CASE STUDY 5]

Athena Ltd. is a company specializing in manufacture of electronic products such as hair straighteners and curlers. Athena Ltd. was incorporated in Country A in September 2011.

Athena Ltd. set up its own manufacturing facility by July 2012 and set up its first retail store in December 2012 in Country A. The retail store displayed and sold the various variants of straighteners and curlers that it had manufactured. The products are sold under Athena's registered trade mark. The first retail store showed tremendous success and sales. Given the success, between the years 2013 to 2016, Athena grew its network of retail stores in Country A. By the end of 2016 it had set up a total of ten retail stores in Country A.

The board of directors of Athena Ltd. consisted of Mr. Lim, his wife Mrs. Lim and his dear friend Mr. Chang and his wife Mrs. Chang. Mr. Lim, Mrs. Lim, Mr. Chang and Mrs. Chang were all residents and citizens of Country B. The board meetings of Athena Ltd. were regularly held in Country A with each director being personally present for such meetings. All decisions relating to setting up and expansion of the retail stores network were taken up duly by the board of directors with unanimous agreement.

Athena Ltd. seeks to expand its presence to other countries including India in the previous year 2017-18. India is a potential market and seems to be a profitable move for the company.

The board thinks that before any substantial investment is made in the Indian market, it would be fit to gain a comprehensive understanding of the Indian market in terms of consumer choices, market rivals, legal compliances, business regulations, etc. Hence, it devises a four stage strategy to launch the Indian operations.

Stage I:

Athena Ltd. will hire three professionals residing in India based on prescribed qualifications. It would be ideal for the team to comprise one lawyer, one accountant and one business professional.

The functions to be discharged by such professionals include authoring a detailed project report enumerating the domestic landscape of the Indian legal and business regulations that would govern the proposed business in India. For example, what are the legal and regulatory compliances required for setting up a business? What is the projected growth trend of the hair care industry? Who are the market rivals and what is their respective market share? The project report would also include financial projections regarding the profitability for next five years.

The professionals are expected to work independently but can raise any queries to the board of directors of Athena Ltd. These professionals will be given two months to complete the report and present the findings to the board of directors. The remuneration of the professionals would be taken care of, by Athena Ltd.

Pursuant to the strategy, Mr. Hari, Mr. Rajesh and Mr. Ravi were hired by Athena Ltd. on March 1, 2017. Their monthly remuneration were fixed at Rs.75,000, Rs.82,000 and Rs.80,000 respectively, for the two month period. The report was duly submitted by them to the board of Athena Ltd. on April 30, 2017. The board was happy to receive the report and duly considered the findings submitted.

Stage II:

Having implemented the first stage, the next step would be to hire an agent with well-established industry knowledge and with networks and connections in the hair care industry in India. The agent was to work exclusively for Athena Ltd.The initial term of engagement would be four months, which may be extended to another term, if found agreeable to both parties.

The agent will be expected to identify potential companies and individuals who can serve as advisors/investors/local partners for Athena Ltd. as and when it intends to establish its local presence in India. The agent can hold the first round of discussions and negotiations with any such interested party. Based on such discussions, the agent must convey the expectations of the interested party to Athena Ltd. While the agent can enter into any such preliminary negotiations with the advisors / investors/ local partners, the desired terms of relationship would be subject to the consideration, confirmation and final approval of Athena Ltd. The agent also had to identify potential customers and promote the company's products. For this purpose, hair curlers and hair straightners would be supplied to the agent, who in turn has to market these products to potential customers. The Board of Athena Ltd. decided that, as a promotional offer, a discount of 30% can be offered initially to such customers.

After a host of interviews, Mr.Shyam was found eligible for the position of the agent. The terms of engagement of Mr. Shyam were fixed for four months. Mr. Shyam acted as an agent from June 2017 to September 2017. He received a remuneration of Rs.1,50,000 per month for the performance of his functions, as described above.

After a series of discussions, Mr. Shyam identified Mr. Garg, Mr. Patnaik and Mr. Sharma as suitable advisors who have relevant industry experience in the hair care and hospitality industries. Mr. Shyam was also able to identify potential customers in western states of India, namely, Maharashtra, Gujarat and Goa and effect sales to such customers during the said period.

Stage III:

The third step is to launch and sell the products in India using e-commerce, given the wide spread use of digital means such as websites and phone based apps by Indians for shopping online. The website, **www.athena.in**, was designed and hosted such that Indian users can make use of its services for placing orders in India. The website was hosted on a server based in Cayman Islands, owned and operated by Athena Ltd. The business was carried on through the server, which carries on the entire set of operations. The Indian user merely has to click on the desired product and fill in the details of the desired address for delivery and make payment using a payment gateway, after which the order is confirmed and delivery is ensured.

In order to enable the delivery of the straighteners and curlers to Indian customers, Athena Ltd. identified warehouse(s) where the stock can be maintained and from which the orders of the customers can be satisfactorily met. Athena Ltd. directly supplied the stock from the Country A entity to the local warehouses.

The website was functional for the said purpose in October, 2017 and thereafter, online sales were effected through the website at the price decided by Athena Ltd. During October 1, 2017 to December 31, 2017 Athena Ltd. was able to sell 2500 units of hair straightners and 1500 units of hair curlers to customers based in India. The hair dryer was priced at Rs.2,500 while the hair curler was priced at Rs.3,500.

Stage IV:

As a fourth step, the board of Athena Ltd. reviewed the strategies adopted. Encouraged by the positive market response in India, the board of Athena Ltd. decided to set up a branch in Mumbai in January, 2018. Mr. Garg and Mr. Patnaik, who are residing in Mumbai, are now entrusted with spearheading the Indian operations and expansion strategy. Sales were effected through the Mumbai branch from January, 2018 itself.

Athena Ltd. is also considering advertising the product on the internet using websites such as Google Inc. The board believes that using digital means of advertising would give the necessary push to sales by educating interested Indian customers of the product range which would contribute to better sales and profits, in turn.

The company enters into talks with Google Inc. for hosting the desired advertisements. It negotiated a sum of Rs.30,00,000, which is paid to Google Inc. in March, 2018 for online advertising services.

Additional facts to be able to answer the questions:

Google Inc does not have a permanent establishment in India.

Assume that Country A and India have a Double Taxation Avoidance Agreement which is identical to that of the provisions of the OECD Model Convention.

Based on the above facts, you are required to answer the following questions:

I. MULTIPLE CHOICE QUESTIONS

Write the correct answer to each of the following questions by choosing one of the four options given. Each question carries two marks.

1. The income earned by Athena Ltd. from sale of hair straightners and hair curlers in India during the period from June, 2017 to December, 2017 –

   (a) Would not be taxable in India, since no business connection is established on account of Mr. Shyam not having authority to conclude contracts on behalf of Athena Ltd.

   (b) Would be taxable in India, since business connection would be established on account of Mr. Shyam securing orders in India wholly for Athena Ltd.

   (c) Would not be taxable in India, since Athena Ltd. does not have a PE in India

   (d) Would be taxable in India, since Athena Ltd. has a PE in India

2. Dividend from an Indian company is exempt in the hands of a non-resident shareholder by virtue of section 10(34). Can such income be subject to tax in his hands in accordance with the provisions of the tax treaty?

   (a) Yes, since the provisions of the treaty override the domestic law

   (b) No, due to the non-aggravation principle

   (c) No, due to the equivalent beneficiary principle

   (d) No, due to allocation of taxing rights principle.

3. Which of the following may be viewed by the tax authorities as a tax avoidance measure undertaken by Athena Ltd.?

   (a) Choosing Google Inc., a company not having a PE in India, for advertising its products.

   (b) Hosting the website on a server based in Cayman islands

   (c) Both (a) and (b)

(d) Entering into limited period engagements with persons resident in India.

4. In respect of remuneration of Rs.1,50,000 per month paid by Athena Ltd. to Mr. Shyam, which of the following statements is correct, having regard to the provisions of the Income-tax Act, 1961 (provisions of DTAA may be ignored) –

(a) No tax is deductible at source as per the provisions of the Income-tax Act, 1961 since Athena Ltd. is a foreign company and is not resident in India

(b) Tax has to be deducted at source under section 192 at the average rate of income-tax computed on the basis of the rates in force.

(c) Tax has to be deducted at source at the rates in force under section 195

(d) Tax has to be deducted at source@5%

5. As per the provisions of the Income-tax Act, 1961, who can act as a representative assessee in respect of the income deemed to accrue or arise in India in the hands of Athena Ltd.?

(a) Only an employee of Athena Ltd.

(b) Only a trustee of Athena Ltd.

(c) Only an agent of Athena Ltd.

(d) All the above

6. As per the DTAA with Country A, which of the following statements is correct? –

(a) The DTAA applies only to taxes on income

(b) The DTAA applies both in respect of taxes on income and capital

(c) The DTAA applies only to persons who are resident of Country A in respect of taxes on income and capital

(d) The DTAA applies only to persons who are resident of India in respect of taxes on income.

7. Which of the following is ordinarily **not** a function served by a tax treaty?

(a) Relieving economic double taxation

(b) Imposing a fresh tax liability

(c) Boosting mutual trade and investment in the two Contracting States

(d) Allocating taxing rights

8. Which of the following statements reflects the **incorrect** position?

(a) Domestic tax laws are irrelevant while considering application of the provisions of a DTAA

(b) Provisions of Income-tax Act, 1961 empower the Union Government to enter into tax treaties for relieving double taxation

(c) Provisions of a DTAA overrides the provisions of domestic laws unless the latter are more beneficial for a taxpayer

(d) In the absence of a DTAA, domestic tax laws provide unilateral relief to tackle double taxation

9. Which of the following is **not** a principle incorporated in the Vienna Convention on Law of Treaties?

(a) Preparatory work of the treaty can be used as a supplementary means of interpretation

(b) A State which is a third party cannot be bound by the terms of a bilateral tax treaty without its con sent

(c) Violation of any term of the tax treaty by one Contracting State entitles the other Contracting State to terminate the treaty

(d) Ordinarily, each authenticated version of a treaty in more than one language carries equal force

10. Which article has been introduced in the India-Mauritius tax treaty to specifically target the practice of treaty shopping?

(a) Elimination of double taxation

(b) Limitation of benefits

(c) Most Favoured Nation clause

(d) Non-discrimination

II. DESCRIPTIVE QUESTIONS

1. In relation to the income earned during previous year 2017-18, does Athena Ltd. have a permanent establishment in India? Answer the question in relation to activities undertaken in each of four stages in the case study. ***(10 Marks)***

2. (a) (i) What may be viewed as a strategy which has been adopted by Athena Ltd. to avoid tax in India in the third stage? Examine. ***(3 Marks)***

(ii) Which action plan of BEPS addresses the tax challenges arising out of the strategy adopted by Athena Ltd. in the third stage? What were the recommendations thereunder to address such challenges? ***(4 Marks)***

(b) From the following hypothetical situation given below, determine whether Athena Ltd satisfies the active business test for determination of place of effective management under the Income-tax Act, 1961:

Particulars	Country A	Country B	India
	Foreign currency equivalent		
Value of assets	Rs.400 lakhs	Rs.100 lakhs	Rs.210 lakhs
Number of employees	30	10	20
Payroll expenses on employees	Rs.160 lakhs	Rs.35 lakhs	Rs.65 lakhs
Number of Board Meetings	10	2	4

Particulars	Rs.
Income from transactions where only the purchases of goods are from associated enterprises	25 lakhs
Income from transactions where only the sale of goods is to associated enterprises	45 lakhs
Income from transactions where both purchases and sales are from/to associated enterprises	110 lakhs
Income by way of dividend and interest involving associated enterprises	22 lakhs
Total income by way of dividend and interest	35 lakhs
Total income of Athena Ltd.	250 lakhs

(5 Marks)

3. (a) What are the tax implications under the Indian tax laws, in respect of fees paid for online advertising services? ***(3 Marks)***

   (b) In respect of the fees referred to in (a) above, examine the requirement, if any, under the Indian tax laws to deduct tax at source and the consequences of non-deduction at source. ***(3 Marks)***

   (c) Is there any provision incorporated in the Indian tax laws to avoid double taxation of such income [i.e., fees referred to in (a) above] in India? Examine. ***(2 Marks)***