings deposits with a bank, co-operative society carrying on the business of banking or post office is allowed to the extent of INR 10,000. Mr. Manan can, therefore, claim deduction u/s 80TTA on account of NRO saving bank interest of INR 4,000.However, no deduction is allowed on interest earned on time deposits.

Therefore, interest earned on fixed deposits by Mr. Manan shall not be eligible for deduction under section 80TTA.

SOLUTION TO CASE STUDY 2

I. ANSWERS TO MCQs (Most appropriate answers)

1. (a)

2. (b)

3. (a)

4. (c)

5. (c)

II. ANSWERS TO DESCRIPTIVE QUESTIONS:

Answer to Q.1:

The facts of the case are similar to the decision of Supreme Court in the case of *Formula One World Championship Ltd. v. Commissioner of Income-tax (International Taxation) 394 ITR 80*. In this case, Supreme Court held that the race circuit constituted fixed place PE of the assessee. The Supreme Court observed that the essential conditions which need to be satisfied for the existence of a fixed place PE under Article 5(1) of the India UK DTAA are:

(a) existence of a fixed place of business; and

(b) the business of the enterprise is wholly or partly carried out through that fixed place.

A major contention put forward on behalf of the assessee was the fact that any access to the assessee was only given during the period of 6 weeks ("Access Period") and that the Circuit was built by Indian Contractor using its own engineers and architects and was at the disposal of Indian Contractor as the promoter of the Event.

The Supreme Court considered the manner in which commercial rights were enjoyed by the assessee and its affiliates to determine who was in actual control of the Event. The facts clearly highlighted that though Indian Contractor was designated as the promoter of the Event, in reality, its authority to act as promoter was severely restricted. These clauses clearly highlighted that:

- The Circuit is required to be constructed in the form and manner prescribed by the assessee;
- The assessee is responsible for the inclusion of the Event in the F1 Championship;
- The assessee had full access to the pit, padlock buildings, etc. during the Access Period;
- The passes issued by the assessee could not be questioned by Indian Contractor;
- Indian Contractor could not permit any recording of footage of the Event in the confines of the circuit or the land over which it had control;
- All intellectual property relating to the Event had been irrevocable and unconditionally assigned to the assessee; and
- Indian Contractor was mandated to engage a third party approved by the assessee to carry out all service relating to the origination of international television feed.

Consequently, Court held that the Circuit constituted assessee's fixed place PE in India since the assessee and its employees had full access to the Circuit and the assessee was granted access for a period of 6 weeks at a time during each race and that the access was for a period of 5 years i.e., the duration of the Race Promotion Contract and Indian Contractor's capacity to act was extremely limited. Accordingly, it held that assessee carried on business in India within the meaning of expression under Article 5(1) of the DTAA. The Apex Court observed that the arrangement clearly demonstrated that the entire event was taken over and controlled by the assessee and its affiliates and accordingly, rejected the assessee's stand that since the duration of the event was only 3 days, there was limited access granted which was not sufficient to constitute the degree of permanence necessary to establish a fixed place PE since for the entire period of race, the control was with the assessee. Further, it held that mere construction of the track by Indian Contractor was of no consequence while determining whether assessee had disposal over the track. Accordingly, it upheld that the tests laid down for constitution of a PE *viz*. stability, productivity and dependence were satisfied. It concluded that the taxable event i.e. earnings from the grand prix had taken place in India and, therefore, assessee was liable to pay tax in India on such income earned by it.

Applying the ratio of above judgement of the Supreme Court, the agreement entered into by HRWC and its activities pursuant thereto constitute Fixed Place PE in India.

Answer to Q.2:

The Supreme Court in the case of *Formula One World Championship Ltd. v. Commissioner of Income-tax (International Taxation) 394 ITR 80* clarified that TDS obligation of Indian Contractor u/s 195 on the payments made to assessee was limited to the appropriate portion of income which is chargeable to tax in India and directed the Assessing Officer to compute the same.

The Supreme Court held that since it had been established that the payments being made by Indian Contractor was in the nature of business income earned by the assessee through its fixed place PE in India, i.e., the Circuit, Indian Contractor was under an obligation to withhold taxes on such payment. Reference was made to the landmark judgement of the Supreme Court in *GE India Technology Centre Private Limited v.*

Commissioner of Income Tax & Anr.,(2010) 327 ITR 456 n this regard. However, the Supreme Court partially agreed with the submission of Indian Contractor that this liability to withhold taxes could only arise for that portion of the income which was chargeable to tax in India on account of the existence of the PE.

Applying the ratio of above judgement of the Supreme Court, RCIL is required to withhold taxes on payments to be made to HRWC on the portion of income which is chargeable to tax in India.

Answer to Q.3:

In the given case, Pride Inc. is a company incorporated under the laws of USA and hence, resident of USA. It is a foreign company under the Income-tax Act, 1961. However, the said company shall be considered to be resident in India if its place of effective management is in India. In this case, the company does not satisfy the active business test outside India since 50% of its assets are located in India. Therefore, since it has failed the active business test outside India on account of 50% of its assets being located in India, the persons who take key management and commercial decisions for conduct of the company's business as a whole and the place where the decisions are made are the key factors in determining whether the POEM of the company is in India. The facts of the case clearly state that the key management decisions and commercial decisions for conduct of the company's business as a whole are made by the directors located in India and at the meetings held in India. Therefore, the POEM of Pride Inc. is in India in the P.Y.2019-20, irrespective of the fact that majority of the board meetings are held outside India.

Section 194J applies when professional fees are being paid to a resident, whereas section 195 applies when payments are made to a non-corporate non-resident or a foreign company. Section 194J is income specific and section 195 is payee specific. CBDT *vide Notification No. 29/2018 dated 22nd June 2018* has clarified that the foreign company shall continue to be treated as a foreign company even if it is said to be resident in India on account of its POEM being in India, and all the provisions of the Act shall apply accordingly. Where more than one provision of Chapter XVII-B of the Act applies to the foreign company as resident as well as a foreign company, the provision applicable to the foreign company alone shall apply. Further, in case of conflict between the provision applicable to the foreign company as resident and the provision applicable to it as foreign company, the latter shall generally prevail. Therefore, the rate of tax in case of foreign company shall remain the same, i.e., rate of income-tax applicable to the foreign company even though residential status of the foreign company changes from non-resident to resident on the basis of POEM.

Hence, Payer Ltd shall deduct tax under section 195 while making payment of fees for professional services to Pride Inc., a foreign company resident in India.

SOLUTION TO CASE STUDY 3

I. ANSWERS TO MCQs (Most appropriate answers)

1. (c)

2. (d)

3. (c)

4. (b)

5. (c)

II. ANSWERS TO DESCRIPTIVE QUESTIONS

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 INR 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 at least 15%, the book value of the assets as on the last balance sheet date preceding the date of transfer, 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.

Further, section 90(2) provides that where the Indian Government has entered into DTAAs which are applicable to the taxpayers, then, the provisions of the Act or the provisions of the DTAA, whichever is more beneficial to the taxpayer, shall apply.

In light of the above, the provisions of the DTAA and the provisions of the Act have been examined with respect to the each of the Groups below.

(a) Transfer of shares of Singapore Intermediary Co by US Co.

In the instant case, specified date is 31.05.2019, being the date of transfer, since the book value of assets on the date of transfer (i.e., Rs.30 crores) exceeds by more than 15%, Rs.25 crores, being the book value of assets as at 30.6.2018, the last balance sheet date preceding the transfer.

Fair value of assets of Singapore Intermediary Co as on 31.5.2019 - INR 50 crores

Fair value of Ind Co as on 31.5.2019 (without reduction of liabilities) - INR 200 crores

Fair value of Ind Co as held by Singapore Intermediary Co (20%) - INR 40 crores

Since the value of assets located in India i.e., INR 40 crores exceeds INR 10 crores and also exceeds 50% of the value of assets of Singapore Intermediary Co, the shares of Singapore Intermediary Co would be deemed to derive its value substantially from assets located in India.

Hence, the shares of Singapore Intermediary Co would be deemed to be a capital asset situated in India and the capital gains from transfer of shares of Singapore Intermediary Co would be deemed to accrue or arise in India. Accordingly, the gains would be taxable in the hands of US Co in India as per the Income-tax Act, 1961. However, the provisions of the applicable DTAA would need to be examined.

The India-US DTAA would be the applicable DTAA, for the purpose of analysing taxability in India of the transfer of shares of Singapore Intermediary Co by US Co, since in the instant case, India is the 'country of source' and US is the 'country of residence'.

As per Article 13 of the India-US DTAA, US and India may tax capital gains in accordance with the provisions of its domestic law. Hence, the capital gains income from transfer of shares of Singapore Intermediary Co by US Co would first be included in the total income of US Co. in India for computation

of tax liability. The US Company would, thereafter, be eligible for foreign tax credit in respect of doubly taxed income.

(b) Transfer of shares of Mauritius Intermediary Co by Germany Co.

In the instant case, specified date is 31.05.2019, being the date of transfer, since the book value of assets on the date of transfer (i.e., Rs.30 crores) exceeds by more than 15%, Rs.25 crores, being the book value of assets as at 31.12.2018, the last balance sheet date preceding the transfer.

Fair value of assets of Mauritius Intermediary Co as on 31.5.2019 - INR 60 crores

Fair value of Ind Co as on 31.5.2019 (without reduction of liabilities) - INR 200 crores

Fair value of Ind Co as held by Mauritius Intermediary Co (25%) - INR 50 crores

Since the value of assets located in India i.e., INR 50 crores exceeds INR 10 crores and also exceeds 50% of the value of assets of Mauritius Intermediary Co, shares of Mauritius Intermediary Co would be deemed to derive its value substantially from assets located in India.

Hence, the shares of Mauritius Intermediary Co would be deemed to be a capital asset situated in India and the capital gains from transfer of shares of Mauritius Intermediary Co would be deemed to accrue or arise in India. Accordingly, the gains would be taxable in the hands of Germany Co in India as per the Income-tax Act, 1961. However, the provisions of the applicable DTAA would need to be examined.

The India-Germany DTAA would be the applicable DTAA, for the purpose of analysing taxability in India of the transfer of shares of Mauritius Intermediary Co by Germany Co, since in the instant case, India is the 'country of source' and Germany is the 'country of residence'.

Clauses (1) to (3) of Article 13 of the India-Germany DTAA, would not be relevant to the instant case. As per clause (4) of Article 13 of the India-Germany DTAA, *"gains from the alienation of shares in a company which is a resident of a Contracting State may be taxed in that State".*

In the instant case, the shares being transferred are those of Mauritius Intermediary Co, which is not a resident of India. Accordingly, the instant case would not be covered under clause (4) of Article 13 and the residual clause (5) of Article 13 would be applicable. As per clause (5), *"Gains from the alienation of any property other than that referred to in paragraphs 1 to 4 shall be taxable only in the Contracting State of which the alienator is a resident"*. The alienator is Germany Co, which is a resident of Germany and not India and accordingly, the capital gains shall be taxable only in Germany and is not taxable in India.

Since the provisions of the DTAA can be applied, where they are more beneficial to the taxpayer than the provisions of the Act, in the instant case, the provisions of the DTAA can be applied and accordingly, the capital gains would not be taxable in India.

(c) Transfer of shares of Australian Intermediary Co by Cyprus Co.

In the instant case, specified date is 31.05.2019being the date of transfer, since the book value of assets on the date of transfer (i.e., Rs.120 crores) exceeds by more than 15%, Rs.100 crores, being the book value of assets as at 31.12.2018, the last balance sheet date preceding the transfer.

Fair value of assets of Australian Intermediary Co as on 31.5.2019 - INR 300 crores

Fair value of Ind Co as on 31.5.2019 (without reduction of liabilities) - INR 200 crores

Fair value of Ind Co as held by Australian Intermediary Co (51%) - INR 102 crores

The value of assets located in India i.e., INR 102 crores exceeds INR 10 crores. However, since it does not represent at least 50% of the value of assets of Australian Intermediary Co, shares of Australian Intermediary Co would not be deemed to derive its value substantially from assets located in India.

Hence, the shares of Australia Intermediary Co would not be deemed to be a capital asset situated in India and the capital gains from transfer of shares of Australia Intermediary Co would not be deemed to accrue or arise in India. Accordingly, the gains would not be taxable in the hands of Cyprus Co in India as per the Income-tax Act, 1961.

Accordingly, it would not be necessary to examine the provisions of the applicable DTAA.

(d) Transfer of shares of Spain Intermediary Co by UK Co.

In the instant case, specified date is 31.03.2019being the last balance sheet date preceding the transfer, since the book value of assets on the date of transfer (i.e., Rs.7 crores) is the same as the book value of assets as at 31.5.2019, being the date of transfer.

Fair value of assets of Spain Intermediary Co as on 31.3.2019 - INR 12 crores

Fair value of Ind Co as on 31.3.2019 (without reduction of liabilities) - INR 200 crores

Fair value of Ind Co as held by Spain Intermediary Co (4%) - INR 8 crores

Since, the value of assets located in India i.e., INR 8 crores does not exceed INR 10 crores, shares of Spain Intermediary Co would not be deemed to derive its value substantially from assets located in India.

Hence, the shares of Spain Intermediary Co would not be deemed to be a capital asset situated in India and the capital gains from transfer of shares of Spain Intermediary Co would not be deemed to accrue or arise in India. Accordingly, the gains would not be taxable in the hands of UK Co in India as per the Income-tax Act, 1961.

Accordingly, it would not be necessary to examine the provisions of the applicable DTAA.

Answer to Q.2:

Computation of capital gains chargeable to tax and tax payable in India on transfer of shares of Singapore Intermediary Co by US Co

S. No	Particulars	Amount (INR crores)
1.	Full value of consideration for transfer of shares of Singapore Intermediary Co	50.00
2.	Cost of acquisition of shares of Singapore Intermediary Co	10.00
3.	**Long-term capital gains**	**40.00**
4.	Fair Market Value of all the assets of the Singapore Intermediary Co as on the specified date (31st May 2019)	50.00
5.	Fair Market Value of assets of the Singapore Intermediary Co located in India as on the specified date (31st May 2019), i.e., Fair value of Ind Co as held by Singapore Intermediary	40.00
6.	Long-term capital gains (income) attributed to assets located in India [(3)*(5)/(4)]	32.00
7.	**Long-term capital gains tax at 10% (as per section 112) (before surcharge and cess)**	**3.20**

Notes:

1. As per Rule 11UC, the income attributed to assets located in India would be based on the proportion of fair market value of assets located in India on the specified date, from which the share derives its value substantially to the fair market value of all assets of Singapore Intermediary Co.
2. As per section 112(1)(c)(iii), in case of a foreign company, the long term capital gain on unlisted securities is chargeable to tax @10% without indexation and currency fluctuation benefit.
3. The rate of 10% is excluding cess and surcharge, if any, depending on the total income of the company.

SOLUTION TO CASE STUDY 4

I. ANSWERS TO MCQs (Most appropriate answers)

1. (d)

2. (c)

3. (c)

4. (d)

5. (d)

II. ANSWERS TO DESCRIPTIVE QUESTIONS

Answer to Q.1:

For the purpose of computing book profit for levy of minimum alternate tax under section 115JB, the profit shown in the statement of profit and loss prepared in accordance with the Companies Act, 1956 can be increased/decreased only by the additions and deductions specified in *Explanation* 1 to section 115JB, in case of a company which is not required to comply with Ind AS.

Therefore, transfer pricing adjustments cannot be made while computing book profit for levy of MAT.

No; the answer will not change even if TCL is required to comply with Ind AS. Even then, only the adjustments listed in 115JB(2A) need to be made, and not the transfer pricing adjustment.

Answer to Q.2:

Any income arising from an international transaction, where two or more "associated enterprises" enter into a mutual agreement or arrangement, shall be computed having regard to arm's length price as per the provisions of Chapter X of the Act.

The items that are to be considered for transfer pricing adjustments are as under:

(a) Sales to SL, XY Inc and AB LLC;

(b) Royalty payments received from D Inc., and

(c) Interest on borrowings from Danubes Inc., Dubai.

Export sales to foreign companies

Sales to SL

Section 92A defines an "associated enterprise" and sub-section (2) of this section speaks of the situations when the two enterprises shall be deemed to be associated enterprises.

In SL, TCL holds 14/50 i.e. 28% of the voting power.

Since TCL holds more than 26% of the voting power in SL, TCL and SL are deemed to be associated enterprises.

SL is a non-resident company. The transaction is for sale of the product. Hence, the sales made by TCL to SL are international transactions.

Sales to GSL

In GSL, TCL holds 18/80 i.e. 22.5% of the voting power

Since TCL holds less than 26% of the voting power, GSL is not an associated enterprise.

Sales to XY Inc and AB LLC

Both these companies are located in notified jurisdictional areas (NJA).

As per section 94A, following are the consequences:

(i) all the parties to the transaction shall be deemed to be associated enterprises within the meaning of section 92A;

(ii) Transactions of purchase and sale shall be treated as international transactions;

(iii) Transfer pricing provisions will apply to such transactions.

Hence, the transactions in question have to be tested with reference to the ALP.

GSL is not an associated enterprise and hence the selling price of Rs.12,000 per MT to GSL can be taken as the ALP, as per CUP method.

Considering the above, the understatement of profits on account of lower selling price is:

Name of the party	Qty in MT	Rate per MT (Rs.)	ALP	Difference per MT	Total amount (Rs. In lakhs)
SL	8,00,000	11,800	12,000	200	1600
XY Inc.	3,00,000	11,900	12,000	100	300
AB LLC.	2,00,000	11,700	12,000	300	600
				Total adjustment to ALP	**2,500**

Royalty receipts

D Inc., is a wholly owned subsidiary of TCL and is a non-resident company. Hence, it is an associated enterprise.

Royalty falls within the meaning of international transaction, since it is payment for supply of know-how, being an intangible property.

D Inc., is currently paying a royalty of 2 million USD per annum (year ended 31-3-2020) to TCL for supply of know-how. For similar supply of know how to Epsilon LLC., a wholly owned Government Company in Japan, TCL receives annual royalty of 3 million.

Under CUP Method, ALP has to be taken as 3 million USD

Understatement of royalty is 1 million USD, i.e. 1 M USD x Rs.70 =Rs.700 lakhs.

Borrowings

If one enterprise advances loan to the other enterprise of an amount of 51% or more of the book value of the total assets of such other enterprise, the two enterprises would be deemed to be associated enterprises.

As on the date of borrowing, the amount advanced is Rs.200 crores out of Rs.330 crores, which comes to 60.6%.

Hence, Danubes Inc., is deemed to be an associated enterprise of TCL.

Interest payments are also covered by the term "international transaction".

Danubes Inc., has charged interest at 8% and TCL has paid interest of Rs.16 crores for the year ended 31-3-2020.

Interest rate charged to other parties is 7%. This has to be taken as the ALP rate.

In the light of this, the interest payment should have been 16x7/8 i.e., Rs.14 crores There has been an excess payment of Rs.2 crores w.r.t. ALP.

Total income of TCL

The total income of TCL, after considering the above adjustments will be as under:

Particulars	Amount (Rs. in cr)
Net profit as given prior to TP adjustments	32.2
Add: Difference on account of value in international transactions	
(i) Export sales	25.0
(ii) Royalty receipts	7.0
(iii) Interest payment	2.0
Total Income	**66.2**

SOLUTIONTO CASE STUDY 5

I. ANSWERS TO MCQs (Most appropriate answers)

1. (c)

2. (d)

3. (d)

4. (c)

5. (b)

II. ANSWER TO DESCRIPTIVE QUESTIONS

1. Stay of Mr. Investor in India during F.Y. 2019-20 is 59 days and hence, he will be considered as non-resident in India for Assessment Year 2020-21.

Comparison of Tax Liability under the regular provisions and special provisions of the Act

As per special provisions under Chapter XII-A of the Income-tax Act, 1961, Mr. Investor is liable to pay tax of Rs. 1,310.	Rs.1,310
As per regular provisions of the Income-tax Act, 1961, Mr. Investor is entitled to a refund of Rs.18,440.	(Rs.18,440)

Since the regular provisions of the Act are more beneficial to Mr. Investor, he should compute his total income and pay tax under the regular provisions of the Act.

Computation of total income and tax liability of Mr. Investor for A.Y.2020-21 under Chapter XII-A

Particulars	Amount (Rs)	Amount (Rs)	Amount (Rs)
Income from House Property			
Gross Annual Value		3,10,000	
Less: Municipal taxes paid and borne by the owner		(10,000)	

Net Annual Value		3,00,000	
Less: Deductions u/s 24			
(a) 30% of NAV	90,000		
(b) Interest on loan	10,000	1,00,000	2,00,000
Capital Gains			
Period of holding of shares – F.Y.2009-10 to F.Y. 2019-20			
Long-term capital gains			
Full Value of Consideration [Rs.3,00,000/75]		$ 4,000	
Less: Expenditure on Transfer			
Brokerage [Rs. 10,000/75]		$ 133.33	
Net Consideration		$ 3,866.67	
Less: Cost of Acquisition [Rs.2,00,000/64]		$ 3,125.00	
		$ 741.67	
TTBR as on 28.2.2020		74	
Long term capital gains [$ 741.67 x 74]			54,884
Income from Other Sources			
Dividend Income	10,10,000		
Less: Exempt under section 10(34)	10,10,000	Nil	
Interest income on debentures (Gross)		75,000	
Sum of money received from friend		60,000	1,35,000
Gross Total Income			**3,89,884**
Less: **Deductions under Chapter VI-A**			
Under section 80C - Loan repayment to HDFC		20,000	
Under section 80G - Prime Minister's National Relief Fund and Drought Relief Fund 100% of Rs. 5,000 = Rs. 5,000 50% of Rs.10,000 = Rs.5000 [allowable since payment is made by a mode other than cash]		10,000	30,000
Total Income			**3,59,884**
Tax Liability:			
Income tax payable on interest income@20%		15,000	
Income tax payable on long-term capital gains@10%		5,488	
Income tax payable on other incomes of Rs.2,30,000		Nil	20,488
Add: Health & Education Cess@4%			820
Total Tax Liability			**21,308**
Less: TDS			20,000
Net Tax Payable			**1,308**
Net Tax Payable (Rounded off)			**1,310**

Computation of total income & tax liability under the regular provisions of the Act for A.Y. 2020-21

Particulars	Amount (Rs)	Amount (Rs)	Amount (Rs)
Income from House Property			
Gross Annual Value		3,10,000	
Less: Municipal Taxes paid and borne by the owner		10,000	
Net Annual Value		3,00,000	
Less: Deductions under section 24			
(a) 30% of NAV	90,000		
(b) Interest on Loan	10,000	1,00,000	2,00,000
Capital Gains			
Period of holding of shares – FY 2009-10 to 2019-20			
Long-term capital gains			
Full Value of Consideration		3,00,000	
Less: Expenditure on Transfer			
Brokerage		10,000	
Net Consideration		2,90,000	
Less: Cost of acquisition		2,00,000	90,000
Higher of the following			
Original cost of acquisition	2,00,000		
Lower of fair market value as on 31.1.2018 and Full value of consideration (i.e., lower of Rs. 1,80,000 and Rs. 3,00,000)	1,80,000		
[Indexation and currency fluctuation benefit not allowable on capital gain chargeable under section 112A]			
Income from Other Sources			
Dividend Income	10,10,000		
Less: Exempt U/s 10(34)	10,10,000	Nil	
Interest Income on Debentures (Gross)	75,000		
Less: Interest Paid	25,000	50,000	
Sum of money received from friend		60,000	1,10,000
Gross Total Income			**4,00,000**
Less: **Deductions under Chapter VI-A**			
Under section 80C- Loan repayment to HDFC		20,000	
Under section 80G - Prime Minister's National Relief Fund and Drought Relief Fund 100% of Rs. 5,000 = Rs. 5,000 50% of Rs.10,000 = Rs.5000 [allowable since payment is made by a mode other than cash]		10,000	30,000

Total Income			**3,70,000**
Tax Liability:			
Income tax payable on long term capital gains [Since10% tax is attracted under section 112A, in excess of Rs.1,00,000]		Nil	
Income tax payable on other incomes of Rs.2,80,000		1,500	1,500
Add: Health & Education Cess@4%			60
Total tax liability			1,560
Less: TDS			20,000
Net Refund Due			**(18,440)**

Notes:

#1 Capital gains on transfer of STT paid shares are covered by section 112A. Consequently, no tax is payable upto gains of Rs.1,00,000.

#2 Indexation and currency fluctuation benefit is not available under the regular provisions of the Act in respect of capital gains chargeable under section 112A.

Indexation benefit is not available under special provisions of the Act.

#3 As per newly inserted clause (viii) in section 9(1), "income arising outside India, being any sum of money referred to in sub-clause (xviia) of clause (24) of section 2, paid on or after the 5th day of July, 2019 by a person resident in India to a non-resident, not being a company, or to a foreign company would be deemed to accrue or arise in India."

Consequently, sum of money received from friend Rs.60,000/- is taxable in India. However, Work of Art shall not be deemed to accrue in India as only "Sum of Money" shall be deemed to accrue in India.

#4 Section 115BBDA is applicable only in case of Residents. Hence, Dividend Income in the hands of Non-resident shall not be taxable. Thus, entire dividend would be fully exempted under section 10(34)

#5 Rebate under section 87A is not available to non-resident individual.

2. Two enterprises shall be deemed to be associated enterprises if, at any time during the previous year, more than half of the board of directors or members of the governing board, or one member executive directors or executive members of the governing board of one enterprise, are appointed by the other enterprise.

In the present case, the power to appoint is only for half the number and not more than half. Hence, they are not associated enterprises under this criteria.

Two enterprises shall be deemed to be associated enterprises, if 90% or more of the raw materials and consumables required for the manufacture or processing of goods or article carried out by one enterprise, are supplied by the other enterprise, or by persons specified by the other enterprise, and the prices and other conditions relating to the supply are influenced by such other enterprise.

Here, Canada Supply Inc supplies more than 90% of the requirements of purchases of Bombay Buying Ltd. Further, the price is controlled by the former by way of written agreement. Also, the conditions for supply are determined by Canada Supply Inc., the two entities would be deemed to be associated enterprises under this criterion.