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# SUGGESTED SOLUTION

## CA FINAL

**SUBJECT- ELECTIVE PAPER**

**(INTERNATIONAL TAXATION)**

## Test Code – FNJ 7369

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## CASE STUDY -1

## I. OBJECTIVE TYPE QUESTIONS

**1.** (c) A Inc., USA; A LLC, Cyprus; and AA Ltd., China.
**2.** (c) Deemed Loan Approach
**3.** (d) Rs. 1 lakh – fixed penalty
**4.** (d) 90 days from 30th November of the assessment year
**5.** (c) A.Y.2019-20 and the amount of primary adjustment is Rs. 1.05 crore

## II. ANSWERS TO DESCRIPTIVE QUESTIONS

**1.** Section 94B is applicable to an Indian company or a permanent establishment of a foreign company in India, being the borrower who pays interest in respect of any form of debt issued by

- non-resident, being an associated enterprises (AE) of such borrower or
- by a lender which is not an AE but where the AE provides either implicit or explicit guarantee to such lender or deposits a corresponding and matching amount of funds with the lender, then such debt would be deemed to have been issued by an AE.

In order to determine the interest disallowance amount under Section 94B, the interest paid to non-resident AEs and deemed AEs needs to be determined. Payment of interest to resident AEs is not to be considered for disallowance since the interest payment made to non-resident AEs alone are to be taken into account for such purpose. In the present case, the interest disallowance and permissible interest deduction under the head "Profits and gains from business or profession" would be -

| **Particulars** | **Amount (Rs. in crores)** |
|---|---|
| Interest paid to A LLC Cyprus [See Note (i)] | 80.00 |
| Interest paid to Bank of Chennai based on guarantee provided by A Inc. USA [See Note (ii)] | 8.00 |
| Guarantee Fee paid to A Inc. USA [See Note (iii)] | 0.50 |
| Interest paid to TN Mercantile bank based on letter of comfort by director of A Ltd. [See Note (iv)] | Nil |
| Interest paid to Union City Bank, India [See Note (v)] | Nil |
| Interest paid to Bank of Taiwan [See Note (vi)] | Nil |
| Guarantee fee paid to AAA Ltd., Taiwan [See Note (vi)] | Nil |

| | |
|---|---|
| Interest paid to Wells Cargo Bank based on deposits made by A Inc. USA [See Note (vii)] | Nil |
| Interest paid to Bank of USA based on deposits made by A Inc. USA [See Note (viii)] | 12.00 |
| Interest paid to AA Ltd, China, being interest on delayed payment to creditor [See Note (ix)] | 1.00 |
| **Interest paid or payable to non-resident AE** | **101.50** |
| EBIDTA | 200.00 |
| **Excess Interest: lower of the following would be disallowed** | **41.50** |
| - Interest paid or payable to non-resident AE in excess of 30% of EBIDTA [Rs. 101.50 crores - Rs. 60.00 crores] — Rs. 41.50 crores | |
| - Interest paid or payable to non-resident AE — Rs. 101.50 crores | |
| Therefore, interest paid or payable allowable as deduction under the head "Profits and gains of business or profession" would be Rs. 76.25 crores<br>[Rs. 60 crores (Rs. 101.50 crores – Rs. 41.50 crores), being the amount paid or payable to non-resident AE ***plus*** Rs. 16.25 crores, being the amount paid to other entities]. | 76.25 |

## Notes:

(i) Interest paid to a non-resident AE falls within the scope of section 94B. A LLC is deemed to be an AE of A Ltd., since the loan advanced by it constitutes not less than 51% of the book value of total assets of A Ltd. Hence, interest paid to A LLC is to be considered for the purpose of limitation of interest deduction under section 94B.

(ii) The proviso to Section 94B(1) states "where the debt is issued by a lender which is not associated but an associated enterprise either **provides an implicit or explicit guarantee to such lender** or deposits a corresponding and matching amount of funds with the lender, such debt shall be **deemed to have been issued by an associated enterprise**."

Since A Ltd., India is a wholly owned subsidiary of A Inc., USA, A Ltd. and A Inc. are AEs.

Thus, the debt issued by Bank of Chennai would be deemed as issued by the A Inc. USA, being the AE, hence, the amount of interest paid on such debt has to be considered for the purpose of limitation of interest deduction under section 94B.

(iii) As per section 94B(5)(ii), debt means, inter alia, any loan that gives rise to interest which is deductible while computing business income.

Though guarantee fee is not specifically referred to in the meaning of the term "debt" defined under section 94B(5)(ii), the term 'interest' is defined in section 2(28A) of the Income-tax Act, 1961 to mean interest payable in any manner in respect of any

moneys borrowed or debt incurred (including a deposit, claim or other similar right or obligation) and includes any service fee or other charge in respect of the moneys borrowed or debt incurred or in respect of any credit facility which has not been utilized." Therefore, given the wide definition that interest partakes, guarantee fee can be classified as interest. Accordingly, the same has to be considered for the purpose of limitation of interest deduction under section 94B.

(iv) Since the loan is obtained based on a letter of comfort provided by a resident director of A Ltd., the said interest will not be factored for the purpose of excess interest disallowance under section 94B.

(v) Since loan was obtained by A Ltd independently from a third-party lender Union City Bank of India, interest paid on such loan shall not be considered for the purposes of Section 94B, as the same is paid to an enterprise which is not a non- resident AE.

(vi) Since A Ltd.'s voting power in AAA Ltd., Taiwan is less than 26%, AAA Ltd., Taiwan is not an AE of A Ltd. Since loan was obtained by A Ltd from Bank of Taiwan, Indian branch, for which guarantee was given by an enterprise, not being an AE, this interest shall not be considered for the purposes of section 94B. Likewise, guarantee fee paid to AAA Ltd. shall also not be considered for the purposes of section 94B.

(vii) The proviso to section 94B(1) provides that "**where the debt is issued by a lender** which is not associated **but an associated enterprise** either provides an implicit or explicit guarantee to such lender or **deposits a corresponding and matching amount of funds with the lender**, such debt shall be deemed to have been issued by an associated enterprise."

Here, the loan of $ 10 million taken by A Ltd. and the amount of $ 5 million deposited by A Inc., USA with Wells Cargo Bank can be viewed as not corresponding and matching to the amount of issued debt, hence, such debt is **not** deemed to have been issued by an AE.

**Alternate view** – It is also possible to take a view that interest on loan to the extent of the deposit made by the non-resident AE has to be considered for the purposes of section 94B. In such a case, Rs. 3 crores being interest corresponding to loan of $ 5 million would be considered for the purposes of section 94B.

(viii) In the given case, the loan taken by A Ltd and the amount deposited by A Inc. USA in Bank of USA is US $ 20 million. Since A Inc. USA, being an AE has **deposited a corresponding and matching amount of funds** with the lender, the debt issued by Bank of USA shall be deemed to have been issued by A Inc., being an AE. Thus, the amount of interest paid on such debt to Bank of USA would be considered for the purpose of limitation of interest deduction under section 94B.

(ix) Section 94B(5)(ii) defines the term "debt" as any loan, financial instrument, finance lease, financial derivative, or any arrangement that gives rise to interest, discounts or other finance charges that are deductible in the computation of income chargeable under the head "Profits and gains of business or profession".

In the present case, interest paid is towards delayed payment to AA Ltd China, being its creditor for supply of raw material can be considered as an arrangement that gives rise to

interest or other finance charges that are deductible in computation of Income under the head "Profits and gains of business or profession[1]".

Further, since 90% of raw materials required by A Ltd. is supplied by AA Ltd., China and price and other conditions for supply of raw material are also influenced AA Ltd., China, AA Ltd., is deemed to be an AE of A Ltd. Thus, the amount of interest paid towards delayed payment has to be considered for the purpose of limitation of interest deduction under section 94B.

**(8 Marks)**

**ALTERNATE ANSWER:**

Section 94B(1) of the Income-tax Act, 1961, provides that notwithstanding anything contained in this Act, where an Indian company, or a permanent establishment of a foreign company in India, being the borrower, incurs any expenditure by way of interest or of similar nature exceeding one crore rupees which is deductible in computing income chargeable under the head "Profits and gains of business or profession" in respect of any debt issued by a non-resident, being an associated enterprise of such borrower, the interest **shall not be deductible** in computation of income under the said head to the extent that it arises from excess interest, as specified in sub-section (2).

As per section 94B(2), the excess interest shall mean an amount of **total interest paid or payable** in excess of 30% of earnings before interest, taxes, depreciation and amortization (EBITDA) of the borrower in the previous year or interest paid or payable to associated enterprises for that previous year, whichever is less.

As per Explanatory Memorandum to the Finance Bill, 2017, the interest expenses claimed by an entity to its associated enterprises shall be restricted to 30% of its earnings before interest, taxes, depreciation and amortization (EBITDA) or interest paid or payable to associated enterprise, whichever is less. It implies that “excess interest” means the amount

- interest paid or payable by an entity to its non-resident associated enterprises in excess of 30% of earnings before interest, taxes, depreciation and amortization (EBITDA) of the borrower in the previous year or
- interest paid or payable to non-resident associated enterprises for that previous year,

whichever is less.

The intent behind insertion of this section also appears to restrict the interest paid to non-resident AE to 30% of EBITDA. In the above solution, the excess amount is computed in line with the intent expressed in section 94B(1) read with the Explanatory Memorandum.

However, an alternate view may also be possible on the basis of the interpretation as per the plain reading of section 94B(2).

On a plain reading of provisions of section 94B(2), it appears that the “excess amount” has to be computed by taking–

- **total interest paid or payable** by the borrower in excess of 30% of earnings before interest, taxes, depreciation and amortization (EBITDA) of the

borrower in the previous year or

- interest paid or payable to associated enterprises for that previous year, whichever is less.

Accordingly, the interest disallowance and amount of interest paid or payable by A Ltd allowable as deduction under the head "Profits and gains of business or profession" would be –

| Particulars | Amount (Rs. in crores) |
|---|---|
| Interest paid to A LLC Cyprus | 80.00 |
| Interest paid to Bank of Chennai based on guarantee provided by A Inc. USA | 8.00 |
| Guarantee Fee paid to A Inc. USA | 0.50 |
| Interest paid to TN Mercantile bank based on letter of comfort by director of A Ltd. | 4.00 |
| Interest paid to Union City Bank, India | 3.00 |
| Interest paid to Bank of Taiwan | 3.00 |
| Guarantee fees paid to AAA Ltd., Taiwan | 0.25 |
| Interest paid to Wells Cargo Bank based on deposits made by A Inc. USA | 6.00 |
| Interest paid to Bank of USA based on deposits made by A Inc. USA | 12.00 |
| Interest paid to AA Ltd., China being interest on delayed payment to creditor | 1.00 |
| **Total interest paid or payable by A Ltd.** | **117.75** |
| **Interest paid or payable to non-resident AE (computed above)** | **101.50** |
| EBIDTA | 200.00 |
| **Excess Interest: lower of the following would be disallowed,** | **57.75** |
| - Total interest paid or payable in excess of 30% of EBIDTA Rs. 57.75 crores **[i.e., Rs. 117.75 crores – Rs. 60.00 crores]** | |
| - Interest paid or payable to non-resident AE Rs. 101.50 crores | |
| Therefore, interest paid or payable allowable as deduction under the head "Profits and gains of business or profession" would be Rs. 60 crores (Rs. 117.75 crores – Rs.57.75 crores) | 60.00 |

**2.** **(i)** Multinational groups are often able to structure their financing arrangements to maximize these benefits. To prevent tax erosion on account of such arrangements, country's tax administrations often introduce rules that place a limit on the amount of interest that can be deducted in computing a company's profit for tax purposes. Such rules are designed to counter cross-border shifting of profit through excessive interest payments, and thus aim to protect a country's tax base. Under the initiative of the G-20 countries, the Organization for Economic Co-operation and Development (OECD) in its Base Erosion and Profit Shifting (BEPS) project had taken up the issue of base erosion and profit shifting by way of excess interest deductions by the MNEs in its Action plan 4. The OECD has recommended several measures in its final report to address this issue. In view of the above, section 94B has been inserted in the Income-tax Act, 1961, in line with the recommendations of OECD BEPS Action Plan 4, to provide that interest paid or payable by an entity to its non-resident associated enterprises shall be restricted to 30% of its earnings before interest, taxes, depreciation and amortization (EBITDA) or interest paid or payable to non-resident associated enterprises, whichever is less.

**(2 Marks)**

**(ii)** Section 94B(4) provides that interest amount disallowed in a particular assessment year shall be carried forward and allowed as deduction against the profits and gains, if any, ***of any business*** carried on by the assessee. Therefore, based on the same, it can be concluded that A Ltd shall be eligible to carry forward the disallowed interest amount and claim the same as a deduction against the profits and gains from any business or profession carried on by it.

**(2 Marks)**

3. Indian Transfer Pricing regulations provide that any income arising from an international transaction shall be computed having regard to arm's length price. However, section 92(3) provides that transfer pricing provisions shall not apply in cases where such application results an increase in the expenditure or decrease in the revenue of the Indian entity. In the given case, as interest payment to the AE would only result in an increase in the expenditure of A Ltd. and subsequent reduction of profits, transfer pricing provisions under the Income-tax Act, 1961 shall not apply.

**(3 Marks)**

## CASE STUDY -2

### I. OBJECTIVE TYPE QUESTIONS

**1.** (a) 30-05-2020

**2.** (c) Long-term capital gain Rs.19,80,000

**3.** (b) under section 194J

**4.** (a) Rs.10 lakhs

**5.** (a) 20.8%

## II. ANSWERS TO DESCRIPTIVE QUESTIONS

A. The presumptive provisions applicable in this case are those contained in section 44BB.

As per this section, the profits and gains shall be deemed to be equal to 10% of the following amounts:

- paid or payable to the taxpayer on account of the provision of such services or facilities or supply of plant & machinery for the aforesaid purposes in India; and
- received or deemed to be received in India by the assessee on account of such service or facilities or supply of plant and machinery used or to be used in prospecting for, or extraction or production of mineral oils outside India

**Computation of income of Good Day Inc. as per section 44BB**

| **Particulars** | **Amt (**Rs. **in crore)** |
|---|---|
| Amount received for movement of rigs from foreign country to an offshore site at Mumbai | 2 |
| Amount received by way of hire charges towards provision of plant and machinery in India | 5 |
| **Amount to be considered for purposes of section 44BB** | **7** |

Income from business under section 44BB at 10% of Rs. 7,00,00,000 is Rs. 70,00,000, which is the income of Good day Inc. chargeable to tax in India under the head "Profits and gains of business or profession" for the A.Y. 2020-21

**Note -** The mobilization fee of Rs. 2 crore received by Good Day Inc. is also includible in the gross receipts for the purpose of computing the income chargeable under section 44BB [Sedco Forex International Inc vs. CIT (2017) 399 ITR 1 (SC)].

**(3 marks)**

B. No, the answer would be the same. The mobilization fee received by Good Day Inc. is liable to tax under section 44BB regardless of the actual amount of expenditure incurred for movement of rigs to the offshore site.

The quantum of expenditure incurred in relation to mobilization fee is immaterial and regardless of the amount of expenditure incurred, the entire fee of Rs. 2 crore is to be included for the purposes of section 44BB. Hence, the answer will not change.

**(2 marks)**

C. As per section 92CA(1), where an assessee has entered into an international transaction in any previous year, and the Assessing Officer considers it necessary or expedient so to do, then, he may refer the computation of the arm's length price in relation to the said international transaction to the Transfer Pricing Officer.

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

There is no requirement under the Act to provide an opportunity of being heard to the assessee before making reference to the Transfer Pricing Officer.

Therefore, the action of Assessing Officer to refer the international transaction to Transfer Pricing Officer for determination of arm's length price without providing an opportunity of hearing to Democrat (P) Ltd. is **correct.**

**Note** – The CBDT has, vide Instruction No.3/2016 dated 10.3.2016, stipulated that the Assessing Officer must, before making reference to the TPO, provide an opportunity of being heard to the assessee before recording his satisfaction or otherwise, in the following cases:

(i) The assessee has not filed accountant's report u/s 92E but has undertaken an international transaction which comes to the notice of the Assessing Officer;

(ii) The assessee has not declared one or more international transaction(s) in the accountant's report filed u/s 92E and the said transaction(s) come to the notice of the Assessing Officer; and

(iii) Where the assessee has declared international transaction in the accountant's report filed u/s 92E but certain qualifying remarks were made to the effect that the said transactions are not international transactions or they do not impact the income of the taxpayer.

In respect of other cases**,** such opportunity of hearing need not be given before making reference to the TPO.

**(3 marks)**

D. As per section 144C(1), the Assessing Officer is required to forward a draft order of assessment to the eligible assessee if he proposes to make any variation in the income or loss returned which is prejudicial to the interest of such assessee.

Eligible assessee means*, inter alia*, any person in whose case variation arises on account of order of Transfer Pricing Officer.

In the present case, Democrat (P) Ltd. is an eligible assessee and the Assessing Officer is required to forward a draft assessment order to Democrat (P) Ltd.

Therefore, the action of Assessing Officer in passing an assessment order without forwarding a draft assessment order to Democrat (P) Ltd. is not tenable in law.

**Note -** In Asstt. CIT vs. Vijay Television P Ltd (2018) 407 ITR 642 (Mad) (decision rendered on 23.04.2018) it was held that the passing of assessment order without forwarding the draft assessment order to the assessee is an incurable illegality and that such illegality could not be protected by section 292B.

**(3 marks)**

E. Value of interest of Mithun Banerjee in Lilly LLP is chargeable to tax in India under the Black Money Act in the A.Y.2020-21, since these assets came to the notice of the Assessing Officer in the P.Y.2019-20.

For computing the value of interest in Lilly LLP, market value as on valuation date, being value on 1st April of the previous year i.e., on 01.04.2019 is to be considered.

**Computation of undisclosed income/asset of Mithun Banerjee**

| Particulars | Amount (In US $) |
|---|---|
| Cash in hand (as per books) | 10,000 |
| Cash at bank (as per books) | 20,000 |
| Stock-in-trade (as per books) | 30,000 |
| Plant and machinery (as per books) | 75,000 |
| **Total of book value of above assets (A)** | **1,35,000** |
| Vacant site (FMV as on 1.4.2019) | 40,000 |
| Bullion (FMV as on 1.4.2019) | 25,000 |
| **Total of FMV of above assets (B)** | **65,000** |
| Sundry creditors (as per books) (C) | 50,000 |
| Net worth of Lilly LLP (A+B – C) | **1,50,000** |
| **Value of interest in Lilly LLP** | |
| Net worth portion equal to capital contribution (D) | 30,000 |
| Balance Net worth portion after capital contribution as per partnership deed in profit sharing ratio [10,000 (1,50,000 – 1,40,000) x 25%] (E) | 2,500 |
| Value of interest of Mithun Banerjee in Lilly LLP (D + E) | 32,500 |
| Value of interest of Mithun Banerjee in Lilly LLP in Rs.[32,500 x 65, being exchange rate as on 1st April of the previous year i.e., on 1.4.2019] | 21,12,500 |

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

Tax liability of Mithun Banerjee would be Rs. 6,33,750, being 30% of Rs.21,12,500.

**(4 marks)**

## CASE STUDY -3

### I. OBJECTIVE TYPE QUESTIONS

**1.** (d) The amount payable to Help All would be chargeable to tax both in the hands of Mr. Shivam and in the hands of the institution.

**2.** (c) INR 37 lakhs

**3.** (c) Both (a) and (b)

**4.** (b) Only (ii) above

**5.** (c) INR 54 lakhs

## II. ANSWERS TO DESCRIPTIVE QUESTIONS

1. (i) As per Article 4(1) of the India and Country "Q" DTAA, the term "resident of a Contracting State" means any person who is a resident of a Contracting State in accordance with the taxation laws of that State.

Therefore, for determining whether Mr. Shivam is a resident of India or Country "Q", first, the residential status as per the taxation laws of respective countries has to be ascertained.

As per section 6(1) of the Income-tax Act,1961, an individual is said to be resident in India in any previous year if he satisfies any one of the following conditions:

a) He has been in India during the previous year for a total period of 182 days or more; or

b) He has been in India during the 4 years immediately preceding the previous year for total period of 365 days or more and has been in India for at least 60 days in the previous year.

An Indian citizen, who leaves India in the previous year for the purpose of employment outside India, shall be considered as resident only if the period of his stay during the relevant previous year in India is 182 days or more.

Since Shivam left on 30th September 2019, he stayed in India during the P.Y. 2019-20 for 183 days. Therefore, he is a resident in India for the P.Y.2019-20.

Further, Shivam had come back to India after completing his engineering in Mid 2011 and since then he has been working in India. Hence, he fulfils the following conditions for resident and ordinarily resident:

(i) He is a resident in atleast 2 out of 10 years preceding the relevant previous year, and

(ii) His total stay in India in last seven years preceding P.Y. 2019-20 is 730 days or more. Thus, Shivam is Resident and Ordinarily Resident in India for the P.Y.2019-20.

As per Country "Q" tax residency rules, Shivam qualifies to be resident for the year 2019-20 in

Country "Q", since he stays for 183 days (more than 180 days) in Country "Q" in the Financial Year 2019-20.

Thus, as per the domestic tax laws of India and Country "Q", Shivam qualifies to be a resident both in India and Country "Q" during the year 2019-20. Hence, the tie-breaker rule provided in Article 4(2) of the India-Country "Q" DTAA will come into play.

This Rule provides that where an individual is a resident of both the countries, he shall be deemed to be resident of that country in which he has a permanent home and if he has a permanent home in both the countries, he shall be deemed to be resident of that country, which is the centre of his vital interests i.e. the country with which he has closer personal and economic relations.

From the facts, it is evident that Shivam has been living in a rented accommodation in Defence Colony, Delhi. Even after he moved to Country "Q", his family continues to stay in the same rented accommodation in Delhi. Hence, it can be considered as permanent home for him in India. In Country "Q", he has been provided with a rent-free accommodation by his employer for a period of three years, which would be considered as permanent home for

him. Since he has a permanent home both in India and Country "Q", the next test needs to be analysed.

Shivam owns a house property in India from which he derives rental income. His family also resides in India. He performs in Carnatic music concerts in India, both in Delhi and in Chennai. Therefore, his personal and economic relations with India are closer, since India is the place where -

(a) the residential property is located and

(b) social and cultural activities are closer

Thus, by applying Article 4 of the India-Country "Q" DTAA, Shivam shall be deemed to be resident in India.

**(5 Marks)**

(ii) As per paragraph 3(b) of Article 5 'Permanent Establishment' of India-Country "R" DTAA, a service PE is established if the foreign enterprise provides services in India through employees or other personnel engaged for more than 180 days in a fiscal year. Thus, Service PE is not dependent upon the fixed place of business. It is only dependent on the continuation of the activity, which does not mandate physical presence/fixed place.

Hence, the project of Cure House for providing consultancy services, will expose it to creation of service PE in India.

**(2 Marks)**

## 2. Computation of total income of Shivam for A.Y. 2020-21

| Particulars | INR | INR |
|---|---|---|
| **Income from Salaries** | | |
| **Salary from services rendered in India (April - September 2019)** | | |
| Basic Salary (INR 70,000 x 6) | 4,20,000 | |
| Dearness Allowance (INR 30,000 x 6) | 1,80,000 | |
| Special Allowance (INR 5,000 x 6) | 30,000 | |
| Bonus | 3,00,000 | |
| [Even though bonus is paid in an overseas bank account after the commencement of his overseas assignment, however, since it pertains to services rendered in India, it would be taxable in India] | | |
| Salary from services rendered in Country "Q" (October 2019 - March 2020) | | 9,30,000 |
| Basic Salary [See Note (i)] | 3,93,680 | |
| Cost of Living Allowance [See Note (i)] | 2,81,200 | 6,74,880 |
| | | 16,04,880 |
| Less: Standard deduction u/s 16(ia) | | 50,000 |
| **Income from House Property at Mumbai** | | **15,54,880** |
| Net Annual Value [See Note (ii)] | 6,00,000 | |

| | | |
|---|---|---|
| Less: Standard deduction @ 30% | (1,80,000) | 4,20,000 |
| **Income from Other Sources** | | |
| Interest earned from investment of security deposit (INR 1,00,000 @10%) | 10,000 | |
| Interest earned on saving bank account with Country "Q" [QGD 150 x INR 48.61] [See Rule 115 in Note (i)] | 7,292 | |
| Interest on Securities of a Country "Q" company [QGD 5000 x INR 48.52] [See Rule 115 in Note (i)] | 2,42,600 | |
| Interest on bonds issued by Country "P" Government | 30,000 | |
| Dividend from a Country "Q" Company (QGD 1000 x INR 48.52] [See Rule 115 in Note (i)] | 48,520 | |
| (Dividend from foreign company is taxable in India) | | 3,38,412 |
| **Gross Total Income** | | 23,13,292 |
| **Less: Deductions under Chapter VI-A** | | |
| **Deduction u/s 80DD** | 75,000 | |
| (Flat deduction of INR 75,000 is allowed in respect of medical treatment of dependent disabled, irrespective of the expenditure incurred) | | |
| Deduction u/s 80GG [See Note (iii)] | 60,000 | 1,35,000 |
| **Total Income** | | **21,78,292** |
| **Total Income (rounded off)** | | **21,78,290** |

## Computation of tax liability of Shivam for A.Y. 2020-21

| Particulars | INR | INR |
|---|---|---|
| Tax on INR 21,78,290 | | 4,65,987 |
| Add: Health and education cess @4% | | 18,639 |
| Tax Liability | | 4,84,626 |
| Less: Foreign Tax Credit [See Note (v)] | | |
| - on salary income | | |
| - on interest income | | 1,34,468 |
| Net tax liability | | 3,50,158 |
| Net tax liability (rounded off) | | 3,50,160 |

**Notes:**

(i) In accordance with Rule 115, following rate of exchange has been used for conversion of income earned outside India :

- Salary – last day of the month immediately preceding the month in which the salary is due
- Interest on securities- last day of the month immediately preceding the month in which the income is due i.e. rate as on 29.02.2020

- Interest earned on other than securities i.e. interest on bank deposits- last day of the previous year i.e. rate as on 31.03.2020
- Dividends - last day of the month immediately preceding the month in which the dividend is declared, distributed or paid by the company i.e. rate as on 29.02.2020

Accordingly, income earned outside India in Indian currency would be computed in the following manner:

**Overseas salary for the period October 2019 to March 2020:**

| Month | Basic Salary in QGD (1) | Cost of living Allowance (COLA) (2) | Rate of Exchange (3) | Basic Salary in INR (1 x 3) | COLA in INR (2 x 3) |
|---|---|---|---|---|---|
| Oct 19 | 1400 | 1000 | 45.95 | 64,330 | 45,950 |
| Nov 19 | 1400 | 1000 | 46.85 | 65,590 | 46,850 |
| Dec 19 | 1400 | 1000 | 45.10 | 63,140 | 45,100 |
| Jan 20 | 1400 | 1000 | 46.95 | 65,730 | 46,950 |
| Feb 20 | 1400 | 1000 | 47.83 | 66,962 | 47,830 |
| Mar 20 | 1400 | 1000 | 48.52 | 67,928 | 48,520 |
| **Total** | **8400** | **6000** | **-** | **3,93,680** | **2,81,200** |

(ii) In absence of information relating to fair market value, standard rent and municipal rent, actual rent received is considered as Gross Annual Value

(iii) As Shivam is not receiving any house rent allowance from his employer and the house property owned by him is not in the same city of his residence/employment, Shivam is eligible to claim deduction under section 80GG as under :

Deduction shall be lower of the following:

- INR 5,000 per month = INR 60,000
- 25% of the adjusted total income = 25% of INR 22,38,292 = INR 5,59,573
- Actual rent – 10% of adjusted total income = INR 3,00,000 (25,000*12) – INR 2,23,829 (10% of 22,38,292) = INR 76,171

**Adjusted total income =** Gross total income after providing for deduction under section 80C to 80U but before deduction under section 80GG = INR 23,13,292 – INR 75,000 = INR 22,38,292.

**Hence, deduction under section 80GG shall be INR 60,000.**

(iv) Deduction under section 80TTA is allowed only on interest earned on saving deposits with Indian bank and not with overseas bank account.

(v) Since Shivam is a resident and ordinarily resident in India for the A.Y.2020-21 by virtue of section 6 of the Income-tax Act, 1961, his global income is taxable in India. In such case, the income arising in Country "Q" is doubly taxed. In order to avoid double taxation, Shivam can take the benefit of DTAA between India and Country "Q" by way of foreign tax credit in respect of the tax paid in Country "Q" or tax paid on such income in India, whichever is lower.

An income earned outside India which is exempt from tax in the respective country cannot be considered as doubly taxed income for the purpose of calculation of foreign tax credit, since no taxes have been paid on such income. Hence, interest on bonds issued by Country "P"

Government, interest on savings bank account in Country "Q" and dividend earned on shares of a Country "Q" Company, though taxed in India but shall not be eligible for claiming foreign tax credit as they are exempt from tax in their respective countries.

With reference to Article 23 of India-Country "Q" DTAA, Indian resident shall be allowed credit of taxes paid in Country "Q" on the income which is also taxed in Country "Q". Hence, foreign tax credit shall be calculated as below:

**Calculation of foreign tax credit**

| **Doubly taxed Salary Income** | | **INR** |
|---|---|---|
| Basic Salary | | 3,93,680 |
| Cost of Living Allowance | | 2,81,200 |
| | | **6,74,880** |
| Less: Standard deduction (50,000 x 6,74,880/16,04,880) | | 21,026 |
| **Doubly taxed salary income** | | **6,53,854** |
| **Computation of foreign tax credit on doubly taxed salary income:** | | |
| **Lower of:** | | |
| Tax withheld in Country "Q" on salary income at 15% | 98,078 | |
| Tax payable in India on salary income@22.25% (INR 4,84,626/ INR 21,78,290) | 1,45,483 | |
| **Foreign tax credit** | | **98,078** |

| **Double taxed Interest Income** | **INR** |
|---|---|
| Interest Income on Securities of Country "Q" company | 2,42,600 |
| **Computation of foreign tax credit on doubly taxed interest income:** | |
| **Lower of:** | |
| Tax withheld in Country "Q" on interest income at 15%, which is also the rate as per the DTAA [750(5000 x 15%) x 48.52] | 36,390 |
| Tax payable in India on interest income@22.25% | **53,979** |
| Foreign tax credit | **36,390** |

**Note –** Questions based on interpretation of articles of a DTAA may have alternate views.

**(8 Marks)**

## CASE STUDY -4

### I. OBJECTIVE TYPE QUESTIONS

**1.** (B) tax is deductible at source@5.2%

**2.** (D) no tax is deductible at source

**3.** (D) None of the above

**4.** (D) constitutes business connection for attracting deemed accrual provisions under section 9(1)(i)

**5.** (C) (ii) and (iii) above

## II. ANSWERS TO DESCRIPTIVE QUESTIONS

**Computation of total income of Rio Grande Inc., a notified FII, for A.Y.2020-21**

| Particulars | Rs. | Rs. |
|---|---|---|
| Interest on Rupee Denominated Bonds | 4,70,000 | |
| Dividend income of Rs. 2,80,000 [Exempt under section 10(34)] | Nil | |
| Interest on securities | 15,48,000 | 20,18,000 |
| [No deduction is allowable in respect of expenses incurred in respect thereof as per section 115AD(2)] | | |
| **Long-term capital gains on sale of bonds of Vaigai Ltd.** | | |
| Sale consideration | 58,00,000 | |
| *Less:* Cost of acquisition<br>[Benefit of indexation is not allowable as per section 115AD(3)] | 29,00,000 | 29,00,000 |
| **Short-term capital gains on sale of STT paid equity shares of Mahanadi Ltd.** | | |
| Sale consideration | 14,50,000 | |
| *Less:* Cost of acquisition | 6,00,000 | 8,50,000 |
| **Short-term capital gains on sale on unlisted equity shares of Godavari Ltd.** | | |
| Sale consideration | 7,80,000 | |
| *Less:* Cost of acquisition | 2,65,000 | 5,15,000 |
| **Total Income** | | **62,83,000** |

**Computation of tax liability of Rio Grande Inc. for A.Y.2020-21**

| Particulars | Rs. |
|---|---|
| Tax@5% on interest of Rs. 4,70,000 received from an Indian company on investment in rupee denominated bonds = 5% x Rs. 4,70,000 | 23,500 |
| Tax@20% on interest on securities of Rs. 15,48,000 =20% x Rs. 15,48,000 | 3,09,600 |
| Tax@10% on long-term capital gains on sale of bonds of Vaigai Ltd. = 10% x Rs. 29,00,000 | 2,90,000 |
| Tax@15% on short-term capital gains on sale of listed equity shares of Mahanadi Ltd., in respect of which STT has been paid = 15% of Rs. 8,50,000 | 1,27,500 |
| Tax@30% on short-term capital gains on sale of unlisted equity shares of Godavari Ltd. = 30% of Rs. 5,15,000 | 1,54,500 |
| | 9,05,100 |
| Add: HEC@4% | 36,204 |
| **Tax Liability** | **9,41,304** |
| **Tax Liability (rounded off)** | **9,41,300** |

**(12 Marks)**

**2.** If a Liaison Office is maintained solely for the purpose of carrying out activities which are preparatory or auxiliary in character, and such activities are approved by the Reserve Bank of India, then, no business connection is established.

In this case, had the liaison office's activities been restricted to forwarding of trade inquiries to Zara Ltd., a Country A based company, its activities would not have constituted business connection. However, the activities of the liaison office in Calcutta extends to also negotiating and entering into contracts on behalf of Zara Ltd. with the customers in India, on account of which business connection is established. Hence, the deemed accrual provisions under section 9(1)(i) would be attracted.

**(3 Marks)**

## CASE STUDY -5

## I. OBJECTIVE TYPE QUESTIONS

**1.** (A) Rs.46,89,000

**2.** (D) Rs.12,30,000 and Rs.29,000, respectively

**3.** (A) Rs.2,53,842

**4.** (C) Royalty arising to Mr. Karan would be taxable only in India; Royalty arising to Ms. Radha Srinivas may be taxed either in India or in Country U

**5.** (B) should be taken into account; thereafter, deduction is to be allowed from the tax payable in India on her total income

## II. ANSWERS TO DESCRIPTIVE QUESTIONS

## 1. Determination of residential status of Mr. Eashwar for A.Y.2020-21

No. of days of stay in Country X = 32 days + 49 days +19 days = 100 days

No. of days of stay in Country Y = 22 days + 42 days +16 days = 80 days

No. of days of stay in India = 366 days – 100 days – 80 days = 186 days

Since Mr. Eashwar's stay in India is for 186 days (i.e., 182 days or more) in the P.Y.2019-20, he is resident in India for A.Y.2020-21.

For determining whether he is resident and ordinarily resident in the A.Y. 2020-21, the number of days of his stay in India in the last seven previous years is relevant

| Previous Year (P.Y.) | No. of days in Country X | No. of days in Country Y | No. of days in India |
|---|---|---|---|
| P.Y.2018-19 | 97 | 78 | 365-97-78 = 190 |
| P.Y.2017-18 | 95 | 85 | 365-95-85 = 185 |
| P.Y.2016-17 | 98 | 82 | 365-98-82 = 185 |
| P.Y.2015-16 | 100 | 80 | 366-100-80 = 186 |
| P.Y.2014-15 | 103 | 75 | 365-103-75 = 187 |

| | | | |
|---|---|---|---|
| P.Y.2013-14 | 110 | 70 | 365-110-70 = 185 |
| P.Y.2012-13 | 120 | 60 | 365-120-60 = 185 |
| **Total number of days in the last seven years** | | | **1303** |

Since his stay in India exceeds 730 days in the last seven previous years and his number of days of stay in India is 182 days or more in all the earlier previous years, he satisfies the condition of being resident in atleast 2 out of the 10 preceding previous years. Therefore, he is resident and ordinarily resident in India for A.Y. 2020-21

**(5 Marks)**

**2. Computation of tax liability of Ms. Radha Srinivas for the A.Y. 2020-21**

| **Particulars** | **Rs.** | **Rs.** |
|---|---|---|
| **Profits and gains of business or profession** | | |
| From concerts held in India | 10,00,000 | |
| From royalty received from Country U [CLD 10000 x 80 (being conversion rate as on 31.3.2020 -Rule 115)] | 8,00,000 | |
| From concerts held in Country W [CWD 10145 x 69 (being conversion rate as on 31.3.2020 – Rule 115) | 7,00,005 | 25,00,005 |
| **Income from Other Sources** | | |
| Income from fixed deposits in her name | 4,00,000 | |
| Income from savings bank account | 25,000 | 4,25,000 |
| **Gross Total Income** | | **29,25,005** |
| Less: Deduction under section 80C | | |
| Deposit in PPF | 1,50,000 | |
| Five year fixed deposit in the name of her son (does not qualify for deduction under section 80C) | | |
| Under section 80D | 50,000 | |
| Medical insurance premium to insure her health and health of spouse (Rs.57,000, restricted to Rs.50,000, being the maximum allowable for senior citizens) (See Note 1) | | |
| **Under section 80TTB**<br>Interest on bank FD and savings bank account restricted to | 50,000 | 2,50,000 |
| **Total Income** | | **26,75,005** |
| **Total Income (rounded off)** | | **26,75,010** |
| **Tax on Total Income** | | |
| Income-tax (See Note 2) | | 6,12,503 |

| | | |
|---|---|---|
| Add: Health and Education Cess @4% | | 24,500 |
| Average rate of tax in India<br>(i.e., Rs. 6,37,003/ Rs. 26,75,010 × 100) | 23.813% | 6,37,003 |
| **Foreign Tax Credit** | | |
| Lower of tax payable under the Income-tax Act, 1961 on income from profession and foreign tax payable on such income | | |
| Tax covered under India-Country U DTAA under section 90<br>[Lower of Rs.1,90,504 (i.e., 23.813% x Rs.8,00,000) and Rs.78,000 (Rs. 78, being the conversion rate as on 28.2.2019 as per Rule 128 x CUD 1000)] | 78,000 | |
| Income-tax referred to in section 91:<br>Country W [Lower of Rs.1,66,692 (i.e., 23.813% x Rs.7,00,005) and Rs.1,75,000 (Rs. 70, being the conversion rate as on 30.9.2018 as per Rule 128 x CWD 2500)] | 1,66,692 | 2,44,692 |
| **Tax payable in India (Rs. 6,37,003 – Rs. 2,44,692)** | | **3,92,311** |
| **Tax payable (rounded off)** | | **3,92,310** |

**Notes:**

1. Section 80D allows a higher deduction of up to Rs. 50,000 in respect of the medical premium paid to insure the heath of a senior citizen. Therefore, in respect of medical insurance premium of Rs.57,000 paid by Mrs. Radha Srinivas to insure the health of herself and her spouse, she will be allowed deduction of Rs. 50,000 under section 80D, since she and her husband are resident Indians of the age of 60 years or more during the P.Y.2019-20.

2. The basic exemption limit for senior citizens is Rs. 3,00,000 and the age criterion for qualifying as a "senior citizen" for availing the higher basic exemption limit is 60 years. Accordingly, Mrs. Radha Srinivas is eligible for the higher basic exemption limit of Rs. 3,00,000, since she is 60 years old.

3. As per Rule 115, for computing income from profession of Mrs. Radha Srinivas, the TT buying rate as on 31.3.2020 has to be considered. Royalty income from Country U and income from concerts in Country W constitute her income from profession, since she is a singer and a composer. However, as per Rule 128, for computing foreign tax credit, TT buying rate as on the last day of the month immediately preceding the month in which tax was deducted or paid in that country has to be considered. Foreign Tax Credi t has been computed accordingly.

4. Since the DTAA with Country U is in line with UN Model Convention, as per article 12(1), royalty income arising in a Contracting State (Country U, in this case) and paid to a

resident of another Contracting State (Mrs. Radha Srinivas, a resident of India, in this case) ***may*** be taxed in that other State (India, in this case). However, such royalties may also be taxed in the Source State according to its laws, but if the beneficial owner is a resident of another State, then the tax so charged shall not exceed a prescribed percentage to be established though bilateral negotiations (assumed to be 10%, as given in the question, in this case). It is presumed that the rate of 10% is as per domestic tax laws and the negotiated rate as per Article 12(2) of the DTAA of India with Country U. Credit for such tax paid by Mrs. Radha Srinivas in Source State, i.e., Country U, in this case, would be available as per Article 23B(1).

**(10 Marks)**