MOCK TEST PAPER

FINAL (NEW) COURSE: GROUP II

ELECTIVE PAPER 6C: INTERNATIONAL TAXATION

SOLUTION TO CASE STUDY 1

I. ANSWERS TO MCQs (Most appropriate answers)

Q. No.	Answer
(i)	b
(ii)	d
(iii)	c
(iv)	d
(v)	b

II. ANSWERS TO DESCRIPTIVE QUESTIONS

Answer to Q.1

Mr. Shiva is a non-resident in India during the P.Y. 2019-20 since he is residing in United States since 1992 and he visits India only for 59 days during the P.Y.2019-20.

In case of a non-resident, only the following incomes are chargeable to tax:

(i) Income received or deemed to be received in India; and

(ii) Income accruing or arising or deemed to accrue or arise in India.

Computation of total income and tax liability of Mr. Shiva for A.Y.2020-21

Particulars	Amount in ₹	
Income from house property		
Residential house at New Delhi [Annual Value would be Nil, assuming that no other benefit is derived from such property]		Nil
Residential house at Mumbai co-owned with Ms. Parvati [Annual Value would be Nil, since it is used for self-occupation by his spouse, Ms. Parvati]		Nil
Note *– Shiva can claim benefit of "Nil" Annual Value in respect of two houses i.e., house at New Delhi and co-owned house at Mumbai self-occupied by him.*		
Commercial apartment in Singapore and residential property at Malaysia [Annual value of house properties outside India would be outside the scope of total income of Mr. Shiva, since he is a non-resident. Consequently, the same would not be subject to tax in India]		Nil
Capital Gains		
Long term capital gains on sale of shares of listed companies		3,60,000
[As per section 64(1)(iv), income arising to Smt. Parvati from transfer of listed equity shares is includible in the hands of her husband, Mr. Shiva, since there has been a transfer of money to a joint account without any consideration, out of which Smt. Parvati has purchased listed equity shares in her own name.		
Long-term capital gains on transfer of STT paid listed equity shares arising to Smt. Parvati includible in the hands of Mr. Shiva **[See Working Note]**		

Long term capital gain on sale of vacant site at Mumbai (long term, since it is held for more than 24 months)		
Full value of consideration	40,00,000	
As per section 50C, the full value of consideration would be higher of actual consideration of ₹ 35,00,000 and stamp duty value of ₹ 40,00,000 since stamp duty value exceeds 105% of the sale consideration		
Less: Indexed cost of acquisition (₹ 7,40,000 x 289/184)	11,62,283	
	28,37,717	
Less: Exemption u/s 54F [Not available since investment in residential house in India is only eligible for exemption]	-	28,37,717
Gross Total income/Total Income		**31,97,717**
Total Income (rounded off)		**31,97,720**
Tax on total income		
Tax@10% on long-term capital gains of ₹ 2,60,000 (₹ 3,60,000 – ₹ 1,00,000) u/s 112A		26,000
Tax@20% on long-term capital gains of ₹ 28,37,720 u/s 112		5,67,544
		5,93,544
Add: Health and education cess@4%		23,742
Tax liability		**6,17,286**
Tax liability (rounded off)		**6,17,290**

Note *– Since Mr. Shiva is a non-resident, the unexhausted basic exemption limit cannot be adjusted against long-term capital gains under section 112A or section 112.*

Working Note:

Computation of long-term capital gains on transfer of equity shares of listed companies in the hands of Smt. Parvati u/s 112A

Particulars	Amount in ₹
Long term capital gain on transfer of shares purchased on 14.4.2014, since held for more than 12 months	
Sale Consideration	15,00,000
Less: Cost of acquisition	14,00,000
Higher of -	
Cost of acquisition ₹ 12 lakhs and	
₹ 14 lakhs, being the lower of -	
(i) FMV as on 31.1.2018 – ₹ 14 lakhs; and	
(ii) Sale consideration – ₹ 15 lakhs	
	1,00,000
Long term capital gain on transfer of shares purchased on 25.3.2017, since held for more than 12 months	
Sale Consideration	17,50,000
Less: Cost of acquisition	14,90,000
Higher of -	
Cost of acquisition ₹ 13.20 lakhs and	

₹ 14.90 lakhs, being the lower of - (i) FMV as on 31.1.2018 – ₹ 14.90 lakhs; and (ii) Sale consideration – ₹ 17.50 lakhs	
	2,60,000

Note *– Since Smt Parvati is a resident, special provisons under Chapter XII-A would not be applicable. Further, since long-term capital gains is computed u/s 112A, benefit of conversion into foreign currency fluctuation and benefit of indexation are not allowable.*

Answer to Q.2

As per section 195, any person responsible for paying interest (other than interest referred to in section 194LB or section 194LC or section 194LD) or any other sum chargeable to tax (other than salaries) to a non-resident, not being a company or a foreign company is liable to deduct tax at source at the rates prescribed by the relevant Finance Act.

Hence, since Mr. Shiva is a non-resident, Mr. Vishnu is required to deduct tax at source at the rates in force i.e., 20% (*plus* HEC@4%) in this case, under section 195, in relation to consideration for transfer of vacant site at Mumbai.

Since, in this case, the whole of the sale consideration payable to Mr. Shiva is not chargeable to tax, Mr. Vishnu has to make an application to the Assessing Officer for determining the appropriate proportion of such sum so chargeable; accordingly, tax has to be deducted at the rate of 20.8% only on that proportion of the sum which is so chargeable.

Tax implication of purchase of land in the hands of Mr. Vishnu

In case immovable property is received for inadequate consideration, the difference between the stamp duty value and actual consideration would be taxable under section 56(2)(x) in the hands of the recipient, if such difference exceeds ₹ 50,000 or 5% of the consideration, whichever is higher. However, if immovable property is received from a relative, section 56(2)(x) would not be attracted. "Brother" falls within the definition of "relative". Hence, the difference of ₹ 5 lakhs [₹ 40 lakhs – ₹ 35 lakhs] would not be taxable in Mr. Vishnu's hands.

Answer to Q.3

The REIT enjoys pass-through status in respect of rental income from real estate asset owned by it directly and interest income from special purpose vehicle, (i.e., A Ltd., in this case, since it is an Indian company in which REIT holds controlling interest). Therefore, such income is taxable in the hands of the unit holders.

(1) **Rental income component of income distributed by REIT**: The distributed income or any part thereof, received by Ganesh from the REIT, which is in the nature of income by way of renting or leasing or letting out any real estate asset owned directly by such REIT is deemed income of the unit-holder as per section 115UA(3). Accordingly, ₹ 1,25,000 would be deemed income of Ganesh as per section 115UA(3). The REIT has to deduct tax at source under section 194LBA@31.2% (being the rate in force) in case of distribution to Ganesh, being a non-resident.

(2) **Interest component of income distributed by REIT**: Interest component of income received from a special purpose vehicle, A Ltd., in this case, and distributed to a unit holder is taxable@5.2% in the hands of a non-resident unit holder. Accordingly, such interest component of ₹ 62,000 is taxable in the hands of Ganesh. The REIT has to deduct tax at source under section 194LBA @5.2%, on ₹ 62,000, since Ganesh is a non-resident.

(3) **Dividend component of income distributed by REIT**: Any distributed income referred to in section 115UA, to the extent it does not comprise of interest [referred to in sub-clause (a) of section 10(23FC)] and rental income from real estate assets owned directly by the business trust [referred to in section 10(23FCA)] received by unit holders, is exempt in their hands under section 10(23FD). Therefore, by

virtue of section 10(23FD), ₹ 58,000, being the dividend component [referred to in sub-clause (b) of section 10(23FC)] of income distributed to Ganesh would be exempt in his hands. Therefore, there is no liability on the REIT to deduct tax at source on the dividend component of income distributed by it to Mr. Ganesh.

SOLUTION TO CASE STUDY 2

I. ANSWERS TO MCQs (Most appropriate answers)

Q. No.	Answer
(i)	(c)
(ii)	(c)
(iii)	(b)
(iv)	(d)
(v)	(c)

II. ANSWERS TO DESCRIPTIVE QUESTIONS:

Answer to Q.1:

MNO Ltd., an Indian company and ABC Inc., a Country A based company are associated enterprises as per section 92A, since ABC Inc. is a parent company of MNO Ltd. Thus, the transaction of purchase of mobile handsets by MNO Ltd. from ABC Inc. would be an international transaction. The value of international transaction is to be worked out on the basis of Arm's Length Price (ALP).

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

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

Computation of Arm's Length Price

Particulars	₹ in crores
Purchase price of mobile phones by unrelated parties from ABC Inc.	2,400
Adjustments for functional differences	
Add: Royalty payable by MNO Ltd. [₹ 100 per mobile phone x 10,00,000]	10
Cost of capital for 1 month credit which is not given to unrelated party [10% x ₹ 200 crore (monthly average sales i.e., ₹ 2,400 crore /12 months]	20
Arm's Length Price of 10,00,000 mobile phones (A)	**2430**
Purchase price of mobile phone by MNO Ltd. from ABC Inc., its parent company (associated enterprise) (B)	**2600**
Amount to be added to its total income (B) – (A)	**170**

Note *– In case it is assumed that ₹ 10 crores is not included in the price of ₹ 2600 crores, the adjustment of royalty of ₹ 10 crores paid/payable is not required. The ALP in such a case would be ₹ 2,420 crores. The amount to be added to the total income would be ₹ 180 crores*

Answer to Q.2

As per section 92CA(1), where the Assessing Officer considers it necessary or expedient so to do, he may refer the computation of the arm's length price in relation to the international transaction entered by any person, being an assessee, to the Transfer Pricing Officer (TPO).

However, the Assessing Officer has to take the prior approval of the Principal Commissioner of Income-tax (PCIT)/Commissioner of Income-tax (CIT) before making such a reference.

As per section 92CA(2A), the Transfer Pricing Officer (TPO) can also determine the ALP of other international transactions which have not been referred to him, but which have come to his notice subsequently in the course of proceedings before him.

The Assessing Officer has made reference for determination of ALP in respect of the manufacturing unit at Hyderabad which shall be taken as the proceedings before him (TPO).

The TPO can enlarge his scope of work during the course of proceedings before him of Hyderabad unit by calling for details of trading activity at Surat, and the same is within the powers conferred by section 92CA(2A).

Answer to Q.3

The term "permanent establishment" means a fixed place of business through which the business of an enterprise is wholly or partly carried on.

However, the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity of a preparatory or auxiliary character would not constitute a permanent establishment.

In the present case, the liaison office of ABC Inc. would constitute permanent establishment, since its activities are not of preparatory or auxiliary character but for procuring orders for supply of mobile phones directly to customers in India.

In the case of *Jebon Corporation India,* the Karnataka High Court held that securing and processing orders have led to the liaison office forming a PE in India. Consequently, the profits attributable to the PE would be chargeable to tax in India.

The Force of Attraction Rule implies that when a foreign enterprise sets up a PE in the State of Source, it brings itself within the fiscal jurisdiction of that State (State of Source) to such a degree that all profits that the enterprise derives from State of Source, whether through the PE or not, can be taxed by it (State of Source).

In the present case, since ABC Inc. is a Country A based company, the taxability of profits attributable to the PE would be determined based on India-Country A DTAA, which is in line with the UN Model Convention, 2017, which has a Force of Attraction Rule. Since the India-Country A DTAA contains the Force of Attraction Rule, the same will apply in the present case. Accordingly, the profits earned by ABC Inc. from orders for mobile phones procured in India, whether through the liaison office or not, would be subject to tax in India.

SOLUTION TO CASE STUDY 3

I. ANSWERS TO MCQs (Most appropriate answers)

(i) d

(ii) b

(iii) b

(iv) d

(v) d

II. ANSWERS TO DESCRIPTIVE QUESTIONS

Answer to Q.1

(i) As per section 115BBA, ₹ 32 lakhs earned by William Peters, a non-resident sports person, who is not a citizen of India, from playing cricket matches and ₹ 8 lakhs from advertisement i.e., ₹ 40 lakhs earned by him totally is chargeable to tax@20.8%.

No deduction is allowable in respect of any expenditure to earn such income.

Section 194E requires tax deduction at source @20.8% from such income paid to a non-resident sportsperson.

TDS = ₹ 40 lakhs x 20.8% = ₹ 8,32,000

Section 195A provides that if such tax is to be borne by the person by whom the income is payable, ABC Ltd., in this case, then the net amount of ₹ 40 lakhs payable has to be grossed up in the following manner:

₹ 40 lakhs x 100/79.2 (i.e., 100 – 20.8) = ₹ 50,50,505

TDS = ₹ 50,50,505 x 20.8% = ₹ 10,50,505

(ii) A match referee is, however, not a sportsperson. Therefore, Samuel Singers is not entitled to the benefit of section 115BBA. The sum of ₹ 6 lakhs received by him would be taxable at normal rates of tax.

Tax would be deductible under section 195 at the rates in force, i.e., 31.2%.

TDS = ₹ 6,00,000 x 31.2% = ₹ 1,87,200

Applying the grossing up provisions under section 195A,

₹ 6 lakhs x 100/68.8 (i.e., 100 – 31.2) = ₹ 8,72,093

TDS = ₹ 8,72,093 x 31.2% = ₹ 2,72,093

Answer to Q.2

A company shall be said to be engaged in "active business outside India" for POEM, 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.

XYZ Inc. shall be regarded as a company engaged in active business outside India for POEM purpose only if it satisfies all the four conditions cumulatively.

Condition 1: Passive income test

The passive income of XYZ Inc. should not be more than 50% of its total income

Passive Income	**₹ in crores**
From sales made by XYZ Inc to ABC Ltd. out of purchases from third parties	**-**
From purchases made from ABC Ltd. and sold to third parties	**-**
Dividend and Interest	13
Total passive global income	**13**
Total income of XYZ Inc.	**155**
Percentage of passive income earned	**8.39%**

Total income of XYZ Inc. during the P.Y. 2019-20 is ₹ 155 crores, being ₹ 65 crores in India [₹ 42 crores + ₹ 10 crores + ₹ 5 crores + ₹ 8 crores] and ₹ 90 crores outside India [₹ 15 crores + ₹ 70 crores + ₹ 5 crores]

Since passive income of XYZ Inc i.e., 8.39% is less than 50% of its total income, **the first condition (Passive income test) is satisfied.**

Condition 2: Assets Test

XYZ Inc. should have less than 50% of its total assets situated in India

Value of assets is determined in the following manner:

In case of pool of fixed asset, being treated as a block for depreciation	The average of its value for tax purposes in the country of incorporation of the company at the beginning and at end of the year;
In case of any other asset	Value as per books of account

Value of assets of XYZ Inc:

Particulars	In India (₹ in crores)	Outside India (₹ in crores)
Warehouses (building portion only), being depreciable asset, at average of its WDV as on 1.4.2019 and as on 31.3.2020	$\frac{6.7 + 13.2}{2}$ = **9.95**	$\frac{4.2 + 10.2}{2}$ = **7.20**
Other fixed assets, being depreciable assets, at average of its WDV as on 1.4.2019 and as on 31.3.2020	$\frac{3.5 + 5.1}{2}$ = **4.30**	$\frac{3.8 + 10.6}{2}$ = **7.20**
Land [Value as per books of account on 31.3.2020]	**10.00**	**12.00**
Total	**24.25**	**26.40**

Percentage of assets situated in India to total assets = ₹ 24.25 crores/₹ 50.65 crores x 100 = **47.88%**

Since the value of assets of XYZ Inc. situated in India is less than 50% of its total assets, **the second condition (Assets test) is also satisfied.**

Condition 3: Number of employees test

Less than 50% of the total number of employees of XYZ Inc. should be situated in India or should be resident in India

XYZ Inc. employed 30 persons in India and 10 other persons, who are resident in India but not directly employed by XYZ Inc. though they perform work like any other employee.

For counting the number of employees in India, the average of the number of employees as at the beginning and at the end of the year has to be considered and it would include persons, who, though not employed directly by the company, perform tasks similar to those performed by the employees.

Therefore, number of **employees situated in India or are resident in India is 40 i.e., 30+10**[1]

Total number of employees of XYZ Inc. is 82, being 42 employed outside India and 40 in India or resident in India.

Percentage of employees situated in India or are resident in India to total number of employees is 40/82 x 100 = **48.78%**

Since employees situated in India or are residents in India of XYZ Inc. are less than 50% of its total employees, **the third condition (Number of employees test) is satisfied** for active business outside India test.

Condition 4: Payroll expenses Test

The payroll expenses incurred on employees situated in India or residents in India should be less than 50% of its total payroll expenditure

[1] Since the number of employees are same throughout the year

Payroll expenditure on employees situated in India or are residents in India is **₹ 1.54 crores** i.e., ₹ 1.20 crores ***plus*** ₹ 0.34 crores

Total payroll expenditure of XYZ Inc. is **₹ 4.54 crores** being expenditure on employees situated in India or are residents in India and expenditure on employees outside India [i.e., ₹ 1.54 crores + ₹ 3 crores].

Percentage of payroll expenditure on employees situated in India or are resident in India to total payroll expenditure is ₹ 1.54 crores/₹ 4.54 crores x 100 = **33.92%**

Since payroll expenditure on employees situated in India or are residents in India of XYZ Inc. is less than 50% of its total payroll expenditure, **the fourth condition (Payroll expenses test) is also satisfied**.

Conclusion:

Since XYZ Inc. satisfies all the above four conditions cumulatively, XYZ Inc. will be regarded as a company engaged in active business outside India (ABOI).

Note - The POEM of a company fulfilling the ABOI test would be outside India if majority of the Board meetings are held outside India. In this case, since 6 out of 10 Board meetings of XYZ Inc. are held outside India in the P.Y.2019-20, the POEM of XYZ Inc. is not in India in that year. Hence, XYZ Inc. is non-resident for A.Y.2020-21.

SOLUTION TO CASE STUDY 4

I. ANSWERS TO MCQs (Most appropriate answers)

(i) d

(ii) c

(iii) d

(iv) c

(v) b

II. ANSWERS TO DESCRIPTIVE QUESTIONS

Answer to Q.1:

Since Mr. Prem Kapoor is resident in India for the P.Y.2019-20, his global income would be subject to tax in India. Therefore, income earned by him in Country X & Y would be taxable in India. He is, however, entitled to deduction under section 91, since India does not have a DTAA with Country X & Y, and all conditions under section 91 are satisfied.

Computation of tax liability of Mr. Prem Kapoor for A.Y.2020-21

Particulars		₹	₹
I	**Income from house property**		
	Income from house property in India	4,30,00,000	
	Less: Loss from house property in Country X	1,30,00,000	
			3,00,00,000
II	**Profits and gains of business or profession**		
	Business income in India		
	From being the owner of cricket team in Pune Knight Riders	12,40,00,000	
	From acting in movies	9,41,50,000	
		21,81,50,000	
	Business income in Country X		
	Own 7,20,00,000		

Share income from firm[2]	4,80,00,000	12,00,00,000	
Business income in Country Y		2,90,00,000	
			36,71,50,000
III Income from Other Sources			
Agricultural income from Country Y			1,20,00,000
Gross Total Income			**40,91,50,000**
***Less:* Deductions under Chapter VI-A**			
Under section 80C			
PPF ₹ 1,50,000 & LIC ₹ 1,00,000			
Total ₹ 2,50,000, restricted to			1,50,000
Total Income			**40,90,00,000**
Computation of tax liability:			
Tax on total income			**12,25,12,500**
[30% x ₹ 40,80,00,000 + ₹ 1,12,500]			
Add: Surcharge@37% (since his total income exceeds ₹5 crore)			4,53,29,625
			16,78,42,125
Add: HEC @4%			67,13,685
Tax liability			**17,45,55,810**
Less: Deduction under section 91 **[See Working Notes 1 & 2 below]**			
			2,72,60,000
Net Tax liability (rounded off)			**14,72,95,810**

Working Note 1: Computation of deduction under section 91			
Particulars			**₹**
I	**Deduction under section 91 in respect of doubly taxed income in India and Country X**		
	Doubly taxed income:		
	Country X (i.e., ₹ 7.2 crores, being business income (+) ₹ 4.8 crores, being taxable share income from firm (-) ₹ 1.3 crores, loss from house property)	₹ 10,70,00,000	
	Lower of Indian rate of tax and rate of tax in Country X **[See Working Note 2 below]**	**18%**	
	Deduction u/s 91 = 18% x ₹ 10.70 crores		1,92,60,000
II	**Deduction under section 91 in respect of doubly taxed income in India and Country Y**		
	Doubly taxed income:		
	Country Y (i.e., ₹ 2.9 crores, being business income (+) ₹ 1.2 crores, being taxable agricultural income)	₹ 4,10,00,000	
	Lower of Indian rate of tax and rate of tax in Country Y **[See Working Note 2 below]**	**19.512%**	

[2] It is logical to take a view that exemption under section 10(2A) in hands of the partner would be available only in respect of share income from an Indian firm. In this case, since the share income is from a foreign firm which is not evidenced by an instrument in writing, the same is taxable in India in the hands of the partner.

	Deduction u/s 91 = 19.512% x ₹ 4.10 crores		80,00,000
Deduction under section 91			**2,72,60,000**

Working Note 2: Computation of average rate of tax in India, Country X & Y		
(1)	Average rate of tax in India [17,45,55,810 x 100/40,90,00,000]	42.68%
(2)	Average rate of tax in Country X [2,16,00,000 x 100/12,00,00,000]	18%
(3)	Average rate of tax in Country Y [80,00,000 x 100/4,10,00,000]	19.512%

Answer to Q.2

As per section 3(1) of Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015, every assessee would be liable to tax@30% in respect of his undisclosed foreign income and asset of the previous year.

However, an undisclosed asset located outside India shall be charged to tax on its value in the previous year in which such asset comes to notice of the Assessing Officer.

As per section 41, in case, where tax has been computed in respect of undisclosed foreign income and asset, the Assessing Officer may direct the assessee to pay by way of penalty, in addition to tax, if any, payable by him, a sum equal to three times the tax so computed.

As per section 43, if any person, being a resident other than not ordinarily resident in India, who has furnished the return of income for any previous year, fails to furnish any information in relation to an asset (including financial interest in any entity) outside India held as a beneficial owner or otherwise, or in respect of which such person was a beneficiary, or if such failure is in relation to any income from a source located outside India, at any time during such previous year, the Assessing Officer may direct such person to pay, by way of penalty, a sum of ₹ 10 lakh.

In this case, search by IT department is conducted on Mr. Prem Kapoor's premises on 31.3.2020 and undisclosed foreign income and assets were found. The undisclosed foreign income would be charged to tax@30% in the P.Y.2017-18. The undisclosed foreign asset would be charged to tax@30% in the P.Y.2019-20, being the year in which it came to the notice of the Assessing Officer. The Assessing Officer may direct penalty, in addition to tax payable by him, a sum equal to three times the tax so computed and ₹ 10 lakh for not disclosing foreign assets and income.

Undisclosed foreign income

Undisclosed foreign income of ₹ 8 crores earned in Country A during the F.Y.2017-18 is chargeable to tax in the A.Y.2018-19.

The tax payable is 30% of ₹ 8 crores = ₹ 2.4 crores.

Undisclosed foreign assets

Though the immovable property in Country B was purchased in the P.Y.2015-16 and piece of art work was acquired in the P.Y.2018-19 in Country C, the same is chargeable to tax in India under the Black Money Act in the A.Y.2020-21 only, since these assets came to the notice of the Assessing Officer in the P.Y.2019-20.

Particulars	Million $	₹ (in crores)
Undisclosed foreign assets:		
Immovable property in Country B		
Purchase price	22.000	

Add: Brokerage (3% of $ 22 million)	0.660	
Cost of acquisition	22.660	
Market value as on valuation date, being value on 1st April of the previous year i.e., on 01.04.2019	30.00	
Fair market value of building in Country B [being higher of cost of acquisition and the price that the property shall ordinarily fetch if sold in the open market on the valuation date]	30.00	
Relevant rate of exchange for the purpose of conversion into Indian currency [being the rate of exchange on 1st April of the previous year i.e., on 01.04.2019] – 69.21		
Fair market value in Indian currency in crores (US $ 30 million x 69.21/10)		207.630
Piece of art work in Country C		
Cost of acquisition	1.00	
Market value as on valuation date, being value on 1st April of the previous year i.e., on 01.04.2019	2.00	
Fair market value [being higher of cost of acquisition and the price that the artistic work shall ordinarily fetch if sold in the open market on the valuation date]	2.00	
Relevant rate of exchange for the purpose of conversion into Indian currency [being the rate of exchange on 1st April of the previous year i.e., on 01.04.2019] – 69.21		
Fair market value in Indian currency in crores (US $ 2 million x 69.21/10)		13.842
Total undisclosed foreign assets		**221.472**
Tax payable@30%		**66.44**

SOLUTION TO CASE STUDY 5

I. ANSWERS TO MCQs (Most appropriate answers)

Q. No.	Answer
(i)	d
(ii)	a
(iii)	b
(iv)	b
(v)	d

II. ANSWER TO DESCRIPTIVE QUESTIONS

Answer to Q.1:

(i) Beta Ltd, the Indian company and PQR Inc., the Country C company are deemed to be associated enterprises as per section 92A(2)(a), since PQR Inc. holds shares carrying 27% of voting power (which is not less than 26% of the voting power) in Beta Ltd.

As per *Explanation* to section 92B, the transactions entered into between two associated or deemed associated enterprises for sale of product, lending or guarantee and provision of services relating to market research are included within the meaning of "international transaction".

Accordingly, transfer pricing provisions would be attracted and the income arising from such international transactions have to be computed having regard to the arm's length price.

In this case, from the information given, the arm's length price has to be determined taking the comparable uncontrolled price (CUP) method to be the most appropriate method.

Particulars		₹ in lakhs
Amount by which total income of Beta Ltd. is enhanced on account of adjustment in the value of international transactions:		
(i)	Difference in price of Pinafore @ $ 2 each for 90,000 pieces sold to PQR Inc. [$ 2 ($ 12 - $ 10) x 90,000 x ₹ 65)	117.00
(ii)	Difference for excess payment of guarantee fee to PQR Inc. for loan borrowed from foreign lender [$ 3,000 ($ 15,000 - $ 12,000) x ₹ 65]	1.95
(iii)	Difference for excess payment for services to PQR Inc. [$ 2,000($ 18,000 - $ 16,000) x ₹ 65]	1.30
		120.25

(ii) Beta Ltd. cannot claim deduction under section 10AA in respect of ₹ 120.25 lakhs, being the amount of income by which the total income is enhanced by virtue of the first proviso to section 92C(4), since the adjustments are made by the Assessing Officer to determine the arm's length price.

Answer to Q.2:

Section 90(2) provides that where the Central Government has entered into an agreement with the Government of any other country for granting relief of tax or for avoidance of double taxation, then, in relation to the assessee to whom such agreement applies, the provisions of the Income-tax Act, 1961 shall apply to the extent they are more beneficial to that assessee. In effect, the provisions of the Income-tax Act, 1961 or the DTAA, whichever is more beneficial would be applicable.

First of all, we have to determine Mr. Arjun's residential status under the provisions of the Income-tax Act, 1961 for A.Y.2020-21. His stay in India is as follows –

Previous Year	No. of days of stay in India
2019-20	153
2018-19	153
2017-18	153
2016-17	153
2015-16	153
2014-15	153
2013-14	153
2012-13	153
2011-12	153
2010-11	153
2009-10	153

He stays in India for 153 days in each previous year and for 612 days (153 days x 4) in aggregate in the four immediately preceding previous years. Since he stays in India for a period of 60 days or more in the P.Y.2019-20 and a total period of 365 days or more during the four immediately preceding previous years, he is resident in India as per the provisions of section 6(1) of the Income-tax Act, 1961 for A.Y.2020-21.

Arjun is resident in India in all the ten immediately preceding previous years (P.Y.2009-10 to P.Y.2018-19) and his stay in India in the seven immediately preceding previous years (i.e., from P.Y.2012-13 to P.Y.2018-

19) is 1071 days. Accordingly, since he is resident in all the ten immediately preceding previous years and his stay in India in the seven immediately preceding previous years exceeds 729 days, Arjun would be resident and ordinarily resident for A.Y.2020-21 under the provisions of the Income-tax Act, 1961,

Arjun is also a resident in Country L in the P.Y.2019-20, since he has stayed there for 213 days in that previous year. Since his stay in Country L exceeds 200 days, he is a resident in Country L as per the domestic laws of that country. Thus, Arjun is a resident of India as well as Country L in the P.Y.2019-20, as per the domestic laws of the respective countries.

India's DTAA with Country L is based on UN Model Convention. Article 4(2) of the India Country L DTAA provides that where an individual is a resident of both India and Country L, 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 shall be deemed to be resident of that country, which is the centre of his vital interests i.e., the country with which he has closer personal and economic relations.

Arjun has residential houses both in India and in Country L. Thus, he has a permanent home in both the countries. Arjun owns tea estates in Country L from which he derives business income. He has no business or permanent establishment of his business in India. Therefore, his personal and economic relations with Country L are closer, since Country L is the place where –

(a) the property is located and

(b) the business of tea estates is being carried on.

Therefore, he shall be deemed to be resident of Country L for A.Y. 2020-21.

The facts of the case and issues arising there from are similar to that of *CIT vs. P.V.A.L. Kulandagan Chettiar (2004) 267 ITR 654*, where the Supreme Court held that if an assessee is deemed to be a resident of a Contracting State where his personal and economic relations are closer, then in such a case, the fact that he is a resident in 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.

However, as per section 90(4), in order to claim relief under the agreement, Arjun has to obtain a certificate [Tax Residency Certificate (TRC)] declaring that he is a resident of Country L from the Government of Country L. Further, he also has to provide such other documents and information, as may be prescribed.

Therefore, in this case, Arjun would not be liable to income tax in India A.Y. 2020-21 in respect of business income and capital gains arising in Country L provided he furnishes the Tax Residency Certificate and such other documents and information as may be prescribed.