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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 (d)

4.2 (a)

4.3 (b)

4.4 (a)

4.5 (a)

4.6 (d)

4.7 (d)

4.8 (c)

4.9 As per Article 13.2 of the OECD Model Tax Convention, Gains from the alienation of movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State, including such gains from the alienation of such a permanent establishment (alone or with the whole enterprise), may be taxed in that other State. Since machine is a moveable property, the resultant loss will be covered under this article. Further, such loss is allowable in the country where PE is located i.e. in USA. It is immaterial that the machines were present in UK at the time of sale or that the machine is sold to a party located in the USA.

[Marking scheme: 2 Marks for identifying correct article of DTAA< balance 2 marks for identifying jurisdiction of USA for allowing loss]

4.10 The loss arising on sale of machine is allowable in the USA being the country where PE is located. Further, in case there is no sufficient profit to absorb this loss, then such will be carried forward in the USA. However, XYZ Limited will also claim this loss in India since XYZ's global income is liable to tax in India. Accordingly, such loss will also form part of total income for set off. This double benefit is called as Double Dip Benefit. In the case of DCIT vs. Patni Computers Systems Limited (2008) 301 ITR 60 Pune, it was held that the country of residence cannot deny the benefit of set off of losses in the year in which such loss is infact incurred. However, in the subsequent years, when the loss is actually set off against taxable income in the country of source, then the country of residence must tax the entire pre-set off income in order to avoid the double dip benefit to assessee.

[Marking scheme: 2 Marks for discussion on concept, balance 2 marks for correct suggestions]

4.11 As per Article 27 of India – Maurtius Treaty, a resident of a Contracting State is deemed to be a shell / conduit company if its expenditure on operations in that Contracting State is less than Mauritian ₹ 15,00,000 or Indian ₹ 27,00,000 in the respective Contracting State as the case may be, in the immediately preceding period of 12 months from the date the gains arise.

Such LOB clause acts as a Specific Anti Avoidance Rule appearing in the DTAA. Further, the LOB rule is based on recommendations under Action Plan 6 of BEPS.

[Marking scheme: 2 Marks for correct discussion, balance 1 mark for identifying BEPS AP = 6]

4.12

(A) Whether to pay dividend to its shareholders or buy back its shares or issue bonus shares out of accumulated reserves is a business choice of the company. Further, at what point of time a company makes such a choice is its strategic decision. Such decisions cannot be questioned under GAAR.

(B) As discussed above, the choice of providing dividend or not is a business decision which cannot be questioned under GAAR. The fact of treaty benefit should be interpreted as incidental to the main transaction. Further, the company is also satisfying the condition for availing treaty benefit [i.e. SAAR]

(C) No dividends were distributed by X Limited since 01.04.2003, the date on which DDT came into force. Subsequently, X Limited obtained tax benefit by not declaring dividend and passing this on as exempt capital gains in the hands of connected company Y Limited. The buy back of shares was accepted only by Company Y Limited and not by other shareholder companies D Limited and E Limited. D and E would have invited capital gains tax by accepting the offer. This appears to be a dubious method and there may not be genuine commercial reasons for D&E in not accepting the buy-back offer. Therefore, the revenue may examine the arrangement under GAAR.

[Marking scheme: 1 Mark for identifying whether GAAR applicable, balance 1 mark for discussion and logic]

Case Study 5

5.1 (c)

5.2 (c)

5.3 (c)

5.4 (a)

5.5 (c)

5.6 It is obvious that there was no commercial necessity to create a separate firm except to obtain the tax benefit. The firm was only on paper as the man power was drawn from the company. The firm did not have any commercial substance. Moreover, it is a case of treaty abuse. Hence, GAAR may be invoked to disregard the firm and tax payment for architectural services as fee for technical services. However, the rate of tax on such payment shall be applicable under the treaty, if more beneficial.

[Marking scheme: 2 Marks for identifying applicability of GAAR, balance 2 marks for logical discussion]

5.7 It is not clear as to which property is being transferred. In case the property is land or building, then irrespective of the agreement value, the FVOC shall be Stamp Duty Value, being higher than the agreement value. Further, it is also not clear whether the recipient has attracted provisions of section 56(2)(x) of the Act. Both these provisions are SAARs. In case such SAARs are not attracted or if they fail, and the Y Limited has set off losses against the capital gains, then it may be reasonably concluded that GAAR will be invoked. Further, it may be a reasonable argument to prevent GAAR, by demonstrating the commercial substance behind the transaction, if any.

[Marking scheme: 2 Marks for identifying applicability of GAAR, balance 2 marks for logical discussion]

5.8 Separate payments made towards drawings and designs (described as "engineering fee") are in the nature of fees for technical services [Aeg Aktiengesllschaft v. CIT (2004) 267 ITR 209 (Kar.)]. Fees for technical services payable by a resident (Super Thermal Power Ltd., an Indian company, in this case) would be deemed to accrue or arise in India under section 9(1)(vii) in the hands of the non-resident recipient (Techno Engineering GMBH, the German company).

The payment made is not in respect of services utilized for a business or profession outside India or for the purpose of making or earning income from any source outside India and, therefore, is deemed to accrue or arise in India as per section 9(1).

Further, as per Explanation to section 9, where income is deemed to accrue or arise in India under section 9(1)(vii), such income shall be included in the total income of the non-resident German company, regardless of whether it has a residence or place of business or business connection in India, and even if such services are rendered from outside India.

Accordingly, in this case, payments towards drawings and designs would taxable in India in the hands of Techno Engineering GMBH, the German company.

[Marking scheme: 3 Marks for correct discussion and answer]

5.9 A careful reading of the definition of royalty reveals that payment towards 'imparting of information' shall be treated as royalty provided it is in respect of a patent, invention, model, design, secret formula or process or trade mark or similar property or in respect of technical, industrial, commercial or scientific knowledge, experience or skill. In the given question, imparting of information is in respect of sale of machinery and therefore, not covered under definition of royalty. The contention of Assessing Officer is incorrect. [DIT v. Haldor Topsoe [2014] (369 ITR 453) (Bombay HC)]

[Marking scheme: 2 Marks for identifying relevant portion of royalty definition, balance 2 marks for logical discussion]