



J.K. SHAH[®]
TEST SERIES

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SUGGESTED ANSWERS

CA FINAL

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Answers

Case Study 1

1.1 (b)

1.2 (d)

1.3 (c)

1.4 (c)

1.5 (c)

1.6 Computation of Arm's Length Price of Products sold to J Inc. Korea by CD Ltd.

Particulars	Rs.	Rs.
Price per Unit in a Comparable Uncontrolled Transaction		16,800
Less: Adjustment for Differences-		
a) Freight and Insurance Charges	700	
b) Estimated Warranty Costs	500	
c) Discount for Voluminous Purchase	200	
d) External Commercial Borrowing (Working Note 1)	35	
e) Depreciation adjustment (Working Note 2a)	1	
f) Adjustment for under- utilisation of manpower (Working Note No 2c)	3333.29	(4,769.29)
Arms's Length Price for Cellular Phone Sold to j Inc. Korea		12,030.71

a) Computation of Increase in Total Income of CD Ltd.

Particulars	Rs.
Arm's Length Price per Unit	12,030.71
Less: Price at which actually sold to J Inc Korea	(10,000)
Increase In Price per Unit	2,030.71
No. Of Units Sold to J Inc. Korea	2,50,000
Increase in Total Income of CD Ltd. (2,50,000*Rs. 2,030.71)	Rs. 50,76,77,500

Working Note 1: Adjustment for External Commercial Borrowings:

Excess Interest rate provided in comparison to ECB guidelines: $(7.50-6.50)\% = 1\%$

Excess Interest cost = 1% of Rs. 100 crores = 1 crore

Installed capacity = 4,00,000 units

Interest Cost per unit, based on Utilised Capacity = $\text{Rs. } 1,00,00,000 / (2,50,000 + 35,000)$
= Rs. 35(appx)

Capacity Utilised = $2,85,000 / 4,00,000 * 100 = 71.25\%$

Working Note 2:**a) Depreciation related to "idle assets" should be adjusted from Profit & Loss Account**

Year Ended	Rs.
Total Depreciation charged in Profit & Loss Account	10,00,000
Add: Proportionate depreciation in relation to "idle assets" to the extent of 28.75%, since utilized capacity is 71.25% = $(10,00,000 * 28.75\%)$	2,87,500
Depreciation adjusted in line with capacity utilisation	7,12,500
Depreciation adjustment per unit based on utilized capacity = $2,87,500 / 2,85,500$ = 1.01 = 1.00 (appx)	

b) Adjustment in Profit & Loss Account

Year Ended	Rs.
Net Profit as per Profit & Loss Account	8,54,000
Add: Proportionate depreciation in relation to "idle assets" to the extent of 28.75%, since utilized capacity is 71.25% = $(10,00,000 * 28.75\%)$, now written back	2,87,500
Adjusted Net Profit	11,41,500

c) Adjustment related to under-utilization of man-power

Steps	Year Ended	Rs.
a)	Head counts	300
b)	Maximum number of hours per employee (ie 300 days * 8 hrs per day)	2,400
C)	Total available hours ($c = a * b$)	7,20,000
d)	Utilisation rate	71.25%
e)	Utilised hours ($= c * d$)	5,13,000

f)	Unutilised hours (= c-e)	2,0,7,000
g)	Unutilised hours after consideration the industry unutilised rate of 10% (f/0.2875*0.10)	72,000
h)	Total Unutilised head counts (=g/2,400)	30
i)	Proportionate unutilized head counts on the basis of output provided to AE = (30*2,50,000/2,85,000)	26,316
J)	Total Employment related costs	1,00,000
k)	Proportionate employee related cost on the basis of output provided to Associated Enterprise = (1,00,000/2,85,000*2,50,000)	87,719
l)	Adjustment to total employee related Cost proportionate to output provided to AE (=k/i)	3333.29

[Marking scheme: 2 Marks for depreciation adjustment, 2 marks for man power capacity utilisation adjustment, balance 4 marks for computing ALP]

- 1.7 Action 6 of BEPS introduced the principal purpose test (PPT) as one of the Minimum Standards to be implemented by the countries participating in the BEPS Inclusive Framework. The PPT aims to tackle treaty abuse including treaty shopping. Tax administrations need to reasonable conclude, having taken into account all relevant facts and circumstances, that obtaining the treaty benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit.
- 1.8 The case of Melina Limited is based on paragraph 182 of the OECD Commentary (example C), which examines the case of a company, resident in state R, that is assessing alternative locations to set up a new manufacturing plant in light of its expanding business. Three states with similar economic and political environments are indentified as alternatives for this purpose. However, given that only state S has a tax treaty in force with state R, state S is chosen as the location for building the plant. In this case, even though the decision to invest in state S is taken in light of the benefits provided by the state R-state S tax treaty, the principal purpose for making the investment and building the plant are related to the expansion of the business. Therefore, it cannot reasonably be considered that one of the principal purposes for building the plant in state S is to obtain treaty benefits. The commentary further refers to the general objective of tax treaties, which is to encourage cross-border investment, assessing that obtaining the

benefits of the state R-state S tax treaty for the investment in the plant built in state S is in accordance with the object and purpose of the provision of the tax treaty. Further, even GAAR cannot be invoked in such case since conditions of section 96 are not satisfied.

[Marking scheme: Entire Marks for identifying application of GAAR / PPT]

Case Study 2

2.1 (b)

2.2 (c)

2.3 (d)

2.4 (c)

2.5 (c)

2.6 From analysis of the question, it is clear that assessee Happy Limited has considered Cost Plus Method for Computing its own margin. Further, since number of comparable companies is less than 6, we use arithmetic mean to compute the Arms' length margin as under:

Summary of Net Cost plus Mark-up of broadly comparable independent companies

No.	Company Name	March 2012	March 2013	March 2014	March 2015	March 2016	Weighted Average
1	Comparable 1	5.93%	10.8%	10.71%	4.69%	10.06%	8.61%
2	Comparable 2	28.81%	3.88%	10.71%	11.72%	16.30%	13.50%
3	Comparable 3	15.38%	8.33%	7.14%	16.67%	13.33%	12.12%
4	Comparable 4	12.64%	13.00%	4.47%	15.38%	19.80%	13.53%
5	Comparable 5	9.40%	4.85%	22.19%	8.20%	8.05%	11.10%
	Arithmetic Mean	14.43%	8.17%	11.04%	11.33%	13.51%	11.77%

Conclusion:

Since the arithmetic mean is 11.77% the transaction of Happy Limited earning margin of 10.46% is not at ALP. However, we check the tolerance band as under:

$$10.46 + 3\% = 10.77\%$$

$$10.46 - 3\% = 10.15\%$$

The Arms' length margin does not fall within the band.

[Marking scheme: 2 Marks for arithmetic mean, 2 marks for computing tolerance band, balance 1 mark for conclusion]

2.7 Total Cost as per Income-statement = 86,000

Arms' length Margin as computed above = 11.77%

Therefore, Arms length Margin required to be earned = 10,122

Hence, ALP as per CUP = 86000 + 10122 = 96,122

Tolerance Band = 95000 +/- 3% = 92,150 – 97,850

Since ALP falls within the tolerance band, it would be advisable for Happy Limited to adopt CUP Method and demonstrate that transaction is conducted at ALP.

[Marking scheme: 2 Marks for identifying that CUP ALP, 2 marks for tolerance band, 1 mark for conclusion]

2.8 As per Article 4.3 of OECD Model Convention, where by reason of the provisions of paragraph 1 [domestic laws] a person other than an individual is a resident of both Contracting States, the competent authorities of the Contracting States shall endeavour to determine by mutual agreement the Contracting State of which such person shall be deemed to be a resident for the purposes of the Convention, having regard to its place of effective management, the place where it is incorporated or otherwise constituted and any other relevant factors. In the absence of such agreement, such person shall not be entitled to any relief or exemption from tax provided by this Convention except to the extent and in such manner as may be agreed upon by the competent authorities of the Contracting States.

A determination under paragraph 3 will normally be requested by the person concerned through the mechanism provided for under paragraph 1 of Article 25. Such a request may be made as soon as it is probable that the person will be considered a resident of each Contracting State under paragraph 1. Due to the notification requirement in paragraph 1 of Article 25, it should in any event be made within three years from the first notification to that person of taxation measures taken by one or both States that indicate that reliefs or exemptions have been denied to that person because of its dual-residence status without the competent authorities having previously endeavoured to determine a single State of residence under paragraph 3. The competent authorities to which a request for determination of residence is made under paragraph 3 should deal with it expeditiously and should communicate their response to the taxpayer as soon as possible.

Since the facts on which a decision will be based may change over time, the competent authorities that reach a decision under that provision should clarify which period of time is covered by that decision.

It is accordingly advisable that XYZ Limited makes an application for MAP under Article 25.1 for speedy determination of its residential status.

[Marking scheme: 2 Marks for identifying tie-breaker test, balance 3 marks for reference to MAP procedure]

Case Study 3

3.1 (d)

3.2 (d)

3.3 (b)

3.4 (a)

3.5 (d)

3.6

- (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 the foreign company.

Therefore, in the present case, the tax paid by KN will be exempt from tax in the hands of ST. In this case, section 195A is not applicable and consequently, the royalty of Rs. 50 Lacs should not be grossed up. As per section 44D, where a foreign company receives income by way of royalty from an Indian concern in pursuance of an agreement made on or after 1st April, 1976 but before 1st April, 2003, no deduction is allowable in respect of any expense or allowance under sections 28 to 44C in computing such income.

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.

- (ii) Since there is no term in the agreement that KN has to bear the tax liability, the benefit under section 10(6A) is not available. KN has to deducted tax at

source on royalty payment to ST, a foreign company, as per section 195. Since in this case, KN has to pay the royalty of Rs. 59 lacs 'net of taxes' to ST, therefore, the royalty has to be grossed up.

The tax liability of ST has to be computed as under: Rs.

Net Royalty income	59,00,000
Gross Royalty income(59,00,000*100/89.7)	65,77,480
Tax on Royalty of Rs. 65,77,480@10.30%	6,77,480

KN has to deduct this tax of Rs. 6,77,480 at source under section 195.

[Marking scheme: 2 1/2 Marks for each part of the answer]

3.7 Section 2(26) defines an "Indian Company." The proviso to section 2(26) states that for a company to be an Indian company, the registered or principal office should be in India. In this case, since the registered office is in Singapore, XY Pvt Ltd. is not an Indian company.

A company, other than an Indian company, would be considered as resident in India only if the place of effective management is in India in that year. In this case, the POEM is not in India and therefore, XY Pvt Ltd. is not a domestic Company.

XY Pvt Ltd. is a non-resident assessee during the previous year relevant to assessment year 2020-21. As per Explanation 1(b) of section 9(1)(i), no income shall be deemed to accrue or arise in India to a non-resident through or from operations which are confined to purchase of goods in India for the purpose of export. XY Pvt Ltd., had purchased the goods in India and thereafter exported the same in total to China and accordingly no income of the non-resident company shall be subject to tax for assessment year 2020-21.;

[Marking scheme: 4 Marks for complete correct answer and identification of section 9]

3.8 Under section 44BBA, a sum equal to 5% of the aggregate of the following amount is deemed to be the profits and gains chargeable to tax under the head "Profits and gains of business or profession" in respect of a non-resident, engaged in the business of operation of aircraft-

a) The amount paid or payable, whether in or out of India, to the assessee or to any person on his behalf on account of the carriage of passengers, livestock, mail or goods from any place in India; and

- b) The amount received or deemed to be received in India by or behalf of the assessee on account of the carriage of passengers, livestock, mail or goods from any place outside India.

In the present case, the income chargeable to tax of M/s. Global Airlines is as follows

Particulars	Fare booked from India to outside India whether received in India or not (Rs.)	Fare booked from New York to Mumbai	
		If received in India (Rs.)	If not received in India(Rs.)
Fare	60,00,000 (1,25,00,000-65,00,000)	65,00,000	65,00,000
Deemed Income @5% u/s. 44BBA	3,00,000 (60,00,000*5%)	3,25,000 (65,00,000*5%)	Nil

[Marking scheme: 3 Marks for complete correct answer]

- 3.9 Under clause (iva) of Explanation 2 to section 9 (1)(vi), the expression “royalty” would include any lump sum consideration for the use of or the right to use of any industrial, commercial or scientific equipment. Under section 44D, no deduction will be allowed in respect of any expenditure or allowance in computing the income by way of royalty, received from the Government or an Indian concern in pursuance of an agreement made between 01.04.1976 and 31.03.2003.

Under section 115A, income-tax payable on such royalty under an agreement entered into after 31st March, 1976 will be 10%. This will be subject to the provisions of the Double Taxation Avoidance Agreement between India and the country in which the foreign company is assessed.

[Marking scheme: 2 Marks for reference to definition of royalty, 1 mark for tax rate]

Case Study 4

- 4.1 (a)
4.2 (a)
4.3 (c)
4.4 (d)
4.5 (d)

4.6 It would be reasonable to conclude that one of the principal purposes for the conclusion of the separate contract under which RS Ltd. agreed to perform part of the construction project was for R Ltd and RS to each obtain the benefit of the rule in paragraph 3 of Article 5 of the Country B and Country D DTAA where a PE is constituted only if the activities are carried out for more than 12 months. By separating the contracts, it is ensured that R Ltd has no PE in country D. Granting the benefit of articles 5(3) in these circumstances would be contrary to the object and purpose of that paragraph as the time limitation of that paragraph is being abused and used for unintended purposes. Therefore, a PE is created in the given case.

[Marking scheme: 2 Marks for identifying correct article of DTAA < balance 2 marks for identifying whether PE is created]

4.7 As per the Circular F.No.225/2/2016/ITA.II dated 7.3.2016 issued by the CBDT, it has been clarified that consortium arrangement for executing Turnkey project which has the following attributes may not be treated as an AOP –

1. Each member is independently responsible for executing its part of work through its own resources and also bear the risk of its scope of work.
2. Each member earns profits or incurs losses, based on performance of the contract falling strictly within its scope of work.
3. The control and management of the consortium is not unified and common management is only for the inter se coordination between the consortium and members for administrative convenience.

However, the benefit of this Circular would not be available if the consortium members are associated enterprises under section 92A.

In the present case, R Ltd. and RS Ltd. are deemed to be associated enterprises since R Ltd holds 100% voting power in RS Ltd (i.e., not less than 26% voting power).

Hence, the benefit of this Circular would not be available and in such a case, Assessing Officer will decide whether an AOP is formed or not keeping in view the relevant provisions of the Act and judicial jurisprudence on this issue. In this consortium arrangement, the scope of work of R Ltd. and RS Ltd. appear to be separately defined, Contract I is to be executed solely by R Ltd. and Contracts II solely by RS Ltd. Consideration has also been fixed separately for these two contracts. The fact that both parties have joint and several responsibility is irrelevant [Refer Linde AG [Delhi HC]]. Taking into consideration these facts,

the Assessing Officer may come to a conclusion that R Ltd and RS Ltd. would not be treated as an AOP.

[2 marks for identifying correct circular with number, balance marks for analysis]

4.8 India E- Commerce and E Ventures Pvt Ltd appear to function contractually, but not actually as a Contract Research Organisation (CRO), after the transfer of the partly developed software to Singapore E-Commerce and E Ventures Pte Ltd. In course of conducting future R&D, India E- Commerce and E Ventures Pte Ltd designs the final e-commerce software, controls the R&D operation, determines the direction of the course of research, makes as well as control the strategic decisions regarding further development of software, and also manages and control the R&D budget.

Thus, India E-Commerce and E-Ventures Pvt Ltd. though contractually claims to function as a CRO, its role is not limited to that of a CRO; India E-Commerce and E – Ventures Pvt Ltd actually performs and controls the key R &D functions.

Specific guidance will ensure that hard value intangibles are remunerated appropriately by ensuring that the analysis is not weakened by information asymmetries between the tax administration and the taxpayer.

For a specific category of hard –to-value intangibles, for which at the time of their transfer no reliable comparable exist or valuation is highly uncertain, information asymmetry between taxpayer and tax administrations about how the pricing was determined may be acute. To address challenges due to information asymmetry, an approach to pricing hard-to-value intangibles has been developed. This approach ensures that tax administrations can consider ex ante pricing arrangements, and the taxpayer can demonstrate that the uncertainty has been appropriately taken into account in the pricing methodology adopted.

Based on these guidances, it must be ensured that BEPS Action Plan 8 is appropriately applied to conduct transactions at ALP. This will in effect result in no erosion of taxable base in either countries.

Case Study 5

5.1 (c)

5.2 (b)

- 5.3 (c)
5.4 (c)
5.5 (b)

5.6

S. No.	Particulars	Amount (Rs. In crores)
1.	Tax payable before foreign tax credit (tax as per normal provisions or MAT whichever is higher)	75
2.	Foreign tax credit	45
3.	Tax payable (2-1)	30
4.	MAT credit before applying this rule to be carried forward	65(75-10)
5.	Foreign tax credit against MAT	45
6.	Foreign tax credit available against the tax payable under the normal provisions.	10
7.	Excess of 5 over 6	35
8.	MAT credit (after application of rule 128)	30

[Marking scheme: 3 Marks for correct answer]

- 5.7 In this case, the Assessing officer in India shall in case assessment is completed for AY 2016-17 reopen the assessment and recomputed the taxes by excluding the refund so received.

[Marking scheme: 2 Marks for identifying reassessment provision]

5.8 Computation of tax liability of Mr. Murli, Non-resident Indian

Particulars	Rs.
A) Tax liability if he opts for Chapter XII-A(Working Note 1)	4,960
B) Tax liability if he opts for normal provisions (Working Note 2)	-10,620

Since the tax computed as per the normal provisions is beneficial to the assessee, the same may be reported to

Working Note 1: Tax liability under Chapter XII-A

Particulars	Rs.	Rs.
a) House property income (computed)		2,00,000
b) Interest on debentures		75,000

c) Long Term Capital Gains (Indexation benefit not available)		90,000
d) Dividend from Indian company	50,000	
Less: Exempt u/s. 10(34)	<u>50,000</u>	Nil
Gross Total Income		3,65,000
Less: Deductions under Chapter VI-A (in respect of income other than LTGG & Interest)		
- u/s 80C – Loan repayment to HDFC	20,000	
- u/s. 80G – Prime Minister’s Relief Fund -100%	<u>10,000</u>	<u>30,000</u>
Total Income		<u>3,35,000</u>
Income tax thereon		
i) Interest (Investment) income @20% (i.e 75,000 *20%)	15,000	
ii) LTCG (Specified asset)@10% (i.e. 90,000*10%)	9,000	
iii) Balance at normal rates (3,35,000-90,000-75,000)	<u>Nil</u>	24,000
Add: Education cess @4%		<u>960</u>
		24,960
Less: Tax Deducted at Source		<u>20,000</u>
Net Tax Payable		<u>4,960</u>

Working Note 2: Computation of tax liability under normal provisions

Particulars	Rs.	Rs.
A) Income from House Property		2,00,000
B) Capital Gains		90,000
C) Income from Other Sources		
- Interest on debentures of an Indian company (Net)	50,000	
- Dividend income –exempt u/s. 10(34)	Nil	<u>50,000</u>
Gross Total Income		3,40,000
Less: Deduction under chapter VI-A		<u>30,000</u>
Total Income		<u>3,10,000</u>
Tax on above		
i) Long term capital gains -90,000@ 10% [Note 2]	9,000	
ii) Balance at normal rates [3,10,000-90,000]	<u>Nil</u>	9,000

Add: Education cess @3%		<u>360</u>
		9,360
Less: Tax deducted at Source		<u>20,000</u>
Net Tax Payable /(Refund)		<u>(10,620)</u>

Notes:

- 1) As regards Income from House property, it is assumed that the property taxes have been paid; 30% of net annual value and interest deductible have also been deducted.
- 2) As it is not indicated that the shares are listed, it is presumed that they are unlisted and accordingly 10% tax rate has been applied u/s. 112.
- 3) Indexation benefit is not available both under Chapter XII-A (Sec.115D) and under normal provisions (second Proviso to Sec. 48) in case of non-resident for specified assets acquired on convertible foreign exchange. Hence in the given case indexation benefit is not availed.
- 4) Repayment of principal amount of loan taken for higher education is not eligible for deduction u/s. 80E.

[3 marks for computation under each option]

5.9 BEPS Action Plan -11**Measuring and Monitoring BEPS**

This action plan highlights the fiscal and economic impacts of BEPS. The impact is higher on developing countries than developed countries.

BEPS causes impacts in the following nature

- Tax revenue losses
- Favours tax –aggressive MNEs
- Worsening the corporate debt bias
- Misdirecting foreign direct investment and
- Reducing the financing of needed public infrastructure

Six Indicators of BEPS activity

By using different sources of data, employing different metrics and examining different BEPS channels, the existence of BEPS and its increase in scale in recent years has been confirmed.

The following are the indicators of BEPS activity:

- The Profits rates of MNE affiliates in lower-tax countries are higher than the average worldwide profit rate of their group.
- The effective tax rates paid by large MNE entities are estimated to be 4 to 8.5 percentage points lower than similar enterprises with domestic only operations.
- Foreign direct investment (FDI) is increasingly concentrated-
For example, FDI in countries with net FDI to GDP ratios of more than 200% increased from 38 times higher than all other countries in 2005 to 99 times higher in 2012.
- The separation of taxable profits from the location of the value creating activity is particularly clear with respect to intangible assets, and the phenomenon has grown rapidly- For example, the ratio of the value of royalties received to spending on R&D in a group of low tax countries was six times higher than the average ratio for all other countries.
- Debt from both related and third –parties are more concentrated in MNE affiliates in higher statutory tax-rate countries.

[Marking scheme: 2 Marks for identifying impacts, balance 2 marks for identifying indicators of BEPS]