ELECTIVE PAPER 6C: INTERNATIONAL TAXATION

SOLUTION TO CASE STUDY 3

I. ANSWERS TO MULTIPLE CHOICE QUESTIONS

1. (c)

2. (c)

3. (b)

4. (d)

5. (c)

6. (d)

7. (a)

8. (b)

9. (c)

10. (b)

II. ANSWERS TO DESCRIPTIVE QUESTIONS

1. **(a)** Mr. Harry Smith is a non-resident in India for A.Y.2018-19, since he has stayed in India only for 54 days in the P.Y.2017-18. Ms. Rita Smith would also be non-resident in India for A.Y.2018-19, since she has also stayed in India only for 54 days in the P.Y.2017-18.

Since Mr. Harry Smith is a non-resident sports person, who is not a citizen of India, the special provisions under section 115BBA would apply to him for income from participation in swimming competition in India, advertisement of product on TV and contribution of articles in newspaper. Income from horse races would, however, be taxable@30% under section 115BB.

Since Ms. Rita Smith is a non-resident entertainer, who is not a citizen of India, the special provisions under section 115BBA would apply to her for computation of income from music performances.

Computation of tax liability of Harry Smith for the A.Y.2018-19

Particulars	₹	₹
Income taxable under section 115BBA		
Income from participation in swimming competition in India	15,00,000	
Advertisement of product on TV	2,00,000	
Contribution of articles in newspaper	20,000	
Income taxable under section 115BB		
Income from horse races	25,000	
Total income	**17,45,000**	
Tax@ 20% under section 115BBA on ₹ 17,20,000		3,44,000
Tax@ 30% under section 115BB on income of ₹ 25,000 from horse races		7,500
		3,51,500
Add*:* Education cess@2% and SHEC@1%		10,545
Total tax liability of Harry Smith for the A.Y.2018-19		**3,62,045**

Computation of tax liability of Rita Smith for the A.Y.2018-19

Particulars	₹	₹
Income taxable under section 115BBA		
Income from music performances given in India	2,00,000	
Total income	**2,00,000**	
Tax@ 20% under section 115BBA on ₹ 2,00,000		40,000
Add: Education cess@2% and SHEC@1%		1,200
Total tax liability of Rita Smith for the A.Y.2018-19		**41,200**

(b) Income chargeable to tax under section 115BBA is subject to tax deduction at source under section 194E. Income earned by Mr. Harry Smith from advertisement of products on TV is chargeable to tax@20.6% under section 115BBA and hence, is subject to tax deduction at source of an equivalent amount under section 194E.

Under section 271C, penalty equal to the amount of tax which the person responsible for deducting has failed to deduct, would be leviable. Accordingly, in this case, penalty of Rs. 41,200 would be attracted under section 271C for such failure.

However, section 271C requires such penalty to be imposed by Joint Commissioner. In this case, since penalty has been imposed by Assistant Commissioner, the same is not in accordance with the provisions of section 271C. Hence, the levy of penalty under section 271C in this case by an Assistant Commissioner of Income-tax is not in order.

2. (a) MNO Ltd. is a non-resident assessee during the previous year relevant to assessment year 2018-19. 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. MNO Ltd. had purchased the goods in India and thereafter exported the same in total to China and accordingly no income of MNO Ltd. shall be subject to tax for assessment year 2018-19.

Note *- 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 Country X, MNO 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, since the board meetings in which key managerial decisions for the conduct of the company are taken, are held in Country X, the POEM of MNO Ltd. is not in India. Therefore, MNO Ltd. is not resident in India.

(b) 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, M/s. Pacific Airlines, in this case :

(i) the amount paid or payable, whether in or out of India, to the assessee on account of the carriage of, *inter alia*, passengers from any place in India; and

(ii) the amount received or deemed to be received in India by or on behalf of the assessee on account of the carriage of, *inter alia*, passengers from any place outside India.

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

Particulars	**Fare for travel from Delhi to Country Y, whether received in India or not (₹)**	**Fare for travel from Country Y to Delhi**	
		Fare received in India (₹)	**Fare not received in India (₹)**
Fare	180 crores (280 crores – 100 crores)	40 crores	60 crores
Deemed income @5% u/s 44BBA	9 (180 crores × 5%)	2 (4 crores × 5%)	Nil

The business income chargeable to tax in the hands of M/s. Pacific Airlines is ₹ 11 crores. No deduction is allowable in respect of any expenditure incurred to earn such income.

(c) As per section 5(2), the total income of a non-resident would include all income which is, *inter alia*, deemed to accrue or arise to him in India in that year.

In the case of a non-resident, being a person engaged in the business of banking, any interest payable by the Permanent Establishment (PE) in India of such non-resident to the head office or any PE or any other part of such non-resident outside India, shall be deemed to accrue or arise in India [*Explanation* to section 9(1)(v)].

In the present case, the Indian branch, being a fixed place of business, is the PE in India of PQR Bank Ltd., being a non-resident engaged in the banking business, since such business is carried on in India through the Indian branch [Clause (iiia) of section 92F].

Accordingly, the interest of ₹ 35 lakhs paid to its head office in Country Z and ₹ 17 lakhs paid to the other branch office in Country N by the Indian branch [being the PE in India of PQR Bank Ltd, a non-resident engaged in the business of banking] shall be deemed to accrue or arise in India and shall be liable to tax in India in the hands of head office and Country N branch, respectively, in addition to any income attributable to the PE in India.

3. (a) Computation of tax liability of Mr. Mahesh Sharma for A.Y.2018-19

Particulars	₹	₹
Indian Income		45,00,000
Foreign Income		12,00,000
Gross Total Income		**57,00,000**
Less: **Deduction under section 80C**		
PPF Contribution	75,000	
Deduction under section 80D		
Medical insurance premium of father, being a resident senior citizen, restricted to	30,000	
Deduction under section 80DD		
Maintenance including medical treatment of his dependent sister, being a person with disability [Flat deduction, irrespective of expenditure incurred]	75,000	1,80,000
Total Income		**55,20,000**
Tax on total income		14,68,500

Add: Surcharge@10% (since total income exceeds Rs.50 lakhs but is less than Rs.1 crore)		1,46,850
		16,15,350
Add: Education cess@2%		32,307
Secondary and higher education cess @ 1%		16,153
		16,63,810
Average rate of tax in India [i.e., ₹ 16,63,810/₹ 55,20,000 x 100]	30.14%	
Average rate of tax in Country P		
[i.e. ₹ 3,36,000/ ₹ 12,00,000 x 100]	28%	
Doubly taxed income	12,00,000	
Rebate under section 91 on ₹ 12,00,000 @28% (lower of average Indian tax rate and Country P tax rate]		3,36,000
Tax payable in India [₹ 16,63,810 – ₹ 3,36,000]		**13,27,810**

Note: Deduction under section 91 is allowable to Mr. Mahesh Sharma, since he fulfils the following conditions are fulfilled:-

(a) He is a resident in India during the relevant previous year, since his stay in India during the P.Y.2017-18 was more than 182 days.

(b) The income of Rs.12 lakhs from concerts accrues or arises to him outside India in Country P during that previous year.

(c) Such income is not deemed to accrue or arise in India during the previous year.

(d) The income in question has been subjected to income-tax in Country P in his hands and he has paid tax on such income in Country P.

(e) There is no agreement under section 90 for the relief or avoidance of double taxation between India and Country P where the income has accrued or arisen.

In this case, Mr. Mahesh Sharma is eligible for deduction under section 91, since all the above conditions are fulfilled.

(b) The REIT enjoys pass-through status in respect of rental income from real estate asset owned by it directly and interest income from special purpose vehicle, (i.e., A Ltd., in this

case, since it is an Indian company in which REIT holds controlling interest). Therefore, such income is taxable in the hands of the unit holders.

(1) Rental income component of income distributed by REIT: The distributed income or any part thereof, received by Vallish from the REIT, which is in the nature of income by way of renting or leasing or letting out any real estate asset owned directly by such REIT is deemed income of the unit-holder as per section 115UA(3). Accordingly, Rs.1,25,000 would be deemed income of Vallish as per section 115UA(3). The REIT has to deduct tax at source under section 194LBA@30.9% (being the rate in force) in case of distribution to Vallish, being a non-resident.

(2) Interest component of income distributed by REIT: Interest component of income received from a special purpose vehicle, A Ltd., in this case, and distributed to a unit holder is taxable@5% in the hands of the unit holder. Accordingly, such interest component of Rs.62,000 is taxable in the hands of Vallish. The REIT has to deduct tax at source under section 194LBA @5%, on Rs.62,000, since Vallish is a non-resident.

(3) Dividend component of income distributed by REIT: Any distributed income referred to in section 115UA, to the extent it does not comprise of interest [referred to in sub-clause (a) of section 10(23FC)] and rental income from real estate assets owned directly by the business trust [referred to in section 10(23FCA)] received by unit holders, is exempt in their hands under section 10(23FD). Therefore, by virtue of section 10(23FD), Rs.58,000, being the dividend component [referred to in sub-clause (b) of section 10(23FC)] of income distributed to Vallish would be exempt in his hands. Therefore, there is no liability on the REIT to deduct tax at source on the dividend component of income distributed by it to Mr. Vallish.