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CA FINAL N'19

SUBJECT- Elective (International Taxation)

Test Code - FNJ 7219

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CASE STUDY – 1

I. ANSWERS TO MCQs (Most appropriate answers)

1. **(d)**
2. **(b)**
3. **(d)**
4. **(a)**
5. **(a)**
6. **(d)**
7. **(b)**
8. **(c)**
9. **(a)**
10. **(c)**

II. ANSWERS TO DESCRIPTIVE QUESTIONS

Answer to Q.1:

Website on Indian soil, whether is PE

The term "permanent establishment" has not been defined in section 2 of the Income-tax Act, 1961. As per section 92F(iiia), "permanent establishment" includes a fixed place of business through which the business of the enterprise is wholly or partly carried on.

The term "permanent establishment" includes (a) a place of management (b) a branch, (c) an office, (d) a factory, (e) a workshop, (f) mines, (g) warehouse, etc. In most of the DTAAs, an exhaustive definition of the term "permanent establishment" is given, wherein several more items are enumerated.

A website is a set of web documents belonging to a particular organization. It consists of data and programs in digital form, from which it is stored in a server which is accessible through internet.

A website does not normally imply "a fixed place of business", even though in the case of some entities, some business could be transacted through a website. Thus, the mere presence of a website in Indian soil, without anything more, will not amount to a permanent establishment.

If the website contains merely information about the concern, the website cannot be regarded as a permanent establishment. Where the website is being used as a virtual office for transacting orders of purchases or sales or for rendering services on a more than casual basis, then it could be regarded as a permanent establishment, if the server supporting the website is located in India.

Answer to Q.2:

An equalisation levy of 6% is attracted in respect of the amount of consideration for specified services received or receivable by a non-resident not having permanent establishment in India, from a resident in India who carries out business or profession, or from a non-resident having permanent establishment in India.

"Specified Service" means

(a) online advertisement;

(b) any provision for digital advertising surface or any other facility or service for the purpose of online advertisement and

c) any other service as may be notified by the Central Government.

However, equalisation levy shall not be levied-

- where the non-resident providing the specified services has a permanent establishment in India
- the aggregate amount of consideration for specified service received or receivable during the previous year does not exceed Rs.1 lakh.
- where the payment for specified service is not for the purposes of carrying out business or profession

<u>Where DLM has no PE in India</u>

In the present case, the assessee is required to deduct equalisation levy of Rs.5,40,000 i.e., @6% of Rs.90 lakhs, being the amount paid towards online advertisement services provided by DLM, a non-resident having no permanent establishment in India.

Non-deduction of equalisation levy would attract disallowance under section 40(a)(ib) of 100% of the amount paid while computing business income.

<u>Payment made to PST having PE in India</u>

Equalisation levy would not be attracted where the non-resident service provider PST Inc., in this case, has a permanent establishment in India. Therefore, the ABL is not required to deduct equalisation levy on Rs.1.2 crores, being the amount paid towards online advertisement services to PST.

However, tax has to be deducted by the assessee at the rates in force under section 195 in respect of such payment to PST.

Non-deduction of tax at source under section 195 would attract disallowance under section 40(a)(i) of 100% of the amount paid while computing business income

Answer to Q.3:

Section 195A enjoins that where under an agreement, the tax chargeable on any income is to be borne by the person by whom the income is payable (payment is made net of tax), then for the purpose of deduction of tax at source, such income shall increase to such amount as would, after deduction of tax thereon, be equal to the net amount payable under the agreement.

As per section 203, every person deducting tax shall furnish to the deductee, certificate of deduction of tax in the prescribed form. No exception has been provided in this regard.

The CBDT has, vide *Circular No.785 dated* 24.11.99, clarified that even in those cases where the tax has been borne by the payer of income under an agreement, the payer is under a legal obligation to furnish a TDS Certificate as per the provisions of section 203 of the Income-tax Act, 1961.

Therefore, the view of ABL that the payee PST is not entitled for TDS certificate, is incorrect.

As regards payment to DLM, there is no provision in law for issuance of TDS certificate in respect of equalisation levy deducted.

Answer to Q.4:

Section 44C restricts the allowability of the head office expenses to the extent of lower of an amount equal to 5% of the adjusted total income or the amount actually incurred as is attributable to the business of the assessee in India.

For the purpose of computing the adjusted total income, the head office expenses of Rs.45 Lacs charged to the profit and loss account have to be added back. In other words, the income before charging such HO expenditure has to be considered.

The amount of income to be declared by the assessee for A.Y. 2019-20 will be as under:

Particulars	Rs. in Lakhs
Net profit before charging HO expenditure	20.00
Less: Share of HO expenditure	
- 5% of Rs.20 lakhs i.e. Rs.1 lakh	
- Actual 45 lakhs	
	1.00
Total income of SI for the A.Y. 2019-20.	19.00

Answer to Q.5:

(i) As per section 10(6A), in the case of a foreign company deriving income by way of royalty or fees for technical services from the Government or an Indian concern under the terms of an agreement entered into before 1.6.2002 relating to a matter included in the industrial policy of the Central Government, the tax paid by the Government or an Indian concern on such income would not be included in the total income of the foreign company. Hence, such tax paid would be exempt in the hands of e foreign company.

Therefore, in the impugned situation, the tax paid by DC will be exempt from tax in the hands of NI.

In this case, section 195A is not applicable and consequently, the royalty of Rs.30 lacs should not be grossed up.

The rate of tax is 10% as per section 115A(1)(b)(A), if the royalty is received in pursuance of an agreement made after 31.3.1976.

Therefore, DC is required to pay tax of Rs.3.12 lakhs i.e., @ 10.4% on Rs.30 lakhs. No deduction is allowable in respect of any expenditure incurred to earn such income.

(ii) Since there is no clause in the agreement that DC has to bear the tax liability, the benefit under section 10(6A) is not available.

DC has to deduct tax at source on royalty payment to NI, a foreign company, as per section 195.

Since in this case, DC has to pay the royalty of Rs.30 lacs 'net to taxes" to NI, the royalty has to be grossed up.

The tax liability of NI has to be computed as under:

	Rs.
Net royalty income	30,00,000
Gross royalty income (30,00,000 x 100/89.6)	33,48,214
Tax on royalty of @10.40%	3,48,214
DC has to deduct tax of Rs.3,48,214 at source under section 195	

Answer to Q.6:

As per section 245S(1), the advance ruling pronounced under section 245R by the Authority for Advance Rulings shall be binding only on the applicant who had sought it and in respect of the specific transaction in relation to which advance ruling was sought. It shall also be binding on the Principal Commissioner/Commissioner and the income-tax authorities subordinate to him, in respect of the concerned applicant and the specific transaction.

Consequently, NI cannot use the advance ruling, obtained on an identical issue by another foreign company, FC, for its tax purposes for the assessment year 2019 -20.

However, though the advance ruling pronounced does not become a precedent, it has persuasive value where the facts warrant such reference to the rulings of AAR. There is no legitimate bar for relying or forming an opinion in consonance with the reasoning of the AAR. It was so held by the Madras High Court in *CIT v. P Sekar Trust (2010) 321 ITR 305*.

CASE STUDY – 2

ANSWERS TO MCQs

MCQ No.	Answer		MCQ No.	Answer
1.	(d)		**6.**	(c)
2.	(c)		**7.**	(a)
3.	(d)		**8.**	(c)

4.	(b)		**9.**	(d)
5.	(d)		**10.**	(d)

ANSWERS TO DESCRIPTIVE QUESTIONS

Answer to Q.1

(i) Since ABC Inc., a foreign company, holds 40% [1,20,000×100/3,00,000] of the voting power in ABC Ltd., an Indian company, ABC Ltd. and ABC Inc. are deemed to be associated enterprises as per section 92A(2). In this case, ABC Limited, the Indian company, supplied steel manufactured by it to its associated enterprise, ABC Inc. ABC Ltd. supplies similar product to PQR Inc., Country A. From the information given in Exhibits A & B, ABC Ltd. does not have any shareholding in PQR Inc; and PQR Inc also does not have any shareholding in ABC Ltd. PQR Inc. has neither borrowed nor lent money to ABC Ltd. It has not given a guarantee on behalf of ABC Ltd. nor has ABC Ltd. given any guarantee on its behalf. The supplies made by ABC Ltd. to PQR Inc. constitute only 10% of the requirement of PQR Inc. Therefore, from the information given in Exhibits A & B, it would be logical to infer that ABC Ltd. and PQR Inc are unrelated parties. Therefore, the transactions between ABC Limited and PQR Inc. can be considered as comparable uncontrolled transactions for the purpose of determining the arm's length price of the transactions between ABC Ltd. and ABC Inc. Accordingly, comparable Uncontrolled Price (CUP) method of determination of arm's length price (ALP) can be applied in this case.

Transactions with ABC Inc. are on FOB basis, whereas transactions with PQR Inc. are on CIF basis. This difference has to be adjusted before comparing the prices.

Particulars	**Amount (in Euro)**
Price per MT of steel to PQR Inc.	1,200
Less: Cost of insurance and freight per M.T.	400
Adjusted Price per M.T.	800

Since the adjusted price for PQR Inc., Country A and the price fixed for ABC Inc. are the same, the arm's length price is Euro 800 per MT. Since the sale price to associated enterprise (i.e., ABC Inc.) and unrelated party (i.e., PQR Inc.) is the same, the transaction with associated enterprise ABC Inc. has also been carried out at arm's length price.

(i) Sigma Ltd., India and Epsilon Ltd., Country B are deemed to be associated enterprises, since Epsilon Ltd. holds shares carrying 26.66% [1,40,000 × 100/5,25,000], voting power in Sigma Ltd, from the information given in Exhibit C. Since Epsilon Ltd. is a non-resident, the transactions of purchase by Sigma Ltd. of goods manufactured by Epsilon Ltd. for sale in India would fall within the meaning of "international transaction" under section 92B. Therefore, transfer pricing provisions would be attracted in this case and the arm's length price have to be applied to such transactions.

Accordingly, penalty would be leviable under the provisions of the Income-tax Act, 1961 for failure to report such transactions and maintain requisite records in respect of such transactions.

The penalty leviable under the provisions of the Income-tax Act, 1961 in respect of its failures are -

(1) Failure to report transactions with Epsilon Ltd. would attract penalty of Rs.132.252 lakhs, being @ 200% of the amount of tax payable on under reported income of Rs.2 crore, since it is a case of misreporting of income referred under section 270A(9) read with section 270A(8).

Computation of penalty leviable under section 270A

Particulars	Rs
Under-reported income [Rs. 8 crore – Rs.6 crore]	**2,00,00,000**
Tax payable on under-reported income:	
Tax on under-reported income of Rs. 2 crore *plus* total income of Rs. 6 crore declared *[30% of Rs. 8 crore + surcharge@ 7% + EC & SHEC@3%]*	2,64,50,400
Less: Tax on total income declared *[30% of Rs. 6 crore + Surcharge@7% + EC & SHEC@3%]*	
	1,98,37,800
	66,12,600
Penalty leviable@200% of tax payable on under-reported income	1,32,25,200

(2) Failure to report the transaction and maintain the requisite records as required under section 92D in relation to international transaction makes it liable for penalty under section 271AA which would be 2% of the value of international transaction with Epsilon Ltd. [1]

However, if reasonable cause can be shown by Sigma Ltd. for failure to maintain requisite records under section 92D, penalty under section 271AA can be avoided.

Answer to Q.2

(i) Any income arising from an international transaction between two or more "associated enterprises" shall be computed having regard to arm's length price.

Section 92A defines an "associated enterprise" and sub-section (2) of this section speaks of the situations when the two enterprises shall be deemed to associated enterprises. Applying the provisions of section 92A(2)(a) to (m) to the given facts in the case study along with Exhibit D, it is clear that "XYZ Motors Ltd." is deemed to be associated with :-

(1) LMN Inc., Country A, as per section 92A(2)(a), because this company holds shares carrying 38.46% [50,000 ×100/1,30,000] (i.e., more than 26%) of the voting power in XYZ Motors Ltd.;

(2) RST Ltd., Country C, as per section 92A(2)(g), since this company is the sole owner of the technology used by XYZ Motors Ltd. in the manufacturing process and the manufacture of vans by XYZ Motors Ltd. is wholly dependent on the use of know-

how owned by RST Ltd.;

However, GHI Inc., Country D is not an associated enterprise of XYZ Motors Ltd. since its voting power in XYZ Motors Ltd. is only 2.31% [3,000 × 100/1,30,000]. Further, HIT Ltd., Country D, is not an associated enterprise of XYZ Motors Ltd., since this company has financed an amount which is only 49.95% [74 × 81 × 100 /12,000] (i.e., less than 51%) of the book value of total assets of XYZ Motors Ltd. Also, it holds shares carrying only 0.77% [1,000 × 100/1,30,000] voting power in XYZ Motors Ltd.

The transactions entered into by XYZ Motors Ltd. with LMN Inc. and RST Ltd. are, therefore, to be adjusted accordingly to work out the income chargeable to tax for the A.Y. 2018 -19.

(1) From the details given in Exhibit B & D, it would be logical to conclude that XYZ Motors Ltd. and PQR Inc. are unrelated parties on the same lines of reasoning for concluding ABC Ltd. and PQR Inc. are unrelated parties. Therefore, the price charged from PQR Inc. can be taken as the price of a comparable uncontrolled transaction for determining the arm's length price of the transaction with LMN Inc.

(2) From the details given in Exhibit E, it would be logical to conclude that RST Ltd. and Birla Motors Ltd. are unrelated parties. Birla Motors Ltd. does not have any voting power in RST Ltd.; nor does RST Ltd. have any voting power in Birla Motors Ltd. Birla Motors Ltd. does not solely depend on technical knowhow provided by RST Ltd. It has neither lent nor borrowed money from RST Ltd. Also, it has neither provided guarantee to, nor obtained guarantee from, RST Ltd. It has not appointed any of the directors of RST Ltd; nor has RST Ltd. appointed any of its directors. Therefore, it is apparent that Birla Motors Ltd. and RST Ltd. are unrelated parties. Therefore, the price charged by RST Ltd. from Birla Motors Ltd. for use of technical knowhow can be taken as the price of a comparable uncontrolled transaction for determining the arm's length price of the transaction with XYZ Motors Ltd.

Particulars		**(Rs.in crores)**
Income of XYZ Motors Ltd. as computed under Chapter IV-D, prior to adjustments as per Chapter X		585.00
Add:	Difference on account of adjustment in the value of international transactions:	
(i)	Difference in price of van @ Euro 280 each for 8,500 vans (Euro 280 x 8,500 x Rs.81) sold to LMN Inc.	19.278
(ii)	Difference for excess payment of royalty of $ 20,00,000 ($ 20,00,000 x Rs.60) to RST Ltd.	12.000
Total Income		**616.278**

(ii) Omega Inc., Country L and OMR Limited, the Indian company are deemed to be associated enterprises, since Omega Inc. has advanced loan constituting 53.33% of the book value of total assets of OMR Ltd. [1,600 × 100/3,000] , as per the information given in Exhibit F. Accordingly, transfer pricing provisions would be attracted. The arm's length rate of interest can be determined by using CUP method having regard to the rate of interest on external commercial borrowing permissible as per guidelines issued under Foreign Exchange Management Act. The interest rate permissible is LIBOR plus 300 basis points i.e., 5% + 3% = 8%, which can be taken as the arm's length rate. The interest rate applicable on the borrowing by OMR Limited, India from Omega Inc., Country L, is LIBOR plus 200 basis points i.e., 5% + 2% = 7%. Since the rate of interest, i.e. 7% is less than the arm's length rate of 8%, the borrowing made by OMR Ltd. is not at arm's length. However, in this case, the taxable income of OMR Ltd., India, would be lower if the arm's length rate is applied. Hence, no adjustment is required since the law of transfer pricing will not apply if there is a negative impact on the existing profits.

Answer to Q.3

(a) Xylo Inc. is a specified foreign company in relation to Alpha Ltd. Therefore, the condition of Alpha Ltd. holding shares carrying not less than 26% of the voting power in Xylo Inc is satisfied. Hence, Xylo Inc. and Alpha Ltd. are deemed to be associated enterprises. Therefore, provision of user documentation services by Alpha Ltd., an Indian company, to Xylo Inc., a foreign company, is an international transaction between associated enterprises, and consequently, the provisions of transfer pricing are attracted in this case.

Preparation of user documentation services falls within the definition of "software development services", and hence, is an eligible international transaction. Since Alpha Ltd. is providing software development services to a non-resident associated enterprise and has exercised a valid option for safe harbour rules, it is an eligible assessee.

Since the value of international transaction entered does not exceed Rs.100 crore, Alpha Ltd. should have declared an operating profit margin of not less than 17% in relation to operating expense, to be covered within the safe harbour rules. However, since Alpha Ltd. has declared an operating profit margin of only 14.71% [10× 100/68], the same is not in accordance with the circumstance mentioned in Rule 10TD. Hence, it is not binding on the income-tax authorities to accept the transfer price declared by Alpha Ltd.

(b) Fulcrum Ltd. and Gigo Inc. are deemed to be associated enterprises since Fulcrum Ltd. appoints more than half of the Board of Directors of Gigo Inc. Manufacture and export of non-core auto components is an eligible international transaction. Since Fulcrum Ltd. is engaged in original manufacture of non-core auto components and export of the same, it is an eligible assessee.

Fulcrum Ltd. should have declared an operating profit margin of not less than 8.5% in relation to operating expense, to be covered within the scope of safe harbour rules. In this case, since Fulcrum Ltd. has declared an operating profit margin of 5.55% [1 × 100/18], the same is not in accordance with the circumstance mentioned in Rule 10TD. Hence, it is not binding on the income-tax authorities to accept the transfer price declared by Fulcrum Ltd in respect of such international transaction.

(c) Yale Inc., a foreign company, is a subsidiary of Buttons & Bows Ltd., an Indian company. Hence, Yale Inc. and Buttons & Bows Ltd. are associated enterprises. Therefore, provision of call centre services by Buttons & Bows Ltd., an Indian company, to Yale Inc., a foreign company, is an international transaction between associated enterprises, and consequently, the provisions of transfer pricing are attracted in this case.

Call centre services with the use of information technology falls within the definition of "information technology enabled services", and is hence, an eligible international transaction. Since Buttons & Bows Ltd. is providing call centre services to a non-resident associated enterprise and has exercised a valid option for safe harbour rules, it is an eligible assessee.

Since the aggregate value of transactions entered into in the P.Y.2017-18 exceeds Rs.100 crore but does not exceed Rs.200 crore, Buttons & Bows Ltd. should have declared an operating profit margin of not less than 18% in relation to operating expense, to be covered within the scope of safe harbour rules. In this case, since Buttons & Bows Ltd. has declared an operating profit margin of 20% [32 × 100/160], the same is in accordance with the circumstance mentioned in Rule 10TD. Hence, the income-tax authorities shall accept the transfer price declared by Buttons & Bows Ltd. in respect of such international transaction.

The safe harbour rules shall not apply in respect of eligible international transactions entered into with an associated enterprise located in a notified jurisdictional area. Therefore, in respect of (c) above, if Yale Inc. is located in a NJA, the safe harbour rules shall not be applicable, irrespective of the operating profit margin declared by the assessee.

CASE STUDY – 3

I. ANSWERS TO MCQs (Most appropriate answers)

1. (c)

2. (d)

3. (a)

4. (b)

5. (a)

6. (c)

7. (b)

8. (b)

9. (b)

10. (c)

II. ANSWERS TO DESCRIPTIVE QUESTIONS

Answer to Q.1

(i) The eligibility of partnership firms for tax treaty benefits have been a controversial area and is a classic case of economic double taxation. This is due to the fact that each country has its own methodology to tax partnership firms. For instance, India taxes the income of a partnership in the firm's hands, but the Contracting State, in this case, Country Y and Country Z, taxes such income in the hands of the partner directly, treating the partnership as "fiscally transparent entity". In both cases, the income is subject to tax in both countries albeit in the hands of different persons i.e., in the hands of the partners in the country of residence and in the hands of the firm in the source country, namely, India.

The conditions for eligibility of benefits under the DTAA are provided in Article 1 read along with the other relevant artilces of the DTAA. These conditions have to be fulfilled including the condition that the entity has to be a **person** and **resident** of the either of the contracting states.

(a) As per Article 3(1)(d) of the India-Country Y DTAA, the term 'person' includes any entity which is treated as a taxable unit under the tax laws in force in the respective States.

In order to be eligible for the DTAA, it has to be seen whether the partnership firm is a resident of the Contracting State. Article 4(1) of the India-Country Y DTAA defines a "resident of a Contracting State" to mean a person "liable to tax in that State by reason of his domicile, residence, place of management or any other criterion of similar nature".

As per Article 2 of the India-Country Y DTAA, the scope of the DTAA extends to both income-tax and trade tax as may be levied under the laws of Country Y. Since trade tax is being levied on the Gryffindors Y partnership firm, it can held that the firm is "liable to tax" and therefore the requirement in Article 4 gets satisfied. Accordingly, Gryffindors Y partnership firm shall be eligible to access the India-Country Y DTAA based on this line of reasoning.

(b) As per Article 3(1)(d) of the India-Country Z DTAA, the term 'person' includes any other entity which is taxable under the laws in force in the either Contracting States.

Article 4(1) of the India-Country Z DTAA defines a "resident of a Contracting State" to mean any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management, place of incorporation, or any other criterion of a similar nature. Further, in the case of income derived or paid by a partnership, this term applies only to the extent that the income derived by such partnership, is subject to tax in that State as the income of a resident, either in its hands or in the hands of its partners.

Thus, Article 4(1) of the treaty clearly provides that in the case of income derived or paid by a partnership, the term "resident of a contracting state", in case of a firm, applies to the extent that the income derived by such partnership, is subject to tax in that State as the income of a resident, either in its hands or in the hands of its partners. The article clearly permits a firm to be treated as a resident of a contracting state in respect of income which is either liable to tax in its hands or in the hands of the partners. Therefore, Gryffindors Z partnership firm would be entitled to the benefits of the India-Country Z tax treaty, even though it is a fiscally transparent entity as per the tax laws of Country Z.

(ii) Article 14 of the India-Country Y and India-Country Z tax treaties deal with Independent Personal Services. Professional services rendered by independent professionals like lawyers, doctors, engineers, accountants etc. are covered by the provisions of this article.

It may be noted that the India-Country Y DTAA restricts the scope of Article 14 to income derived by an individual who is a resident of the Contracting State. Consequently, Article 14 of the DTAA with Country Y cannot be invoked in the case of income derived by a firm.

However, the India-Country Z DTAA does not restrict the scope of Article 14 to income derived by a resident individual and includes within its scope, a resident firm as well. Therefore Article 14 of the India-Country Z DTAA can be invoked in respect of income derived from such services by Gryffindors Z firm, which is resident in Country Z.

(iii) Article 2 of the DTAAs specifies the 'taxes covered' under the DTAA entered into between the Contracting States. In the DTAAs which India has entered into with Country X, Country Y and Country Z, taxes covered include income tax including **any surcharge thereon**. The issue under consideration is whether surcharge, education cess and secondary and higher education cess (SHEC) have to be added separately to the rate provided in the DTAA. In this regard, since the DTAA specifically mentions in Article 2 that taxes include surcharge, there is no requirement to include surcharge.

As per sub-section (11) and (12) of section 2 of the Finance Act, 2017, the amount of income-tax as increased by the applicable surcharge shall be further increased by an additional surcharge to be called "Education cess" and "secondary and higher education cess". Therefore, education cess and secondary and higher education cess are nothing but an additional surcharge. Since as per the DTAAs, taxes covered include any surcharge on income-tax, additional surcharge called as education cess and SHEC are also included therein.

Therefore, if the tax treaty rate is invoked, the tax rate specified thereunder is all inclusive and there is no requirement to separately add surcharge, education cess and SHEC over and above the rate prescribed in the DTAA.

Answer to Q.2

(i) In this case, payment is to be made to the law firm in Country X in respect of income earned outside India i.e. in Country X. Considering the nature of income, it is possible to characterise the same either as Royalty or Fees for technical services (FTS). Section 9(1)(vi)/(vii) spells out the cases where royalty and fees for technical services is deemed to accrue or arise in India as well as the exceptions thereto. The income earned by the law firm in Country X is covered under exceptions to Section 9(1)(vi)(b) and 9(1)(vii)(b). Income by way of royalty payable by a person who is a resident is deemed to accrue or arise in India, **except where the royalty is payable in respect of any right, property or information used or services utilized for the purposes of a business or profession carried on by such person outside India or for the purposes of making or earning any income from any source outside India**. Likewise, income by way of fees for technical services payable by a person who is resident, is deemed to accrue or arise in India **except where the fees are payable in respect of services utilized in a business or profession carried on by such person outside India or for the purposes of making or earning any income from any source outside India.**

In this case, since the payment is to be made for information used or services to be utilised for making or earning a new source of income outside India, these payments fall within the exceptions spelt out in section 9(1)(vi)/(vii). Accordingly, such income would not be deemed to accrue or arise in India in the hands of the non-resident law firm. Hence, such income earned by the law firm in Country X is not taxable in India as per the provisions of the Income-tax Act, 1961.

(ii) Since the income is not chargeable to tax in India as per the domestic tax laws, the same cannot be taxed under the DTAA. The fundamental principle of tax treaty is that it can only relieve tax burden. DTAA simply tries to eliminate double taxation. It does not grant any tax jurisdiction to any Government nor take away any jurisdiction already existing. DTAA does not create any additional tax in any state; it can only relieve tax. This is known as the principle of non-aggravation.

Further, section 90(2) of the Income-tax Act, 1961 clearly specifies that provisions of the Act shall apply to the extent they are more beneficial to the assessee. Also, the Supreme Court, in the case of *Azadi Bachao Andolan 263 ITR 706 and Ishikawajima Harima 288 ITR 408*, has held that tax treaties cannot create more onerous obligations or liabilities than provided under the Income-tax Act, 1961. Therefore, the India-Country X DTAA cannot bring into existence a new claim, if the said income is not taxable under the Income-tax Act, 1961.

(iii) Assuming that the income earned by Country X is taxable in India, M/s Gryffindors LLP, a Country X based partnership firm, can mitigate the tax by taking recourse to the grossing up provisions under section 195A of the Income-tax Act, 1961. In such a case, the resident payer shall have to bear the burden of tax on payments due to the non-resident. The amount paid by the resident payer will be considered as net of tax payment and the payment is required to be grossed up for calcu lation of tax liability. The grossed-up amount will be treated as the amount agreed to be paid and tax shall be calculated at the prescribed rate on the gross amount. Such tax would be payable by Abhimanyu Holdings Bank Ltd., India, in this case. Therefore, the Country X firm, being non-resident in India, can enter into a suitable agreement based on which the firm will not bear the Indian tax liability, even if taxes are to be withheld. The tax liability would be borne by Abhimanyu Holdings Bank Ltd., India, the payer, in this case.

(iv) The Country X firm, being a non-resident, may apply for an advance ruling under section 245N for determination of tax liability in relation to a transaction which is proposed to be undertaken by it with a view to avoiding litigation and providing certainty. Therefore, in this case, the Country X firm can make an application to the Authority of Advance Rulings in the prescribed form and manner to determine its taxability in India for the proposed Assignment C to be undertaken by it.