NOV 2019 Final New P 6C

Roll No. ....

Total No. of Questions – 5

Total No. of Printed Pages – 39

Time Allowed – 4 Hours

Maximum Marks – 100

Final New Syllabus
Paper - 6 C
International Taxation

JND

Answers to questions are to be given only in English except in the case of candidates who have opted for Hindi Medium. If a candidate who has not opted for Hindi Medium, his/her answers in Hindi will not be valued.

The Question Paper comprises five case study questions. The candidates are required to answer any four case study questions out of five.

Answers in respect of Multiple Choice Questions are to be marked on the OMR Answer Sheet only.

Answers to other questions are to be written on the descriptive type answer book.

Answers to Multiple Choice Questions, if written in the descriptive type answer book will not be evaluated.

Candidates may use calculator.

All questions relate to **Assessment Year 2019-20,** unless stated otherwise in the questions / case studies

Case Study 1.

Safe advisors LLP is a firm of Chartered Accountants at Mumbai. You are the tax partner of the firm. All the facts require resolution with reference to the provisions applicable for the assessment year 2019-20.

Sale of shares of foreign company outside India

Tiger Co Ltd, UK has no PE in India. It has 50% shareholding in Lion Co Ltd, UK who has branches in India. Tiger Co Ltd sold 10% of the shareholding in

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Lion Co Ltd to Deer Co Ltd also located in UK for £ 20 lakhs on 20.07.2018. The 50% shareholding in Lion Co Ltd, UK was acquired by Tiger Co Ltd for £ 50 lakhs on 27.01.2011.

The details of the assets and liabilities of Lion Co Ltd are as under :

	UK		India	
	31.03.2018	31.03.2019	31.03.2018	31.03.2019
	₹ in lakhs			
Fair market value of assets	3,000	8,000	15,000	20,000
Liabilities	2,000	5,000	6,000	8,000

There was no change in the book value of assets of Lion Co Ltd during the year 2018-19. Tiger Co Ltd adopts a year ending on 30 June of each year for the purposes of tax and financial reporting, while Lion Co Ltd adopts a period ending on 31 March.

The telegraphic transfer buying rates are as under :

27.01.2011: 1 £ = ₹ 50 ;	30.06.2018: 1£ = ₹ 78;	20.07.2018: 1 £= ₹ 80;
31.03.2018: 1 £ = 75;	31.03.2019: 1£ =₹ 90	

Cost inflation index F.Y.2010-11 = 167 and F.Y. 2018-19 = 280.

Advance Ruling sought by Resident as regards tax liability of itself and non-resident.

The branch of Deer Co Ltd, UK has carried out some transactions with Lotus Co Ltd, Bengaluru in the financial year 2017-18. The value of the transaction exceeds ₹ 600 crores. The branch of Deer Co Ltd filed its return of income for the assessment year 2018-19 in September, 2018. Lotus Co Ltd applied for advance ruling in January, 2019 to know exactly the tax consequences of its transactions with the non-resident Deer Co Ltd, UK, both for itself and on non-resident. The branch of Deer Co Ltd was informed of the advance ruling application filed by Lotus Co Ltd for achieving clarity by both the parties. The branch of Deer Co Ltd on its part informed the Assessing Officer the fact of the application filed by Lotus Co Ltd before the Authority for Advance Rulings (AAR). The Assessing Officer selected the return of Deer Co Ltd for scrutiny and issued a notice under section 143(2) in March, 2019. Lotus Co Ltd and Deer Co Ltd are not associated enterprises.

Lotus Co Ltd exported goods to its associated enterprise Douglas LLC of Norway during the financial year 2018-19. Lotus Co Ltd and Douglas LLC of Norway find that some of the items of income are taxed arbitrarily and wish to apply for Mutual Agreement Procedure (MAP).

Sale of goods to customers in India by foreign company.

Deer Co Ltd who has a branch in India, during the financial year 2018-19, sold 1,00,000 units of its product to its branch @ ₹ 5,000 per unit. The same identical units were sold to unrelated parties @ ₹ 6,000 per unit. From July, 2018 Deer Co Ltd also began supplying the goods directly to customers throughout the world and during the financial year 2018-19 it sold 20,000 units to customers in India at ₹ 7,000 per unit. The Assessing Officer wants to tax the income earned on direct sale of goods by Deer Co Ltd in India in the assessment of its branch.

The branch of Deer Co Ltd has following incomes for the year ended 31.03.2019. (i) Commission income from head office ₹ 2,50,000; (ii) Interest paid to head office ₹ 5,00,000 on money advanced by the head office to the branch;

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(iii) Royalty paid to head office ₹ 1,10,000; (iv) Dividend from Indian companies ₹ 1,50,000; and (v) Income from business (after deducting / including items (i) to (iv) above) ₹ 18,00,000.

Douglas LLC of Norway wishes to establish an eligible investment fund in Singapore and appoint a fund manager in India. For the year ended 31.03.2018, listed companies in India declared dividend in August, 2018 and Douglas LLC received ₹ 15,20,000 by way of dividend.

Issues in advance pricing agreement.

Lotus Co Ltd is also engaged in export of goods to its associated enterprise located in Durban, South Africa. Its turnover exceeded ₹ 200 crores in 5 years including financial year 2018-19. It anticipates that its annual turnover would exceed ₹ 500 crores for the next 5 years commencing from 01.04.2019. It proposes to apply for advance pricing agreement and avail the benefit of roll back.

Choose the correct alternative for the following MCQs :

1.1 What would be the total income of the Indian branch of Deer Co Ltd as per the applicable article of UN model (ignore DTAA between India and UK). Also, before considering ALP in respect of transactions with associated enterprises. **2 × 5 = 10**

(A) ₹ 7,90,000

(B) ₹ 20,10,000

(C) ₹ 13,10,000

(D) ₹ 22,90,000

Marks

1.2 In determining the ALP of transactions between Lotus Co Ltd. and its associated enterprise in South Africa, which of the following comparability adjustments cannot be made ?

(A) Risk Adjustment

(B) Accounting Adjustment

(C) Adjustment for Control Premium

(D) Adjustment for Capacity Utilisation

1.3 Mutual Agreement procedure opted / contemplated by Lotus Co Ltd and Douglas LLC of Norway is meant for providing relief

(A) from economic double taxation of income

(B) from juridical double taxation of income.

(C) from multiple interpretation of tax treaties.

(D) from penalties in international transactions.

1.4 What is the minimum number of members to satisfy the condition of eligible investment fund contemplated by Douglas LLC in Singapore so that the fund management activity through the fund manager in India would not constitute business connection in India ?

(A) 200

(B) 100

(C) 50

(D) 25

1.5 What is the tax liability on the dividend income in the case of Douglas LLC of Norway for the assessment year 2019-20 on the assumption that dividend is its only source of income in India ?

(A) ₹ 54,080

(B) ₹ 1,58,080

(C) Nil

(D) ₹ 6,20,160

Marks

You are required to answer the following issues :

1.6 Compute the capital gain taxable in the hands of Tiger Co Ltd on sale of shares of Lion Co Ltd. In case, no capital gain is taxable in India, give reasons to support your answer. 5

1.7 Can the Assessing Officer complete the assessment of the branch of Deer Co Ltd, UK ignoring the application filed by the Lotus Co Ltd before AAR? What would be your advice to the Assessing Officer as regards completion of assessment of the branch of Deer Co Ltd located in India ? 5

1.8 Is the action of the Assessing Officer in taxing the profits of Deer Co Ltd by direct sale of goods to customers in India, from UK, taxable along with the profits of its branch located in India valid ? Note : You must decide the validity of action of the Assessing Officer as per UN Model of DTAA. [Ignore DTAA between India and UK]. 2

1.9 Advise Lotus Co Ltd as regards (a) pre-filing consultation; (b) amount of fee to be paid for filing APA application; (c) time limit for filing APA application; (d) possibility of making amendments after the application has been filed; and (e) applicability of roll back provisions. 3

Marks

Case Study 2

Ram Process Ltd

Ram Process Ltd, Chennai manufactured textile goods and sold the same with brand name 'Vela'. It also manufactured on contract basis for Taylor Inc. of Singapore being its associate enterprise (holding company). Taylor Inc. marketed the goods so manufactured by Ram Process Ltd in its brand name 'Crowe'. The total borrowing of Ram Process Ltd as on 31.03.2018 stood at ₹ 50 crores. Ram Process Ltd entered into a business agreement with Jim Laker LLP of UK in April, 2019 for export of goods to various countries as directed by Jim Laker LLP. The amount of transaction between Ram Process Ltd and Jim Laker LLP by way of sale of goods would be ₹ 180 crores spread over 3 financial years commencing from 01.04.2019. The parties (i.e. both Ram Process Ltd and Jim Laker LLP) apprehend some ambiguity as regards the income chargeable to tax in the hands of Jim Laker LLP in India and Ram Process Ltd. It is decided by the parties that Ram Process Ltd would seek advance ruling to overcome the uncertainty in taxation of its income vis a vis Jim Laker LLP in respect of the transaction contemplated by the parties.

The income-tax assessment of Ram Process Ltd for the assessment year 2018-19 is pending under section 143(3). The Assessing Officer made reference to Transfer Pricing Officer (TPO) in December, 2018. Ram Process Ltd did not furnish information or documents sought by the TPO in respect of the international transactions of the value of ₹ 3.50 crores. Ram Process Ltd has done export turnover exceeding ₹ 100 crores to its associate enterprise in the financial years 2015-16 to 2018-19. The Assessing Officer made reference to TPO for the assessment years 2016-17 and 2017-18. There was upward revision of income by 5% of the sale price for the assessment years 2016-17 and 2017-18 in accordance with the ALP determined by the TPO. The assessee Ram Process Ltd is willing to accept the addition of 5% for the assessment year 2018-19 also as there is no change in nature of business or terms of trade made by it with its associate enterprises.

The Assessing Officer has completed the assessment of assessment year 2018-19 by making identical addition of 5% of the export turnover made to associate enterprises as in the preceding assessment years.

Ram Process Ltd has agricultural land in Country `N'. There is a DTAA between India and Country N. As per DTAA, agricultural income earned by any person in India would be exempt from tax in India and whereas Country N may or may not levy tax on agricultural income earned therein based on its domestic law. The agricultural income of Ram Process Ltd would be dealt with accordingly in Country N.

Botham (P) Ltd

Botham (P) Ltd of Bengaluru is yet another subsidiary company of Taylor Inc. of Singapore since 2006. From 1st April, 2018 Botham (P) Ltd did back office support service to Taylor Inc. which is engaged in multifarious manufacturing and trading activities. The aggregate international transactions of Botham (P) Ltd always exceeded ₹ 50 crores since the financial year 2014-15. It may be noted that both Botham (P) Ltd and Taylor Inc. were also trading goods by purchasing them from Ram Process Ltd, Chennai.

On 01.10.2018 Botham (P) Ltd entered into an agreement with Somatsu LLC of Tokyo, Japan who is engaged in providing online advertisement service. As per agreement, Botham (P) Ltd has to pay ₹ 90,000 per month to Somatsu LLC for online advertisement facility after deducting the amounts as per the applicable legal provisions. It paid the monthly fee up to January, 2019 in one lump sum on 05.02.2019. The balance monthly amounts were credited to Somatsu LLC and debited to expenditure on 31.03.2019 with equalization levy payable shown as liability. The entire amount payable by way of equalization levy was remitted on 10.11.2019.

Botham (P) Ltd borrowed ₹ 60 crores from its associate enterprise Arnold Ltd of Switzerland on 01.05.2018. Interest is payable on such loan @ 9% per annum. The total income of Botham (P) Ltd for the financial year 2018-19 was ₹ 305 lakhs after deduction of interest payable to Arnold Ltd but before deducting depreciation and taxes. The above said borrowing is the only borrowing of Botham (P) Ltd. Tax was deducted at source on the interest paid / payable within the prescribed time.

Gopal Sharma

Shri. Gopal Sharma a software engineer born and brought up in India went to United States on 10th April, 2000 for the purpose of employment. He acquired a property in USA in July, 1998. He commenced business in USA in April, 2005. He closed his business in USA and returned to India permanently on 10th April, 2015 and became Managing Director of Ram Process Ltd at Chennai. He never visited India from April, 2000 to March, 2016. The property in USA was let out by Gopal Sharma fetching rental income of US $ 30,000 per annum from 1st April, 2016. The entire annual rent was received in advance in April, 2016 and

Marks

April, 2017 respectively. He has not disclosed the rental income in his Income-tax returns of the assessment years 2017-18 and 2018-19. The Deputy Director of Income tax launched prosecution proceedings against Gopal Sharma under the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015. The exchange rates are given below :

Date	Exchange rate of Rupee per US Dollar
31.03.2016	60
31.03.2017	66
31.12.2017	67
31.03.2018	68
31.12.2018	69
31.03.2019	70

Choose the correct alternative for the following MCQs : **2 × 5 = 10**

2.1 Which method would be the most appropriate method for determination of arm's length price for contract manufacturing carried out by Ram Process Ltd to Taylor Inc.?

(A) Transactional Net Margin Method

(B) Profit Split Method

(C) Cost Plus Method

(D) Comparable Uncontrolled Price Method

2.2 What is the latest date for Botham (P) Ltd to remit equalization levy for allowance of deduction of the amount paid and / or payable to Somatsu LLC ?

(A) Latest date 31.03.2019

(B) Latest date 31.07.2019

(C) Latest date 30.09.2019

(D) Latest date 30.11.2019

Marks

2.3 How much of the amount of interest paid by Botham (P) Ltd to Arnold Ltd is liable for disallowance for the assessment year 2019-20 ?

(A) Nil

(B) ₹ 4.95 crores

(C) ₹ 2.55 crores

(D) ₹ 4.035 crores

2.4 The DTAA provisions providing exemption for agricultural income in one country and providing option to the other State for taxing or exempting the same such as Ram Process Ltd having agricultural income in Country `N' being taxable or exempt in that State is known as

(A) Mutual agreement procedure

(B) Anti-fragmentation rule

(C) Distributive rule

(D) Limitation of Benefit Clause

2.5 What must be the minimum value of the transaction between Ram Process Ltd and Jim Laker LLP in order to allow the resident taxpayer to seek advance ruling in respect of its tax liability ? How much is the amount of fee to be paid for seeking advancing ruling ?

(A) It cannot seek AAR as regards the liability of non-resident taxpayer. The question of paying fees does not arise.

(B) Minimum value of transaction ₹ 100 crores / amount of fee ₹ 5,00,000

(C) Minimum value of transaction ₹ 200 crores / amount of fee ₹ 10,00,000

(D) Minimum value of transaction exceeding ₹ 500 crores / amount of fee ₹ 25,00,000.

Marks

You are required to answer the following issues :

2.6 What are the tax implications of Ram Process Ltd. agreeing to accept the adjustment made by the Assessing Officer to the transaction price ? Are there any penalty implications on Ram Process Ltd.? Is there any way for Ram Process Ltd. to avoid repetitive transfer pricing litigation in respect of its transactions with AEs ? **5**

2.7 What would be the tax consequence in the case of Botham (P) Ltd for the payments made to Somatsu LLC if there is a branch of Somatsu LLC at Delhi ? **4**

2.8 Compute income from property of Shri. Gopal Sharma for the assessment years 2017-18 and 2018-19 and decide the validity of the initiation prosecution proceedings against him under the Black Money Act, 2015 by the Deputy Director of Income-tax. Will it make any difference as regards prosecution proceedings if the assessee Shri. Gopal Sharma had filed revised returns voluntarily ? **6**

Case Study 3.

Ratan Co Ltd

Ratan Co Ltd, Mumbai is engaged in manufacture of medicines, textiles and automobile parts. It has total borrowing of ₹ 50 crores by way of loan as on 31.03.2019. It entered into an agreement with Tikosha LLC of Japan for digital advertising space for online advertisement of its products. The amount payable to Tikosha LLC as per agreement is ₹ 2,12,000 and it was paid on 10.03.2019. In yet another transaction with Geneva LLC, UK, Ratan Co Ltd did not deposit equalization levy amount of ₹ 36,000 before the prescribed date and the delay was of 30 days.

Ratan Co Ltd has a subsidiary by name Knowledge Source (P) Ltd at Chennai which provided predominantly knowledge process outsourcing services (KPO) to its associate enterprise Walters Inc. of USA. For the year ended 31.03.2019, it declared operating profit of ₹ 33 crores out of aggregate gross receipts of ₹ 183 crores and operating expense of ₹ 150 crores. It incurred expenditure towards employees as under: (i) Salaries ₹ 50 crores; (ii) Bonus ₹ 12 crores; (iii) staff welfare expenses ₹ 2 crores; and (iv) staff training expenses ₹ 1 crore.

Clinch Inc. advanced USD 10 million on 01.06.2018 to Knowledge Source (P) Ltd in foreign currency. Knowledge Source (P) Ltd accepted the loan amount after taking permission from appropriate government authorities in India. The loan is eligible for interest @ 9% per annum payable in foreign currency. For the financial year 2018-19, Knowledge Source (P) Ltd paid interest after deducting income-tax on 31.03.2019. The TT buying rates on various dates are 01.06.2018 one USD= ₹ 69; on 31.03.2019 one USD = ₹ 70.

Marks

Shri Anand Bhargava having 15% shareholding in Knowledge Source (P) Ltd is employed as a crew in an Indian ship as per section 3(18) of the Merchant Shipping Act, 1958. His voyage details show that the date of joining the ship was entered in the Continuous Discharge Certificate (CDC) as 01.11.2017 and the date of signing off in the CDC as 03.05.2018. He remained in India before he flew by air to Colombo, Sri Lanka on 31.10.2018 and joined as crew of the ship again on 02.12.2018 at Colombo port which was the date of entry recorded in the CDC. He received salary income of ₹ 15 lakhs for the financial year 2018-19. He has remained in India for more than 500 days in 4 previous years preceding the previous year 2018-19. Assume that he was on 'eligible voyage' during the previous year 2018-19.

Mary Mark LLP

Mary Mark LLP of Singapore imported textile goods from Ratan Co Ltd in the form of finished goods and acted as distributor in Singapore. Ratan Co Ltd sold 10 lakh units @ ₹ 1000 per unit to Mary Mark LLP and sold similar goods to other dealers in Singapore @ ₹ 1,100 per unit. Ratan Co Ltd received bank guarantee on 01.04.2018 for availing cash credit limit of ₹ 8 crores for which Mary Mark LLP was the guarantor. The proposal helped Ratan Co Ltd to avail bank facility with interest @ 7.5% per annum which otherwise would have cost @ 10% per annum. The terms of trade for other dealers was to make payment within 1 month from the date of sale of goods by Ratan Co Ltd and whereas for Mary Mark LLP the credit period allowed was 3 months from the date of sale of goods. The cost of capital may be taken as 12% per annum and supply of goods as uniform throughout the year.

Proceedings against non-resident under Black Money Act

Ravinder, an ex-director of Ratan Co Ltd was doing individually some business at Delhi. He left India and settled in United Kingdom from 10.04.2014. He had never left India previously since April, 2006. He acquired a property in his name in the financial year 2011-12 at Malaysia by under-invoicing his export sale bills for ₹ 200 lakhs. The Assessing Officer came to know of this in March, 2019 based on the investigation made by Enforcement Directorate in some other person's case.

The Assessing Officer having received some concrete evidences against Ravinder issued a notice under section 10 of the Black Money and Imposition Act of 2015 on 27.03.2019. The assessee's counsel contended that since the assessee is not a resident in the financial year 2018-19 a notice under section 10 could not be issued to him.

Zing Zong LLC, Japan

Zing Zong LLC, Japan entered into an agreement for executing a turnkey project for setting up a power plant in India for Ratan Co Ltd. The consideration was US dollar 150 million which could be proceeded with through a term loan given by SBI. The payment was split as per separate agreements in the following manner :

(i) US dollar 15 million for design of power plant outside India (which is taxable as per applicable presumptive provision)

(ii) US dollar 100 million for offshore supplies of equipments and spares. (No role was played by the PE in India of Zing Zong LLC).

Marks

(iii) US dollar 35 million for local supplies to be sourced in India and towards installation charges in India for the project. Assume it is taxable on net income basis.

The fair market value of offshore design is US dollar 25 million. The offshore supplies were over-invoiced by equal amount.

Zing Zong LLC has a branch in India from 01.01.2017. It follows calendar year as accounting year. The annual turnover of the Indian branch always exceeded ₹ 100 crores. The consolidated group revenue of Zing Zong LLC on the various dates are (i) 31.12.2017 US dollar 7000 million; (ii) 31.03.2018 US dollar 7700 million; (iii) 31.12.2018 US dollar 12000 million; (iv) 31.03.2019 US dollar 12200 million. The Telegraphic Transfer (TT) buying rates are 31.03.2017 $ 66; 31.12.2017 $ 67; 31.03.2018 $ 68; 31.12.2018 $ 69; and 31.03.2019 $ 70. The Indian branch is the alternate reporting entity of the international group.

Choose the correct alternative for the following MCQs : **2 × 5 = 10**

3.1 When does the consolidated group revenue of Zing Zong LLC exceeds the threshold limit for CbC reporting and state the 'due date' for filing such report ?

(A) 31.03.2018 / group revenue ₹ 5,236 crores / CbC reporting not required.

(B) 31.12.2017 / group revenue ₹ 4,690 crores / CbC reporting not required.

(C) 31.12.2018 / group revenue ₹ 8,280 crores / CbC report due date 31.12.2019.

(D) 31.03.2019 / group revenue ₹ 8,296 crores / CbC report due date 31.03.2020.

Marks

3.2 What is the income-tax liability of Clinch Inc. in India for the assessment year 2019-20 in respect of interest income earned in foreign currency from Knowledge Source (P) Ltd ?

(A) Nil, exempt income

(B) ₹ 109.7928 lakhs

(C) ₹ 111.384 lakhs

(D) ₹ 222.768 lakhs

3.3 How much Ratan Co Ltd must pay towards equalization levy for the online advertisement space provided by Tikosha LLC, Japan and what is the 'due date' for payment of equalization levy ?

(A) ₹ 12,000 / 07.04.2019

(B) ₹ 12,720 / 07.04.2019

(C) ₹ 63,600 / 30.09.2019

(D) ₹ 21,200 / 31.07.2019

3.4 How much is the amount of penalty payable by Ratan Co Ltd for the delayed remittance of equalization levy in respect of the transaction with Geneva LLC and how much of the expenditure would be disallowed for non-remittance ?

(A) Penalty ₹ 30,000 / Disallowance ₹ 6,00,000

(B) Penalty ₹ 30,000 / Disallowance 'Nil'

(C) Penalty ₹ 30,000 / Disallowance ₹ 1,80,000

(D) Penalty ₹ 36,000 / Disallowance ₹ 6,00,000

Marks

3.5 Decide whether Knowledge Source (P) Ltd can opt for safe harbour rules based on any of the reasons given below.

(A) Can claim the benefit of safe harbour rules as the aggregate value of international transaction does not exceed ₹ 200 crores.

(B) Ineligible as the operating profit margin is less than 24% and employee cost is less than 60% of operating expense.

(C) Eligible as the operating profit margin is more than 18% of the operating expenses and employee cost is less than 60%.

(D) Eligible as the operating profit is more than 21% and employee cost is more than 40% but less than 60% of the operating expenses.

You are required to answer the following issues :

3.6 Determine if Ratan Co. Ltd. and Mary Mark LLP are associated enterprises. If they are associated enterprises, compute the ALP of the transaction between them and quantify the amount to be added to the income of Ratan Co. Ltd, if any, by way of an ALP adjustment. **5**

3.7 Determine the residential status of Shri Anand Bhargava and the taxability of his salary income earned in the previous year 2018-19. **4**

3.8 Is the issue of notice on Ravinder under section 10 of the Black Money Act, 2015 tenable in law ? **3**

3.9 Does the arrangement between Zing Zong LLC, Japan and Ratan Co Ltd, Mumbai attract GAAR provisions ? If not, will the provisions of transfer pricing apply for determination of arm's length price ? **3**

Marks

Case Study 4 :

Sprint Group Inc

Sprint Group Inc ('SGI') is a diversified US based multinational enterprise, operating worldwide through various subsidiaries and joint ventures, engaged in variety of businesses and ventures, having consolidated turnover exceeding INR 5,500 crores in recent past three years. For FY 2018-19, corresponding to AY 2019-20, some of the entities within Sprint Group had the following transactions having potential income tax implications :

1. Product Distribution transactions of UK Ltd.

UK Ltd, a subsidiary of SGI, incorporated and tax resident of UK, manufactures and sells engineering machines. These machines are sold in UK by UK Ltd and outside UK through its Associate Enterprises who act as distributors of UK Ltd. UK Ltd designs and manufactures its machines country-wise. Machines designed for Country X are different from machines designed for Country Y.

INITO Private Limited ('INITO) is another subsidiary of SGI incorporated in and tax resident of India, functioning in India as the distributor of the machines of UK Ltd. INITO promotes and sells UK Ltd.'s machines in India. INITO purchases machines from UK Ltd and resells them to unrelated customers in India. INITO has adequate financial and operating resources of its own to undertake such distribution and sales activities and has been doing these activities for past 10 years not only for UK Ltd but also for other unrelated international engineering machines manufacturers.

Marks

In FY 2018-19 the purchases and sales of INITO are tabulated below :

Sr. No	Particulars	Qty	Price/ unit (INR)	Value (INR in crores)
	Purchase Details			
(i)	Machine Purchases from UK Ltd	5,000	40,000	20.00
(ii)	Machine Purchases from unrelated manufacturer 'A Inc.' of USA	4,000	25,000	10.00
(iii)	Machine purchases from unrelated manufacturer 'B Ltd' based in Japan	2,000	30,000	6.00
	Sales Details:			
(i)	Sales of machines purchased from UK Ltd	5,000	46,000	23.00
(ii)	Sales of machines purchased from 'A Inc.'	4,000	27,500	11.00
(iii)	Sales of machines purchased from 'B Ltd'	2,000	36,000	7.20

UK Ltd sells similar machines to its associate enterprise 'SL Ltd' in Srilanka at the per unit price of INR 35,000 for distribution and resale in the Srilankan market. Other terms and conditions of sale of machines by UK Ltd to INITO and SL Ltd are same.

An overview of the Functions, Assets and Risk ('FAR') analysis of INITO's transactions with UK Ltd, A Inc., and B Ltd (the manufacturers) is tabulated below :

Marks

I. FAR of INITO –

Type of entity	Functions	Assets	Risks
Distributor	– Budgeting – Administration – Purchasing – Inventory management – Logistics – Marketing – Sales – Customer support	– Storage/ Warehouse – Office equipment – Land & Building – Vehicles	– Business risk – Inventory risk – Credit & collection risk – Foreign exchange fluctuation risk

II. FAR of UK Ltd, A Inc., and B Ltd –

Type of entity	Functions	Assets	Risks
Manufacturer	– Budgeting – Administration – Product strategy & design – R&D – Procurement of raw materials – Product manufacturing – Quality control – Inventory management – Logistics – Sales & Marketing – Customer support	– Intangibles – Patents, technical knowhow, trademarks, etc. – Plant & Machine – Storage/ Warehouse – Office equipment – Land & Building – Vehicles	– Business risk – Inventory risk – Scheduling risk – Product liability risk – Credit and collection risk – Foreign exchange fluctuation risk

Marks

In respect of similar machine purchase transactions with UK Ltd, Transfer pricing officer ('TPO') has made transfer pricing adjustment of INR 2.5 crores for AY 2014-15, in the hands of INITO by determining the ALP purchase price of machine at lower price of INR 35,000 per machine.

2. External Commercial Borrowing Transaction :

For selling UK Ltd.'s machines in neighbouring Country 'X', INITO established a branch office in Country X, following the due procedure under FEMA, 1999. INITO purchases machines meant for Country X from UK Ltd and transfers such machines to its Country X branch office for sale to unrelated customers in Country X.

Country X branch office maintains its own books of accounts and pays due Income tax in Country X as per tax laws of Country X. Country X and India do not have a Double Taxation Avoidance Agreement.

For financing the Country X branch operations, INITO borrowed INR 10 crores from SGI, USA at 9% p.a. An interest of INR 90 lacs is required to be paid to SGI, USA by INITO in this respect. The loan amount was remitted by SGI, USA to INITO, who in turn, immediately transferred the money to bank account of Country X branch office outside India.

3. Allegation of UK Ltd.'s Permanent Establishment in India.

In the course of assessment for AY 2014-15 of INITO, the Assessing Officer also issued a show cause notice to INITO alleging that INITO's arrangement with UK Ltd for distribution of machines creates a permanent establishment of UK Ltd in India in terms of India-UK DTAA and thus, why the consequential Income tax consequence arising out of that shall not follow.

Marks

Choose the correct alternative from the following MCQs : 2 × 5 = 10

4.1 In respect of its transactions with UK Ltd, which of the compliances INITO is required to do under Indian Transfer Pricing Regulations of the Act :

(A) Obtaining Accountants report in the prescribed Form and furnishing such report on or before the due date.

(B) Keeping and maintaining such information and document as are prescribed in Rule 10D.

(C) Furnishing of report to and/or filing the notification to prescribed Income Tax Authority u/s 286 of the Act.

(D) All.

4.2 Arm's length price is required to be computed by any of the prescribed transfer pricing method. Which of the prescribed transfer pricing method is not a profit-based method ?

(A) Resale Price Method

(B) Comparable Uncontrolled Price Method

(C) Cost Plus Method

(D) Transactional Net Margin Method

4.3 As per section 92 of the Act, transfer of goods by INITO to its branch in Country X is :

(A) A specified domestic transaction (SDT)

(B) An International transaction

(C) Neither an SDT nor an International Transaction

(D) Both an SDT and an International Transaction

Marks

4.4. In respect of payment of interest by INITO to SGI USA, INITO is required to deduct tax at source under the Act at the rate of :

(A) Nil.

(B) 10%

(C) 20%

(D) 40%

4.5 The residential status of Country X branch of INITO for the purpose of the Act is :

(A) Resident of India

(B) Non-resident of India

(C) Foreign Company

(D) None

You are required to answer the following issues :

4.6 In the context of UK Ltd.'s transactions with INITO, answer the following : 4

(i) Discuss and determine "the most appropriate method" which INITO may apply to determine the ALP of machine purchase transaction by it from UK Ltd, based on the facts and information set out in the case study.

(ii) In respect of the transfer pricing adjustment of INR 2.5 crore made by TPO in India in the hands of INITO for AY 2014-15, can UK Ltd seek corresponding adjustment in UK to adjust its reported UK taxable income, assuming that the text of India-UK DTAA is identical to UN Model Tax Convention 2017. 2

Marks

(iii) Assuming that both INITO and UK Ltd are not agreeable to the transfer pricing adjustment of INR 2.5 crore made by the TPO, can UK Ltd invoke the Mutual Agreement Procedure to seek appropriate relief in the matter ? For this purpose, assume that the text of India-UK DTAA is identical to UN Model Tax Convention 2017. 2

4.7 Discuss and determine the taxability of profits of Country X branch under the Act in the hands of INITO, including following : 4

(a) Entitlement of INITO to claim tax credit in India for the Income taxes paid in Country X on Country X branch profits.

(b) Entitlement of INITO to claim deduction for interest paid to SGI, USA.

4.8 Examine and discuss the validity of the Assessing Officer's claim, that the business arrangement between INITO and UK Ltd creates UK Ltd.'s permanent establishment in India. For this purpose, assume that the text of the India-UK DTAA is identical to UN Model Tax Convention 2017. 3

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Case Study 5

Bellisimo Group Ltd ('BGL') is a transnational conglomerate incorporated, registered and head quartered in a low tax country, having worldwide operations through subsidiaries, joint ventures and branches, including India. You are Head of Taxation, India. The Global Head – Taxation of BGL has referred to you the following cases related to the Indian taxation of some of BGL Group's entities for AY 2019-20.

Part A : H Ltd.'s Indian operations :

H Ltd, a Hungarian wholly owned subsidiary of BGL, is engaged in the manufacture and sale of power transformers worldwide. H Ltd has manufacturing operations in Hungary only. I Co. Ltd, an Indian company and tax resident of India, is also engaged in the manufacture and sale of power plant equipment. H Ltd holds 40% shareholding in I Co Ltd and the remaining 60% shareholding is held by an unrelated Indian group.

P Ltd, an Indian public sector company, invited tenders/ bid proposals on turnkey basis from power plant equipment manufacturers either singly or in consortium provided they meet the financial and technical qualification criteria. The scope of this turnkey project involved "design, engineering, test, manufacture, supply, installation and commissioning of 10 transformers and 5 switches."

H Ltd and I Co. Ltd, both meeting the qualification criteria, decided to bid for this tender of P Ltd, on a consortium basis. Further, as per the terms of tender, H Ltd and I Co Ltd also executed a consortium agreement between themselves providing that :

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(i) Both H Ltd and I Co Ltd will be jointly and severally responsible to P Ltd for any default and/or damages payable to P Ltd.

(ii) H Ltd and I Co Ltd, inter se, will be responsible for executing their respective scope of work as set out in the Annexure to the consortium agreement and receive the sale consideration thereof.

Moreover, as per the terms of the tender, I Co. Ltd was designated as the lead consortium member who would be responsible for liaisoning and co-ordinating with P Ltd in respect of this project. For the purpose of communication between P Ltd and the consortium, the registered office of I Co Ltd was designated as the office address of the consortium.

P Ltd awarded & executed three separate contracts to the consortium of H Ltd & I Co Ltd as follows :

(i) Contract I for design, engineering, manufacture and supply of 10 transformers to be made by H Ltd on FOB Hungarian port basis, for the lumpsum contract price of INR 250 crores (converted amount). Out of INR 250 crores, INR 200 crores was directly remitted by P Ltd to H Ltd outside India on supply of transformers from time to time over 4 years. H Ltd authorised I Co Ltd to receive mobilisation advance of INR 50 crores in India from P Ltd and remit the same to H Ltd outside India.

(ii) Contract II for design, engineering, manufacture and supply of 5 switches to be made by I Co. Ltd in India on ex-works basis, for lumpsum consideration of INR 100 crores.

(iii) Contract III for handling, installation and commissioning of imported transformers and domestically supplied switches. Contract III is a service contract and all the services are to be performed in India by I Co Ltd. The lumpsum consideration under Contract III is INR 50 crores and it was directly paid to I Co Ltd by P Ltd.

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H Ltd manufactured all transformers in its manufacturing facility in Hungary and supplied them to P Ltd on FOB Hungarian port of shipment. These transformers were supplied with post sales warranty period of 5 years. Transformers were imported into India in the name of P Ltd and it also paid custom duty thereon. Except for a period of 5 days in each year for meeting with P Ltd, none of the employees of H Ltd visited India during the project duration of 4 years.

The supply of transformers and payment thereof received by H Ltd over 4 years period is as follows :

Assessment Year	Particulars	No. of transformers supplied	Value (INR)
2016-17	Receipt of mobilisation advance (through I Co Ltd)	-	50 crores
2017-18	Receipt of sale consideration	3	60 crores
2018-19	Receipt of sale consideration	3	60 crores
2019-20	Receipt of sale consideration	4	80 crores.

H Ltd did not maintain separate books of accounts for its Indian sales. Neither it is possible to separately identify the specific profits/ income earned from sale of transformers to P Ltd. However, H Ltd does maintain its global financial statements which shows its global profit margin of 6% of sales for AY 2019-20.

P Ltd applied to the prescribed tax authorities for determination of appropriate rate of deduction of Income tax at source for payments to be made to H Ltd. Prescribed tax authorities directed it to deduct tax at source at 1% of contract value.

H Ltd has also been advised to consider applying for Advance Ruling in India.

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Part B : Financing transactions of FCO, USA.

I Co 2 Pvt Ltd ('I Co. 2'), an Indian company, is a subsidiary of Company F Co. (non-resident) from USA. F Co. is a wholly owned subsidiary of BGL. The capital structure of I Co. 2 is as follows :

- Equity Capital : INR 500 Million contributed by Company F Co.
- Debt : INR 800 Million

The nature of loan and expenditure incurred by way of interest or of similar nature on these loans during the year by I Co. 2 are as follows :

Loan No.	Nature of Loan	Interest or expenditure of similar nature (INR millions)
1	Loan from non-resident AE, Company F Co.	Interest = 30.00
2	Loan from Independent Third Party in India	Interest = 11.00
3	Loan from Mumbai branch of an Indian bank on the strength of Letter of Comfort issued by resident AE; Company R Co.	Interest = 5.50
4	Loan from Indian branch of a foreign bank on the strength of guarantee of non- resident AE, Company F Co.	Interest = 9.00 Guarantee Fees = 1.00
5	Loan from Delhi branch of an Indian bank on the strength of Letter of Comfort issued by Company F Co	Interest = 6.00
6	Loan from outside India branch of a foreign bank on the strength of guarantee issued by resident AE; Company R Co.	Interest = 5.40 Guarantee Fees = 0.60

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Loan No.	Nature of Loan	Interest or expenditure of similar nature (INR millions)
7	Foreign Currency Loan of USD 2 Million from outside India branch of foreign bank for which there is back to back deposit kept by its non-resident AE; Company F Co	Interest = 3.25
	TOTAL	Interest = 70.15 Guarantee Fees = 1.60

Company I Co. 2's EBITDA for the current year is INR 200 Million.

Part C : Shipping Operations :

S. Co. Ltd. ('SCL'), a company incorporated in and tax resident of country X, is engaged in shipping operations. SCL owns various vessels which it operates for carrying goods cargoes from one country to another. Vessels of SCL regularly calls on Indian ports twice a week. In addition to the aforesaid container line business, break bulk vessels of SCL also occasionally call on Indian ports.

To promote and administer its business in India, SCL has appointed Q Ltd. as its shipping agent in India. Q Ltd. is an Indian company and is an exclusive agent of SCL for booking the export cargoes and import cargoes; handling of work at ports when SCL vessels calls on Indian port, issuing invoices to India shippers and collecting the freight and other charges on behalf of SCL. For all these activities, SCL pays agency commission to Q Ltd. All the amounts collected by Q Ltd. on behalf of SCL are deposited into a separate bank account maintained by Q

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Ltd. and then remitted to SCL. Thus, entire Indian operation of SCL are effectively managed by Q Ltd., whereas overseas and other countries operations are managed by SCL.

For FY 2018-19, the receipts of SCL are as follows, in so far it concerns its India operations :

Sr. No.	Nature of Receipt	Amount (INR in Crores)	Place of Collection
1.	Export Freight for cargoes loaded from Indian ports	7.5	In India by Q Ltd
		1.5	Outside India by SCL
2.	Import Freight for cargoes loaded from a port outside India for destination port in India	10	Outside India by SCL
		2.5	In India by Q Ltd
3.	Terminal handling charges for handling Export and Import cargoes at Indian port	5	In India by Q Ltd
4.	Interest paid by Indian bank on balances lying in Indian bank account	1.75	Credited to Indian bank account

Against the aforesaid receipt, SCL has following expenses for its Indian operations :

(i) Agency commission paid to Q Ltd.: INR 3 Cr.

(ii) Port dues and other incidental expenses: INR 1.25 Cr.

India has DTAA with Country X identical to text of UN Model Tax Convention 2017. Article 8 of said DTAA is based on Alternative A text of Article 8 of UN Model Tax Convention 2017.

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Choose the correct alternative from the following MCQs : **2 × 5 = 10**

5.1 H Ltd is considering applying for an advance ruling to determine its taxability in India and is seeking your advice on the nature of such a ruling.

An Advance Ruling pronounced by the Authority for Advance Rulings is binding on :

(A) The applicant who had sought it

(B) High Court

(C) Income Tax Appellate Tribunal

(D) All

5.2 If a resident and ordinarily resident individual having substantial equity shareholding in a foreign company, fails to furnish his income tax return before the end of relevant assessment year, he/she would attract penalty of INR _____ under the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015.

(A) INR 5,000

(B) INR 5,00,000

(C) INR 10,00,000

(D) INR 1,50,000

5.3 H Ltd will not be able to rely on a DTAA (based on the UN/OECD Model Tax Convention) for :

(A) Determination of tax residency

(B) Providing relief from double taxation

(C) Protection of investment from appropriation

(D) Allocation of taxing rights

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5.4 The basic rules of interpretation of any international agreement (including a DTAA) are provided in :

(A) OECD Model

(B) UN Model

(C) US Model

(D) Vienna Convention on the Law of Treaties

5.5 In order to protect against the un-intended use of a DTAA or the benefits provided under DTAA, which measures/ rules have been recommended by BEPS Action Plans ?

(A) Advance Pricing Agreement (APA)

(B) Safe Harbour Rules

(C) Limitation of Benefits (LOB) Rule and Principal Purpose Test (PPT)

(D) Allocation of taxing rights

You are required to answer the following issues :

5.6 Examine and discuss the Indian income-tax liability of H Ltd in respect of its income from supply of transformers to P Ltd. Examine and answer the following questions in particular :

(i) Can the income arising from the turnkey project executed by H Ltd and I Co. Ltd be assessed as Income of an Association of Persons (AOP)? 2

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(ii) Whether H Ltd.'s income from sale of transformers to P Ltd is chargeable to tax in India considering the provisions of the Act and India-Hungary DTAA ? (Relevant extracts of the DTAA are set out as exhibits) 2+2

(iii) Assuming that H Ltd is chargeable to Income tax in India in respect of sale made to P Ltd and given that H Ltd cannot separately identify its income from such sale made to P Ltd, what are the options available to the Assessing Officer under the Act/Rules to ascertain and quantify the amount of Income chargeable to income tax in India ? 1

5.7 In the context of financing transactions of F Co, USA with I Co. 2, compute the total amount of excess interest which shall not be deductible under the head 'Profit and gains of business or profession' of Company I Co. 2 applying Section 94B of the Act. 4

5.8 In respect of Indian shipping operations of SCL :

(i) Compute the taxable income of SCL under the Act (ignoring DTAA) 2

(ii) Compute the taxable income of SCL considering the provisions of DTAA which are identical to the text of Article 8 (Alternative A) of UN Model Tax Convention 2017. 2

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Reference Material

Exhibit I : Article 5 - Permanent Establishment (India – Hungary DTAA)

1. *For the purposes of this Convention, the term "permanent establishment" means a fixed place of business through which the business of an enterprise is wholly or partly carried on.*

2. *The term "permanent establishment" includes especially:*

   (a) a place of management;

   (b) a branch;

   (c) an office;

   (d) a factory;

   (e) a workshop; and

   (f) a mine, an oil or gas well, a quarry or any other place of extraction of natural resources.

3. *A building site or construction, installation or assembly project or supervisory activities in connection therewith constitute a permanent establishment only if such site, project or activity lasts more than nine months.*

4. *Notwithstanding the preceding provisions of this Article, the term "permanent establishment" shall be deemed not to include :*

(a) *the use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise;*

(b) *the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery;*

(c) *the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;*

(d) *the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of collecting information, for the enterprise;*

(e) *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;*

(f) *the maintenance of a fixed place of business solely for any combination of activities mentioned in sub-paragraphs (a) to (e), provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character.*

5. *Notwithstanding the provisions of paragraphs 1 and 2, where a person - other than an agent of an independent status to whom paragraph 6 applies - is acting on behalf of an enterprise of the other Contracting State, that enterprise shall be deemed to have a permanent establishment in the first-*

Marks

mentioned Contracting State in respect of any activities which that person undertakes for the enterprise, if such a person :

(a) has and habitually exercises in that State an authority to conclude contracts in the name of the enterprise, unless the activities of such person are limited to those mentioned in paragraph 4 which, if exercised through a fixed place of business, would not make this fixed place of business a permanent establishment under the provisions of that paragraph; or

(b) has no such authority, but habitually maintains in the first-mentioned State a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the enterprise;

(c) habitually secures orders in the first-mentioned State, wholly or almost wholly for the enterprise itself or for the enterprise and other enterprises controlling, controlled by, or subject to the same control, as that enterprise.

6. An enterprise shall not be deemed to have a permanent establishment in a Contracting State merely because it carries on business in that State through a broker, general commission agent or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business. However, when the activities of such an agent are devoted wholly or almost wholly on behalf of that enterprise, he will not be *considered an agent of an independent status within the meaning of this paragraph.*

7. *The fact that a company which is a resident of a Contracting State control or is controlled by a company which is a resident of the other Contracting State, or which carries on business in that other State (whether through a permanent establishment or otherwise), shall not of itself constitute either company permanent establishment of the other.*

Exhibit II : Relevant extracts of protocol to India – Hungary DTAA relevant for Article 7.

With reference to Article 7:

(a) ***In the determination of the profits of a building site or construction, assembly or installation project there shall be attributed to that permanent establishment in the Contracting State in which the permanent establishment is situated only the profits resulting from the activities of the permanent establishment as such. If machinery or equipment is delivered from the head office or another permanent establishment of the enterprise (situated outside that Contracting State) or a third person (situated outside that Contracting State) in connection with those activities or independently therefrom there shall not be attributed to the profits of the building site or construction, assembly or installation project the value of such deliveries.***

(b) *With respect to paragraph 3 it is understood that the administrative and general expenses incurred outside India will be allowed as a deduction in accordance with the provisions of section 44C of the Indian Income-tax Act, 1961, as effective on the date of the signing of this Convention.*