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CA FINAL

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Answers

Case Study 1

1.1 (b)

1.2 (c)

1.3 (b)

1.4 (c)

1.5 (b)

1.6 Facts of the question are based on decision in the case of **Dimension Data Asia Pacific Pte. Ltd. v. DCIT [2018] 99 taxmann.com 270 (Mumbai - Trib.).** The Tribunal held that in case of multiple sources of income, an assessee is entitled to adopt the provisions of the Act for one source while applying the beneficial DTAA provisions for the other, relying on Bangalore ITAT ruling in IBM world Trade Corporation. Thus, it accepted the assessee's aforesaid claim of non-taxability with respect to Management Fee for AY 2012-13 in absence of Service PE.

[Marking scheme: 2 Marks for identifying pick and choose approach, balance 3 marks for stating that assessee is correct in approach]

1.7 However, alternatively, if the period of employees' stay exceeded 30 days for management support services also, the Tribunal upheld Service PE. In such case, the assessee's profit reasonably attributable to the PE shall be taxable in India. However, it noted that the Service Fees received by the assessee would be taxable under the Act as FTS (fees for technical services) under section 9(1)(vii) r.w.s. 115A(1)(b) @ 10% and not as business income and thus held that the maximum possible taxability in the hands of the assessee could not exceed 10%. In short, assessee's stand of adopting taxability under DTAA for one source of income and under IT act for another source would not be affected even if the stay of employees exceeded 30 days in respect of management services.

[Marking scheme: 2 Marks for identifying existence of Service PE, balance 1 mark for stating rate of tax]

1.8 IZA is a not-for-profit organization and works for the benefit of its members. On the principle of mutuality, that is on the dictum that one cannot earn from oneself.

Acting as per its objects, it is hosting members' information on its website, publishing various materials, organizing conferences, representing its members etc., not aimed at deriving any profit. Such services may be customized and focused but are not "special services" in the sense that their utility is not restricted to a few beneficiaries, but across the board to all members and those in this industry. Besides, these are rendered in the ordinary course of its activities and are as per its stated objects, which it has been permitted to carry out by the RBI is being allowed to set up the LO in India.

There are no services focused at any specific member or the benefit of which is denied to others. Similarly, the use of communication materials and its websites are for the benefit of all the member companies, and general facilities for all its members. The conferences are also organised in the normal course for carrying out its activities in accordance with its objects as outlined in its Articles of Association. Being the only global industry association dedicated exclusively to the interests of Zinc and its users, these activities directly benefit them. The funds raised by the Applicant for the Conferences organized by it are through fees charged from all participants, members and some non-members alike. Here also all the members are eligible to the same services and benefits. The fee charged does not constitute consideration for any specific services performed or for some specific members.

Other services also, like Representation and Technical Expertise; training and networking opportunities, technical and marketing materials, organizing conferences and workshops; and Commercial listing etc, are performed in fulfillment of its objects for the members in the normal course and there is nothing special about these services nor are they for any specific set of members as contemplated under section 28(iii) of the Act.

Since the LO in India has been set up on a not-for-profit basis, as is the parent organization in Belgium, profit, if any, is only in the nature of surplus that would incidentally occur at the end of the financial year, being the difference of the receipts over expenditure. This does not acquire the nature of profit, as contemplated under the Act, since the receipts are from the execution of objects that are not in the nature of business, nor intended to be so. Secondly, such surplus, if any, is ploughed back into the organization, again to be utilized for the same objects, as enumerated earlier. This is the real test in not-for-profit organisations, namely that the surplus is not siphoned off into private hands, especially the settlors / founders of the not-for-profit organisation. Hence, in the absence of profit motive, there is no PE constituted in India.

[Marking scheme: 2 Marks for identifying functions of liaision office, balance 3 marks for critical analysis and arriving at conclusion]

1.9 In case of the LO procured orders of customers, then such LO is in reality acting as an agent in India which creates Agency PE exposure for the assessee. **[Marking scheme: Entire Marks for identifying creation of Agency PE]**

Case Study 2

2.1 (d)

2.2 (b)

2.3 (c)

2.4 (a)

2.5 (b)

2.6 On a cursory glance, it may appear that functions of L1, L2, L3 and L4 are of preparatory and auxiliary in nature. However, it has to be remembered that Article 5 Para 4.1 encompasses Anti – fragmentation rules in order to prevent artificial splitting of functions by enterprises which are closely related. The purpose of paragraph 4.1 is to prevent an enterprise or a group of closely related enterprises from fragmenting a cohesive business operation into several small operations in order to argue that each is merely engaged in a preparatory or auxiliary activity. Under paragraph 4.1, the exceptions provided for by paragraph 4 do not apply to a place of business that would otherwise constitute a permanent establishment where the activities carried on at that place and other activities of the same enterprise or of closely related enterprises exercised at that place or at another place in the same State constitute complementary functions that are part of a cohesive business operation. For paragraph 4.1 to apply, however, at least one of the places where these activities are exercised must constitute a permanent establishment or, if that is not the case, the overall activity resulting from the combination of the relevant activities must go beyond what is merely preparatory or auxiliary.

In the given case, undoubtedly, the functions of all 4 places are cohesive in nature and they are all working in tandem. Further, the over all combined outlook from all 4 places of business, suggests that there is a permanent establishment in India. Accordingly, the contentions of assessee are incorrect. It would make no

difference even if one were to look at the situation under UN Model Tax Convention.

[Marking scheme: 2 Marks for identifying fragmentation, 1 mark for identifying article 5.4.1 of OECD Convention, balance 2 marks for stating that assessee is in fact having a PE]

2.7 Facts of the case are based on **Essar Power Limited vs ACIT [ITAT Mumbai]**. The TPO had made the disallowance of foreign travel expenses incurred to the extent of Rs.24.66 lakhs since he was of the view that expenses were incurred for the benefit of AE and treated it as an international transaction accordingly, made the adjustment. The ITAT accepted assessee's contention that expenses were incurred on foreign travel of employees and could not be considered as expenses incurred for benefit of AE and accordingly could not be considered as international transaction.

[Marking scheme: 2 Marks for identifying that there is no international transaction, balance 1 mark for stating that TPO is incorrect]

2.8 In the given case, Pride Inc. is a company incorporated under the laws of USA and hence, resident of USA. It is a foreign company under the Income-tax Act, 1961. However, the said company shall be considered to be resident in India if its place of effective management is in India. In this case, the company does not satisfy the active business test outside India since 50% of its assets are located in India. Therefore, since it has failed the active business test outside India on account of 50% of its assets being located in India, the persons who take key management and commercial decisions for conduct of the company's business as a whole and the place where the decisions are made are the key factors in determining whether the POEM of the company is in India. The facts of the case clearly state that the key management decisions and commercial decisions for conduct of the company's business as a whole are made by the directors located in India and at the meetings held in India. Therefore, the POEM of Pride Inc. is in India in the P.Y.2019-20, irrespective of the fact that majority of the board meetings are held outside India.

Section 194J applies when professional fees are being paid to a resident, whereas section 195 applies when payments are made to a non-corporate non-resident or a foreign company. Section 194J is income specific and section 195 is payee specific. CBDT vide Notification No. 29/2018 dated 22nd June 2018 has clarified that the foreign company shall continue to be treated as a foreign company even if

it is said to be resident in India on account of its POEM being in India, and all the provisions of the Act shall apply accordingly. Where more than one provision of Chapter XVII-B of the Act applies to the foreign company as resident as well as a foreign company, the provision applicable to the foreign company alone shall apply. Further, in case of conflict between the provision applicable to the foreign company as resident and the provision applicable to it as foreign company, the latter shall generally prevail. Therefore, the rate of tax in case of foreign company shall remain the same, i.e., rate of income-tax applicable to the foreign company even though residential status of the foreign company changes from non-resident to resident on the basis of POEM.

Hence, Payer Ltd shall deduct tax under section 195 while making payment of fees for professional services to Pride Inc., a foreign company resident in India.

[Marking scheme: 2 Marks for identifying residential status, balance 3 marks for stating that assessee must withhold tax under section 195]

2.9 The AAR shall not allow the application where the question raised in the application,—

(i) is already pending before any income-tax authority or Appellate Tribunal [except in the case of a resident applicant falling in sub-clause (iii) of clause (b) of section 245N] or any court;

(ii) involves determination of fair market value of any property;

(iii) relates to a transaction or issue which is designed prima facie for the avoidance of income-tax [except in the case of a resident applicant falling in sub-clause (iii) of clause (b) of section 245N or in the case of an applicant falling in sub-clause (iiia) of clause (b) of section 245N:

[Marking scheme: 2 Marks for identifying all conditions.]

Case Study 3

3.1 (c)

3.2 (d)

3.3 (d)

3.4 (b)

3.5 (c)

3.6 Determination of Net Repatriable Dividend by US Limited to India:

Particulars	USD
Net Profit as per Profit / Loss account / Taxable Income	65
Add: Base Erosion payments*:	
(i) Fees for technical services to related parties	10
(ii) Royalty	225
Adjusted total income for BEAT	300
5% of 300	**15.00**
Normal corporate tax @ 21 % of 65	13.65
BEAT Tax [15 – 13.65]	**1.35**
Net remittable dividend [65 – 13.65 – 1.35]	**50**
Net remittable dividend in INR [50 X 80 X 1000]	**40,00,000**

*Covers all payments for services to related parties except payments which do not carry a mark up i.e. cost to cost reimbursements

[Marking scheme: 2 Marks for computing corporate tax, 1 Mark for computing BEAT tax, balance 1 mark for identifying the net dividend]

3.7 The receipt of Rs. 40,00,000 will be taxable @ 15% on gross basis without allowing any deduction for expenses under section 115BBD;

3.8 Computation of FMV of Interest in Firm as per Rule 3 of BM Rules:

Particulars	USD
Value of assets as per A + B – L	
Drawings	110.00
Buildings	150.00
Bank account	112.00
Other Assets [Assumed that MV on 1st April is also 165]	165.00
A + B – L	537.00
Total Capital contribution (A)	220.00
Excess over capital contribution (B) [537 – 220]	317.00
(A) – Divided in capital ratio: Share of Harsh	100.00
(B) – Divided in PSR share of Harsh [60% of 317]	190.20
Total value of interest	**290.20**
Converted in to INR [290.20 X 95]	**27,569.00**
Tax @ 30% on above	**8270.70**

3.9 Since provisions of DTAA are more beneficial, it is advisable to opt for the same. Therefore, tax liability of Trump = 5% of 60,00,000 = 3,00,000

3.10 In case appropriate taxes are withheld at source, then there is no requirement to furnish return in India provided the only source of income in India is the one which is covered under section 115BBA;

3.11 As per Decision of Supreme Court in the case of PILCOM, ABC Limited is required to withhold tax under section 194E at 20% plus surcharge and cess. It has to disregard DTAA for this purpose.

3.12 As per Finance (No.2) Act, 2019, in case any payer fails to withhold tax at source but the ~~resident~~ payee has furnished return in India, considered such income and paid due taxes thereon, in such case, the payer shall not be considered as assessee in default. Therefore, suppose ABC Limited does not withhold appropriate taxes at source, it may still take a stand that when Trump furnishes return in India, considers Rs. 60 lakhs as his income and pays due taxes thereon, then ABC Limited ceases to be assessee in default in respect of the tax. However, naturally, interest under section 201(1A) @ 1% will be attracted till such return is furnished in India.

[Marking scheme: 2 Marks for identifying correct amendments, balance 3 marks for critical examination of provisions]

Case Study 4

4.1 (b) No, it won't be covered

4.2 (c) Rs. 10 lakhs

4.3 (b) The principle of effectiveness

4.4 (a) 30th April, 65/CYD

4.5 (d) Not required to furnish Form 15CA

4.6 Holding Ltd, the Indian company and Beyond Ltd., Country A are deemed to be associated enterprises as per section 92A, since Beyond Ltd. is the subsidiary of Holding Ltd.

As per *Explanation* to section 92B, the transactions entered into between these two companies for purchase of Wagon is included within the meaning of "international transaction".

As Holding Ltd. purchased similar product from an unrelated entity at $14,000, the transactions between Holding Ltd. and such unrelated party can be considered as comparable uncontrolled transactions for the purpose of determining the arm's

length price of the transactions between Holding Ltd. and Beyond Ltd. Comparable Uncontrolled Price (CUP) method of determination of arm's length price (ALP) would be applicable in this case.

(3 Marks)

However, such figure needs to be adjusted by the functional adjustments:

	Amount (in $)
Purchase of Wagon from unrelated party	$14,000
Less: Difference in Warranty (Note-1)	($525)
Add: Adjustment for credit extended (Note-2)	$420
Arm's length price	**$13,895**

Therefore, transfer pricing adjustment would be of Rs. 55,250 [($ 15,000 - $ 13,895) x Rs.50]. The profits of Holding Ltd chargeable to tax would be Rs. 25,00,000+ Rs. 55,250 = Rs.25,55,250.

(2 Marks)

Note:

(1) Beyond Ltd offered warranty only for 3 months while unrelated party provided it for 1 year. Therefore 9 months' cost of warranty shall be adjusted. ($700 x 9/12)

(2) Beyond Ltd has provided credit for 4 months whereas unrelated party has not provided such credit. Therefore adjustment for the cost of such credit is needed to be carried out to arrive at arm's length price. ($14000 x 9 x 4/12)

4.7

As per section 6(1), an individual is said to be resident in India in any previous year if he satisfies the conditions:-

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

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

(2 Marks)

In this case, Mr. Yatish stay in India during the P.Y. 2019-20 is 180 days (i.e., 6+31+30+31+31+30+21 days). Since, his stay in India is for less than 182 days, he does not satisfy condition (i) . As regards, condition (ii), since Mr. Yatish came India for the first time in P.Y. 2019-20, he cannot satisfy basic condition of stay of atleast 365 days in the four immediately preceding previous years.

Hence, his residential status for A.Y. 2020-21 is Non-Resident.

(1 Mark)

Taxability of income

As per section 5(2), in case of a non-resident, only income which accrues or arises or which is deemed to accrue or arise to him in India or which is received or deemed to be received in India in the relevant previous year is taxable in India.

(1 Mark)

Calculation of income chargeable to tax in the hand of Mr. Yatish

Particulars	Amount (Rs.)
Salary earned in India	15,00,000
Salary earned outside India but received in India	9,00,000
Salary earned outside India and received outside India (not taxable)	Nil
Amount Taxable in India	**24,00,000**

(2 Marks)

4.8

In *CIT v. Vishakhapatnam Port Trust's case [1983] 144 ITR 146*, the Andhra Pradesh High Court observed that, "in view of the standard OECD Models which are being used in various countries, a new area of genuine 'international tax law' is now in the process of developing. Any person inte rpreting a tax treaty must now consider decisions and rulings worldwide relating to similar treaties. The maintenance of uniformity in the interpretation of a rule after its international adoption is just as important as the initial removal of divergences. Therefore, stand taken by the Income-tax Department may not be accepted by the Court.

(2 Marks)

4.9

As per Article 5 of the DTAA between India – Country D, which is in line with OECD Model Tax Convention, 2017, the term "permanent establishment" shall be deemed not to include maintenance of stock of goods solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise , where such activity are preparatory or auxiliary. Therefore Statue Ltd (Country D)'s office in India will not constitute Permanent Establishment, since its preparatory activities are confined only to storage, display and delivery of goods.

However, if India's DTAA with Country D is in line with UN Model Convention, 2017 , then, maintenance of stock of goods for the purpose of delivery may constitute a Permanent Establishment.

(2 Marks)

Case Study 5

5.1 (b) tax is deductible at source@5.2%.

5.2 (d) no tax is deductible at source

5.3 (d) None of the above

5.4 (d) constitutes business connection for attracting deemed under accrual provisions section 9(1)(i)

5.5 (c) Introduction of equalization levy

5.6

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	
[No deduction is allowable in respect of expenses incurred in respect thereof as per section 115AD(2)]		20,18,000
Long-term capital gains on sale of bonds of Vaigai Ltd.		
Sale consideration	58,00,000	
Less: Cost of acquisition	29,00,000	
[Benefit of indexation is not allowable as per section 115AD(3)]		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**

(7 Marks)

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

(5 Marks)

5.7

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)