# THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

June 2023

# MODULE 2.05 – INDIA OPTION

## SUGGESTED SOLUTIONS

# PART A

## Question 1

Part 1

Given the facts in the case study, F Co. shall be liable to long-term capital gains tax in India. Since the shares of I Co. 1, which is an Indian company, are situated in India, provisions of section 9 of the Act get attracted, and the transaction shall be chargeable to tax in India under the head 'Income from Capital Gains.'

As per section 112(1)(c)(iii) of the Act, capital gain arising from the above-mentioned transaction shall be taxable in the hands of F Co. as the income from capital gains at the rate of 10% without indexation. The computation of capital gains and resulting income tax liability in the hands of F Co., computed under provisions of the Act, for transaction under consideration is tabulated below.

Capital Gains Computation

| Particulars | No. of shares (mn) | Price per share (INR) | Amount (INR mn) | Total Amount (INR mn) |
|---|---|---|---|---|
| Sale Consideration | 35 | 60 | | 2,100 (A) |
| Less: Cost of Acquisition | | | | |
| Shares purchased on 17/02/2012 | 15 | 25 | 375 | |
| Shares purchased on 14/06/2013 | 20 | 35 | 700 | 1,075 (B) |
| Long Term Capital Gain (LTCG) [(A) – (B)] (as equity shares are held for more than 24 months) | | | | 1,025 |

Tax Computation

| Particulars | Amount (INR mn) |
|---|---|
| LTCG | 1,025 |
| Tax on LTCG @ 10% | 102.5 |
| Add: Sur-charge @ 5% | 5.125 |
| Add: Health & Education Cess @ 4% | 4.305 |
| Total Tax Liability | 111.93 |

Part 2

F Co. is a tax resident of Singapore. The TRC has been duly issued to it by Singapore IRAS. Accordingly, as per section 90(4) of the Act, the Applicant is eligible for the beneficial provision under the DTT.

As per the beneficial provisions of paragraph 4A of Article 13 of the DTT, transfer of shares which have been acquired before April 01, 2017, shall be only taxed in the Contracting State in which the alienator/ transferor is a resident i.e., Singapore in the instant case. In other words, investments in shares made before April 01, 2017 have been grandfathered and will continue to enjoy the benefits of the erstwhile provisions of the DTT.

Since the shares proposed to be sold were acquired by F Co. before the year 2017, i.e., 2012 & 2013 respectively, income by way of capital gains through the transfer of the shares of I Co. 1 shall be taxable in Singapore only and no tax is required to be paid in India, as per the provisions of Article 13 of the DTT.

Part 3

It may be pertinent to note that the aforesaid relief/ exemption shall be allowed only where the provisions laid down under the Article 24A of the DTT are satisfied.

With reference to the aforesaid provisions, F Co. shall be entitled to the benefits of paragraph 4A of Article 13 of the DTT basis the following:

- F Co. is a manufacturing hub for the group entities and has been operating and carrying out bona-fide business activity in Singapore for past 10 years. F Co. has made investment into and has been holding shares in I Co. 1 since 2012, much before amendment of India-Singapore DTT and insertion of Paragraphs 4A to 4C in Article 13 and by not stretch of imagination can it be considered that the affairs of F Co. are arranged with the primary purpose to take advantage of the benefits of the DTT.
- F Co. is not a shell or conduit company i.e., it has business operations in Singapore with real and continuous business activities carried out in Singapore.
- F Co.'s annual expenditure on the operations in Singapore is more than SGD 200,000 in each of the 12-month periods in the immediately preceding period of 24 months from the proposed date of shares transfer.

Thus, F Co. is fully eligible to claim exemption in respect of capital gains income arising to it from transfer of shares of I Co. 1 under Article 13 of the DTT.

Part 4

F Co. being a non-resident/Foreign Company can seek an Advance Ruling under Chapter XIX-B of the Act. Advance Ruling means a written opinion or authoritative decision by an Authority empowered to render it with regard to the tax consequences of a transaction or proposed transaction or an assessment in regard thereto.

A Board for Advance Ruling has been constituted for giving advance rulings under the said Chapter. The Board consists of two members, each being an officer not below the rank of Chief Commissioner. Advance rulings of such Board shall not be binding on the applicant or the Department and if aggrieved, the applicant or the Department may appeal against the ruling or order passed by the Board before the High Court.

The effect of the ruling is stated to be limited to the parties appearing before the authority and the transaction in relation to which the ruling is given. This is because the ruling is rendered on a set of facts before the Authority and cannot be for general application.

Under section 245R of the Act, certain restrictions have been imposed on the admissibility of an application, if the question concerned is already pending before other authorities. According to it, the Authority shall not allow an application where the question raised by the non-resident applicant (or a resident applicant having transaction with a non-resident) is already pending before any income-tax authority or appellate Tribunal or any Court of law. Further, the authority shall not allow the application where the question raised in it involves determination of fair market value of any property; or it relates to a transaction or issue which is designed, prima facie for the avoidance of income-tax.

F Co. may also explore the option of applying for a certificate for deduction at lower/nil rate under section 197 of the Act. The tax withholding on payments to non-residents is governed by section 195 of the Act. However, the relevant income tax authorities, on an application made in the prescribed manner under section 197(1) of the Act by the non-resident recipient, are required to issue an appropriate certificate for no tax withholding or at a lower rate (as the case may be) upon satisfaction that the total income of the non-resident recipient justifies the deduction of income-tax at any lower rates or no deduction of income-tax at all.

Where any such certificate is given, the person responsible for paying the income shall, until such certificate is cancelled by the Assessing Officer, deduct income-tax at the rates specified in such certificate or deduct no tax, as the case may be.

The above determination/ certification is provisional and subject to final assessment during the course of regular audit. The certificate under section 197(1) of the IT Act is valid for the relevant tax year for which the application is lodged.

## Question 2

### Part 1

In terms of section 9(1)(i) of the Act, all income accruing or arising, whether directly or indirectly, through or from any business connection in India, or through or from any property in India, or through or from any asset or source of income in India, or through the transfer of a capital asset situated in India or due to significant economic presence shall be deemed to accrue or arise in India.

As per section 90(2) of the Act a non-resident entity is eligible for DTAA benefits. Under the DTAA, current transaction may be taxable in India only if a business income arises out of a PE (generally Fixed Place PE, Service PE, and Agency PE) or the same is taxable as Royalty or FTS.

Candidates should discuss applicability of all 3 PEs in detail and also what can constitute a Fixed Place PE (ie place of business, permanent, disposal, and business activity):

- For fixed place PE, I Co. or L Co. doesn't seem to be virtual projection of S Co. given that though S Co. is the entrepreneur entity and earns bulk of the profits, I Co. is acting on its own account, L Co. is hired by I Co. and not S Co., I Co. retains title in the goods in India, I Co. is earning margin which is commensurate with arm's length, business activity and disposal test may not be satisfied for S Co. Additionally, employees travelling to India is for very less days to constitute a fixed place PE. Candidates may also discuss Formula 1 decision of Supreme Court and try and highlight why a shorter duration may not meet the Fixed Place PE test here.
- For Agency PE, candidates can argue that the transaction between S Co. and I Co. is on principal to principal basis, I Co. is not an agent of S Co. per se in absence of such facts, etc.
- For Service PE, though there is no remuneration for services to S Co., the presence of employees in India demonstrates that S Co. is providing some service to I Co. Even where S Co. employees come to L Co. and help L Co.'s employee in production related processes, it is arguable that services are being rendered by S Co. to I Co. as L Co. has been hired by I Co. to undertake contract manufacturing. As such, there is 'furnishing of services' and a 30 days criteria would apply under India Singapore DTAA notwithstanding there is no specific payment for such services to S Co. Candidates can also discuss whether services can be classified as stewardship in nature or not and whether service PE risk can be alleviated.

### Part 2

Under the transfer pricing regulations, I Co. and S Co. are associated enterprises. However, L Co. and I Co./ S Co. are not associated enterprises notwithstanding the fact that they are party to a joint agreement. It is also assumed that L Co. is a listed entity and thus would have significant other business.

If the transaction of licensing of IP is between S Co. and I Co., there is a theoretical risk that the tax department may try and impute some royalty/ licensing income in the hands of S Co. given that the transaction is between AEs. However, in terms of section 92(3) of the Act, there is an argument to suggest any imputation of royalty/ licensing income in the hands of S Co. would also lead to expense deduction for I Co. and is not permitted. A royalty/ licensing income in the hands of S Co. would be taxable at 10% plus surcharge and cess whereas I Co. may get a deduction and tax rate applicable to I Co. would be higher at 22/ 25/ 30 % plus surcharge and cess.

In case of any negative action by Indian tax authorities against S Co., S Co. can take recourse of MAP under India Singapore DTAA to avoid double taxation.

Part 3

I Co. is acting a limited risk manufacturer and sells final products to third party in India. Based on details available, it can be assumed that the only transaction with AEs is that of purchase of goods. As such, the most appropriate transfer pricing method should be a CUP or TNMM. Candidates may discuss more about CUP (including internal and external CUP) and TNMM.

## PART B

### Question 3

Part 1

Section 90 of the Act read along with rule 128 of the Income Tax Rules, 1962 (the Rules) provides for double taxation relief in cases where the DTT is in force between India and the other country (Singapore in the instant case.)

Section 90(1)(a)(i) of the Act provides relief from double taxation where income of an assessee is chargeable under the Act as well as in corresponding law in force in the foreign country.

Rule 128 of the Rules lays down the prescribed mechanism to claim such relief by way of FTC.

FTC is to be calculated on country-wise basis for each individual source of income and not on the basis of aggregation or amalgamation of income of all foreign countries.

Rule 128 read along with the DTT restricts FTC and allow credit of foreign taxes only to the extent income-tax (without FTC) payable under the Act that is attributable to the income from foreign country.

Since income from S Co., subjected to tax withholding in Singapore, is also liable to be taxed in India in the hands of I Co., FTC can be availed by I Co. to the extent of tax is payable in India on such income.

In the context of I Co., FTC shall be restricted to income tax payable (at the applicable rates) under the Act on ‘income’ from S Co. as tabulated below.

Table 1: India Tax Position

| Particulars | India | Singapore | Total |
|---|---|---|---|
| Revenue (1) | 70 | 30 | 100 |
| (80%) Expenses (2) | (56) | (24) | 80 |
| Net Income [(1)-(2)] | 14 | 6 | 20 |
| Tax @ 25% | 3.5 | 1.5# | 5 |

Table 2: FTC Credit

| Particulars | Amount | Amount |
|---|---|---|
| Total Tax Payable | | 5 |
| Total Ftc (Wht-Singapore) | 3 | |
| Tax Liability in India on Singapore-Source Income | 1.5# | |
| Less: Ftc Credit | Lower Of (3) Or (1.5) | (1.5) |
| Balance Tax Payable | | 3.5 |

Part 2

The unutilized FTC (i.e. 1.5 in the illustration above) may however be claimed by I Co. as a ‘deduction’ by virtue of section 40(a)(ii) of the Act.

The position finds support from the judgement of Hon'ble High Court of Bombay in the case of Reliance Infrastructure Ltd. vs. CIT [(2016) 390 ITR 271 (Bom)] followed by Mumbai Income Tax Appellate Tribunal in the case of Bank of India vs. ACIT [ITA No. 869/Mum/2018]. It may be noted here that the judgement pronounced by the Hon'ble High Court of Bombay was rendered in the context of section 91 of the Act. However, considering that section 90 and 91 are in pari materia, a position may be taken that unutilized credit, not allowable as deduction under section 90 of the Act read with DTT/Rule 128 of the Rules would not be hit by embargo under section 40(a)(ii) of the Act, and accordingly may be claimed as a deduction under section 37(1) of the Act.

Though the aforesaid position, supported by decision of Hon'ble Bombay High Court in the case of Reliance (supra), is followed in practice at large, the same may potentially be challenged by the field-level tax authorities on the ground that the decision in the case of Reliance (supra) did not consider the principles enunciated by Hon'ble Supreme Court of India in the case of Smithkline & French India Ltd. [(1996) 219 ITR 581 (SC)].

The Hon'ble Supreme Court in the case of Smithkline (supra) while holding that Indian sur-tax was hit by embargo under section 40(a)(ii) of the Act, and thus not allowable as a deduction, inter alia stated that section 40(a)(ii) of the Act do not contain any words indicating that the profits and gains (of any business or profession) should be determined in accordance with the provisions of the Act.

All they say is that it must be a rate or tax levied on the profits and gains of business or profession. Accordingly, it may not be open to hold that the meaning of expression 'tax' under section 40(a)(ii) of the Act will exclude foreign-taxes that are paid directly with reference to income generated by the taxpayer. In other words, drawing an analogy from Hon'ble Supreme Court's observations in context of Indian sur-tax, and also as implied vide Explanation 1 to section 40(a)(ii) of the Act, foreign taxes paid as a proportion of profits or gains of business or profession may not qualify as permissible deduction by virtue of the embargo under section 40(a)(ii) of the Act.

Having said that, the issue is technically open to interpretation since there is no conclusive finding of a competent court directly on this particular issue at present.

## Question 4

### Part 1

The total income of a non-resident includes all income from whatever source derived which (a) is received or is deemed to be received in India and (b) which accrues or arises or is deemed to accrue/ arise in India.

In terms of section 9(1)(vi) of the ITA, income by way of royalty is deemed to accrue or arise in India as per the provisions of the said section. Though a non-resident may be liable to tax in India by virtue of the provisions of the Act, the tax liability is determined by keeping in mind the relevant provisions of the DTAA (that India has entered into with the country of which the foreign company is a resident) if the same is more beneficial. Candidates should then discuss Explanation 2(v) to section 9(1)(vi) of the Act, conclude taxability under the Act, and applicability of Article 13 of the India-UK DTAA.

The Supreme Court of India in the case of Engineering Analysis Centre of Excellence Private Limited v CIT (Civil Appeal Nos. 8733-8734 of 2018) dt March 2, 2021 along with multiple clubbed appeals held that a copyrighted article being computer software is not taxable as royalty under the DTAA definition and accordingly no tax withholding is warranted under section 195 of the Act. Multiple other judicial precedents are also available.

In the current set of facts, it appears that the sale is of copyrighted article or/ and hardware embedded with such copyrighted article. Thus, the no TDS would be applicable on the said transaction given that the same does not amount to royalty under the DTAA.

Candidates should also discuss requirement of TRC and Form 10F.

### Part 2

Yes. Under section 239A, where under an agreement or other arrangement the tax deductible under section 195 of the Act is to be borne by the deductor, then an application can be made to the Assessing Officer for refund of such tax where such deductor denies such a liability. Candidates to discuss other details of the section.

### Part 3

In the current case, mainly Fixed Place PE and Agency PE would be relevant. Candidates should discuss the following:

- Exclusions contained in Article 5(3) as relevant to Fixed Place PE.
- Whether A Ltd appears to be dependent agent or independent agent (discuss both legal independence and economic independence).
- The activities carried out should be discussed in detail highlighting positive and negative factors, eg: identifying potential customers in India does not by itself trigger Agency PE exposure in India, negotiating prices on behalf of X Inc so long is based on a price list defined by X Inc and where overseas entity is not binded by A Ltd as such may not lead to a PE exposure. However, maintaining stock of goods (software in CD and hardware) from where it delivers final goods to customers in India as and when order is received may lead to an Agency PE exposure unless the activities are by an independent agent.

### Part 4

Where A Ltd. is treated as a PE of X Inc., so long as A Ltd. is remunerated under on an arm’s length basis also factoring in all activities undertaken by A Ltd. as a PE of X Inc., no further attribution of income is warranted as held in Morgan Stanley, Efunds judgements.

# PART C

## Question 5

### Part 1

Apparently, the allocation of price to different parts of the contract has been decided in such a manner as to reduce tax liability of F Co. in India.

Both conditions for declaring an arrangement as impermissible are satisfied:

1) The main purpose of this arrangement is to obtain tax benefit; and
2) The transactions are not at arm‘s length.

Consequently, GAAR may be invoked and prices would be reallocated based on arm‘s length price of each part of the contract determined as per transfer pricing regulations under the Act.

### Part 2

GAAR provisions in such cases may be invoked only where there is an overall benefit in reallocation of prices to different parts of the overall contract. For instance, theoretically, where import duty is levied on offshore supplies, it may not result in any net gain on reallocation of prices; or where offshore designs are not taxable in India as per the relevant DTT between India and Country A.

### Part 3

Anti-Avoidance Rules can be broadly divided into two main categories: General Anti- Avoidance Rule (GAAR) and Specific Anti Avoidance Rules (SAAR).

Anti-Avoidance Rules that target specific tax avoidance schemes are known as SAAR. A SAAR seeks to prevent abusive tax avoidance by laying down certain objective tests which need to be complied with by the Taxpayer. Some examples of SAAR under the Act are - Transfer Pricing provisions, Sec.40A(2), Sec.64, Sec.93, Sec.94(7), Sec.94 B and Sec.80-IA(3).

The SAARs relate to particular areas of Tax Law. These have been set up to target specific, known arrangements of tax avoidance. Indeed, innovative abusive schemes to avoid tax were addressed by the Government in a piecemeal fashion through specific provisions introduced in the Tax Statute.

By virtue of sec. 100 of the Act read with the non-obstante clause (notwithstanding anything contained in the Act) with which sec. 95 begins, GAAR overrides SAARs and other provisions of the Act. Vide Circular No. 7 of 2017, the CBDT has clarified - in response to the query ‘will GAAR be invoked if SAAR applies?’ - that it is internationally accepted that specific anti avoidance provisions may not address all situations of abuse and there is need for general anti-abuse provisions in the domestic legislation. In view of the CBDT the provisions of GAAR and SAAR can coexist and are applicable, as may be necessary, in the facts and circumstances of the case.

## Question 6

Given the facts in the case study, clearly, since M is a ROR in India and also a tax resident of the US, he is a dual-resident. As a result, M could continue to be taxed on his worldwide income both in India as well as the US.

In such a situation, while both the countries would have first claim to tax the income which is sourced by M in their respective country, the question to resolve would be that which country would let go of the taxing rights in case of income which is considered taxable in both the countries because of dual residency.

To resolve the above conflict, tie-breaker tests as prescribed under Article 4(2) of the DTT would need to be applied for determing tax residence of M.

The analysis would involve applying each of the tests prescribed under Article 4(2) of the DTT to the facts of M in the following order of priority:

1) Permanent Home – if this does not help determination, then
2) Centre of Vital Interest – if this is indecisive, then
3) His habitual abode – is this is also indecisive, then
4) His nationality – only if this is in both the countries, we need to resort to the next, i.e.
5) Competent authorities by mutual agreement.

### Permanent Home

From the facts, M has owned accommodation in the US where his parents are residing and he staying in company provided accommodation in India. Both these houses are at his disposal and available to him as his permanent home at all times. Accordingly, M can be said to have permanent home available to him both in India and the US. Therefore, the next test of 'centre of vital interest' needs to be examined.

### Centre of Vital Interest

M's parents, spouse and his two children continue to reside in the US. The OECD Commentary states that the most important factor in establishing an individual's personal relations with a particular country is the place where he regularly lives with his family including children. Further, M continues to receive salary income in the US.
Accordingly, M's centre of vital interests can be said to be closer to the US than to India. Therefore, M would be considered to be a Resident in the US under the DTT for FY 2022-23.

## Question 7

### Part 1

In terms of section 9(1)(i) of the Act, all income accruing or arising, whether directly or indirectly, through or from any business connection in India, or through or from any property in India, or through or from any asset or source of income in India, or through the transfer of a capital asset situated in India shall be deemed to accrue or arise in India.

Candidates should discuss on trigger of significant economic presence by virtue of Explanation 2A to Section 9(1)(i). 2 thresholds have been prescribed under Rule 11UD – (a) the amount of aggregate of payments arising from transaction or transactions in respect of any goods, services or property carried out by a non-resident with any person in India, including provision of download of data or software in India during the previous year – INR 20 million and (b) number of users with whom systematic and continuous business activities are solicited or who are engaged in interaction – 300,000.

Candidates can discuss whether sale of goods, services or property should only be digital or physical goods as well.

SEP trigger is breached in the instant case due to value of sale of goods being more than INR 20 million. Thus, related income is taxable in India.

### Part 2

Taxability can be relieved by operation of India UK DTAA as final taxability needs to be governed by provisions of the Act or DTAA whichever is favourable. In absence of any other facts, it may be presumed that F LLP does not have a PE in India and hence any business income (i.e. from sale of goods) shall not be taxable in India in absence of a PE. It may further be assumed that there is no advertisement or related income in absence of specific information and hence the same is not required to be discussed.

Whether an LLP is altogether eligible to tax treaty benefits may be a contentious issue. Candidates may discuss on ‘liable to tax’ under the DTAA and judgement of Linklaters and others to highlight why a UK LLP should be eligible for tax treaty benefit in India.

Candidates should also discuss the need to obtain TRC and file Form 10F electronically now.

### Part 3

A foreign entity is liable to tax in India or related compliances where there is a nexus to India. Sale of goods which is taxable as per provisions of SEP establish such a nexus. Thus, in terms of section 139 of the Act, F LLP must be liable to file its tax return in India to be eligible for tax treaty benefit.

## Question 8

Part 1

In terms of section 9(1)(i) of the Act, all income accruing or arising, whether directly or indirectly, through or from any business connection in India, or through or from any property in India, or through or from any asset or source of income in India, or through the transfer of a capital asset situated in India shall be deemed to accrue or arise in India.

Candidates should discuss on trigger of significant economic presence by virtue of Explanation 2A to Section 9(1)(i). Candidates should then discuss trigger of DTAA and whether the transaction can be taxable if there is no PE.

In the current transaction, Check provides online short video content services to individuals and receives compensation as a premium subscription model and advertisement income. The transaction arguably is not royalty as the payment is for services being provided as such without transfer of any right in the copyright. Similarly, the services are not for any technical or consultancy services and may not be characterized as FTS as well. Additionally, the transaction may not qualify as FTS under the DTA if the same is for private consumption of the individual in terms of Article 12(5)(d) of India Singapore DTAA.

Candidates should then discuss applicability of different types of PEs.

Part 2

Candidates should discuss in detail provision of Equalisation Levy, both advertisement EL in the hands of Indian company who is advertising on Check's portal and e-commerce EL in the hands of Check.

Part 3

Candidates should discuss requirement of filing income-tax return in India as there is nexus with India/ Indian territory. Candidates should also discuss requirement to file Equalisation Levy return by Check.

Question 9

Candidates should discuss the following:

- RSU/ ESOP is taxable in the year of exercise, i.e. FY 2022-23 at the fair market value (section 17(2)(vi)). Ideally the employer, Best India Pvt Ltd, would have done TDS as well on this amount which can be used as perquisite income by Robert. Robert should also take TDS credit.
- The cost of acquisition of shares in Best Inc. is same as the amount of perquisite income (section 49(2AA)).
- Since the shares have been received in FY 2022-23 and sold in the same year, the same is short term in nature (long term is where shares are held for more than 2 years as the shares are not listed in India). Such capital gains should accordingly be taxed at slab rates and section 111A does not apply.
- Since the shares sold are short term in nature, benefit of section 54F is not available for claiming deduction of capital gains.
- India introduced specific taxation of virtual digital assets (cryptocurrencies and others) under section 115BBH at the rate of 30% (plus surcharge and cess) with effect from 1 April 2022. TDS provisions have also been made available so Robert should be mindful in claiming credit of such TDS as well.
- Loss from sale of VDA held as capital asset will not be allowed for setoff from income from sale of another VDA held as capital asset (section 115BBH(2)(b)). Accordingly, profit from sale of cryptocurrency shall be taxable in the current year and loss from sale of NFTs shall not be allowed to be carried forward.