

THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

June 2024

MODULE 2.05 – INDIA OPTION

SUGGESTED SOLUTIONS

PART A

Question 1

Part 1

Candidates to evaluate the eligibility of Mauritius company to avail tax treaty benefits including beneficial ownership test. Candidates may refer to Supreme Court ruling in the case of Azadi Bachao Andolan (125 Taxman 826), applicability of GAAR and interplay between GAAR and tax treaty eligibility.

Part 2

Candidates should discuss about Section 194LC and mention that the loan is undertaken before the amendment to Section 194LC. Hence lower withholding tax rates prevailing under the domestic tax law have been applied as compared to tax treaty. Hence there should not be any impact on the existing loans granted by Mauritius company to India. For new loan, basis analysis in sub-question 1, lower withholding tax rate under the India – Mauritius tax treaty may not be eligible in the present case and consequently higher withholding tax under the domestic tax law should be applicable.

Part 3

Candidates should discuss applicability of exemption from filing return of income under Section 115A to Mauritius company. For loan granted by Walnut Plc, where Walnut Plc claims tax treaty benefit, it shall be required to file return of income in India. In all cases, the candidates should also outline about transfer pricing compliances that needs to be undertaken.

Part 4

Candidates should discuss about applicability of Section 94B provisions on interest paid by Walnut India for financial year ended 31 March 2025, 31 March 2026 and 31 March 2027 and compute disallowance under Section 94B of the Act. Candidates should also discuss about applicability of Section 43 on capitalization of interest cost and that such capitalized cost can be claimed as part of depreciation.

Question 2

Part 1

Candidates to give reference to OECD commentary and identify issues that are resulting in a fixed place permanent establishment and dependent agent permanent establishment getting created in India. For fixed place PE, reference can be made to direct contract between HS Plc and individuals, approval of leave by HS Plc, grant of employee stock options to demonstrate employer-employee relationship between HS Plc and individual and rent of premise directly by HS Plc and not in name of LO to conclude on creation of fixed place PE. With respect to dependent agent PE, candidates to highlight conclusion of contracts by individuals on behalf of HS Plc to conclude that the individuals are carrying on core activity. Candidates should also make reference to rulings such as Delhi High Court in the case of GE Energy Parts Inc (101 taxmann.com 142).

Part 2

Candidates can make reference to HP Plc shifting its India operations under a new subsidiary and follow buy sell model wherein HP Plc sells products to the Indian entity and Indian entity in turn sells product to end customer. The candidates should also refer to closure of Indian liaison office. With respect to modifications of business operations, the candidate needs to outline changes to reporting structure, signing of employment contracts, signing of customer contracts. With respect to TP considerations, the candidates may highlight about Indian entity following limited risk distributor model and also to ensure that the transfer pricing is at arm's length. Candidates may outline any other solution that will be relevant to the facts with necessary assumptions.

Part 3

HS Plc shall be required to file income-tax return in India, maintain books of accounts, be subject to MAT provisions, undertake tax audit and transfer pricing audit.

PART B

Question 3

Part 1

Candidates need to conduct an analysis after taking into account CBDT Circular 6 of 2017 (Guiding principles on POEM) and Circular 8 of 2017 (Exemption from POEM applicability for turnover below 50 Crore). For both entities, POEM needs to be evaluated individually.

For Farma Dubai, payroll expenses incurred on India employees exceed 50% of total payroll expenditure. Thus, Farma Dubai cannot be said to be engaged in active business outside India. Therefore, POEM examination will become a 2 stage process. First - identifying persons making key commercial and management decision and thereafter - identifying the place from where such decisions are made. Since the board has delegated the power to CEO and Marketing Head who operate from India, POEM of Farma Dubai will be in India. Further, turnover is more than INR 1 billion. Thus, exemption from POEM provisions do not apply.

For Farma Kenya, similar evaluation needs to be done. Strategic decisions are taken in Kenya, thus POEM lies in Kenya. Place of maintenance of accounting records is not determinative. POEM determination for SDS would not depend upon POEM determination for WOS.

Part 2

Candidates can make a reference to the notification issued under Section 115JH:

- 40% tax rate as applicable to a foreign company. Foreign company being a resident would be eligible for DTAA relief.
- TDS provisions as applicable to a person resident in India will continue to apply. Therefore, adherence to Section 195 would be required.
- Being a resident under section 6, carry forward of losses shall be allowed for a period of 8 assessment years.

Question 4

Part 1

Candidates should analyse Section 6 and specifically Section 6(1A). Thereafter, candidates should apply the tie-breaker test.

As per Section 6(1A), Mr. X becomes a 'Resident but Not Ordinary Resident' under ITA. However, being eligible for DTAA benefits, as per the tie-breaker test, he becomes a resident of UAE under DTAA.

Part 2(a)

Candidates should give reference of Article 13(5) of India-UAE DTAA. As per this Article, there is no tax in India upon sale of mutual fund investments.

Distributive right under Article 13(5) does not depend upon location of the seller. Rather, it is dependent upon the tax residence.

Part 2(b)

Candidates should analyse applicability of Article 13 vs. Article 7. Income from derivative transactions qualifies as business income and would be covered under Article 7.

Part 2(c)

Candidates should refer to Chapter XA on GAAR. They should analyse whether the individual derives any tax benefit from the facts of the case. Thereafter, whether the circumstances result in executing an impermissible avoidance arrangement. They should refer to Section 97(1)(c) and conclude that change of residence is not merely for obtaining a tax benefit but for bona fide reasons.

PART C

Question 5

Part 1

Candidates should first explain whether the international transaction of overdue receivables can be aggregated with the international transaction of export of services for the purpose of benchmarking? Thereafter, candidates should explain the judicial discourse on this subject especially the ratio laid down by Delhi High Court in the case of Kusum Health Care Pvt Ltd. [2018] 99 taxmann.com 431 (Delhi).

If working capital adjustment is made, then it is possible to argue that it will subsume interest benchmarking on outstanding receivables.

Part 2

Candidates should make a reference of Bombay High Court decision in the case of Vodafone India Services Pvt. Ltd. [2014] 368 ITR 1 (Bombay) and the consequent CBDT Instruction 2/2015. In light of these, the transaction of issue of share capital falls outside the scope of Chapter X even though Explanation to Sec. 92B specifically covers it. Even if the assessee does not disclose it, there can't be any levy of penalty on it.

Part 3

Candidates should refer to judicial decisions of High court for stating that rate of interest prevailing in the jurisdiction of borrower has to be adopted and currency would be that in which transaction has taken place. In this case it would be international benchmark rate. Decisions such as Tata Autocomp Systems Ltd. [2015] 56 taxmann.com 206 (Bombay), Aurionpro Solutions Ltd. [2018] 95 taxmann.com 657 (Bombay) may be quoted.

Part 4

Candidates should give reference to Sec. 92F(ii) to state that ALP should be a price to be applied in transactions other than AEs. Candidates may also give reference to Rule 10A(d) to state that uncontrolled transaction is a transaction between enterprises other than AEs. Thus, transactions between group entities cannot be taken as internal comparable.

Question 6

Part 1

Candidates should analyse the applicability of Section 56(2)(viib), Section 68 (along with its relevant tests), Section 56(2)(x), Rule 11UA.

Part 2

Candidates should make reference to Section 50CA. Candidates should also discuss the interplay between the provisions of Section 112(1)(c)(iii) and Section 48. Consequently, applicability of Rule 115A should also be examined.

Part 3

Candidates should discuss the application of beneficial ownership test to Article 13. Candidates may also mention judicial analysis on this subject.

Question 7

Part 1

Candidates should analyse applicability of Article 8 of India-Singapore DTAA to different receipts earned by Cross SG. Article 8 would apply to outbound cargo receipts, inbound cargo receipts and slot charter receipts. Domestic routes would not qualify as international traffic and hence receipts arising from domestic shipment would not be eligible for exemption under Article 8. Candidates should support their analysis by OECD commentary and judicial decisions (such as Bombay High Court decision in the case of APL Pte. Ltd. [2016] 75 taxmann.com 32 (Bombay)) wherever required.

Part 2

Candidates should explain the concept of Limitation of Benefit under Article 24 and how it operates under India-Singapore DTAA. They should analyse the remittance conditions under the article against the contention placed by the assessee. Candidates may give reference to judicial decisions such as Bombay High Court decision in the case of APL Pte. Ltd. [2023] 156 taxmann.com 530 (Bombay).

Question 8

Part 1

Candidates to discuss the applicability of Supreme Court ruling in the case of Engineering Analysis Center of Excellence Private Limited (125 taxmann.com 42). Since the software provided is standard embedded software, the Supreme Court ruling should apply and tax are not required to be withheld.

Part 2

Candidates to discuss the provisions of Article 12(4)(b) as well as example 5 of India – US MOU to conclude that the services qualify as fees for included services under India – US tax treaty.

Part 3

Candidates to discuss provisions of Section 195 to outline applicability of withholding tax on payment of any other sum chargeable to tax. Candidates to also discuss the Supreme Court ruling in the case of Kanchanganga Sea Foods Ltd (192 Taxman 97) to conclude that withholding tax provisions are applicable even if transactions are netted off.

Question 9

Part 1

Candidates to analyse the Supreme Court ruling in the case of Nestle SA (458 ITR 756) and CBDT Circular No .3 of 2022 to conclude that Power India cannot apply withholding tax rate under India Slovenia DTAA to India – Netherlands DTAA.

Part 2

Candidates to discuss the applicability of Section 47 of the Act in the hands of Power NL to conclude that the transaction is not taxable in India. Further in the hands of recipient i.e. Power India, provisions of Section 56(2)(x) of the Act do not apply.

Part 3

Candidates to analyse the applicability of Section 115QA of the Act and outline the tax rate applicable on buy-back of shares.