

NEW SCHEME

FINAL COURSE – GROUP I PAPER 6C: INTERNATIONAL TAXATION

Syllabus 100%

*Attempt any **two** out of **three** case study based questions.*

Each Case Study carries 50 Marks

Maximum Time : 4 hours

Maximum Marks : 100

Question 1

M/s. Hari Om & Co., an Indian firm, is a leading tax consultant with headquarters in Mumbai. The firm has four resident partners, Mr. Shivakumar, Mr. Hari Prakash, Mr. Om Prakash and Mr. Narayan and one non-resident partner, Mr. Vallish. As per the partnership deed, the profits and losses are shared equally amongst partners. All partners are working partners and salary is paid to all partners as per the terms of the partnership deed.

Mr. Vallish, the non-resident partner, is a resident of Country L. Mr. Vallish has also invested in India Infradebt Ltd., an infrastructure debt fund notified under section 10(47). He is due to receive interest of Rs.5 lakhs in March, 2018 from such fund. He incurred expenditure of Rs.10,000 to earn such income. Mr. Vallish's brother Harish is also resident of Country L. Both Mr. Vallish and Mr. Harish are citizens of India.

M/s. Hari Om & Co. provides consultancy services in relation to domestic tax laws, both direct and indirect. Over the last couple of years, they have taken up few assignments in the area of international taxation. These assignments relate to double taxation avoidance agreements, non-resident taxation and other international taxation matters.

The details of the assignments are as follows -

Assignment 1 [Client – Mr. Harry Smith]

Mr. Harry Smith, a citizen and resident of Country Y, and a swimmer came to India for participation in international swimming competition held in New Delhi. He came to New Delhi on 5th February, 2018 and left on 30th March, 2018 for Country Y. He received Rs. 15 lakhs for

participation in competitions in India. He also received Rs. 2 lakh from XYZ Ltd. for advertisement of a product, namely shaving cream, on television. He contributed articles related to swimming in a newspaper for which he received Rs. 20,000. He incurred Rs.1 lakh as his travel costs to India. All other expenses were met by his sponsors. When he stayed in India, he also won a prize of Rs. 25,000 from horse racing in Mumbai. He has no other income in India during the year ended 31.3.2018. He wants to know his tax liability in India. He also wants to know whether he has to file return of income in India.

Mr. Harry Smith has a sister Ms. Rita Smith and a brother Mr. Austin Smith, who are also citizens and residents of Country Y. Ms. Rita Smith is a pop singer who accompanied Mr. Harry Smith to India in February-March, 2018. She earned Rs. 2 lakhs from music performances given by her in India during that period. She has no other income in India during the year. Mr. Harry Smith wants to know Ms. Rita Smith's tax liability in India and whether she has to file her return of income in India.

Assignment 2 [Client – MNO Ltd.]

MNO Ltd., a company having registered head office in Country X, for the first time, carried out operations during the year 2017-18 of purchase of goods in India on three occasions. Immediately after purchase, the company exported the same to China. The total value of such exports was Rs. 85 lakhs, on which it earned profits of Rs. 15 lakhs, before the expenses of Rs. 8 lakhs, which were directly paid by H.O. The company does not carry on any other operation in India. All its board meetings are held in Country X and key management and commercial decisions for the conduct of the company's business as a whole are taken in such board meetings. The company wants to know its tax liability in India for A.Y.2018-19.

Assignment 3 [Client - M/s. Pacific Airlines]

M/s. Pacific Airlines, incorporated as a company in Country Y, operated its flights to India and vice versa during the year 2017-18 and collected charges of Rs. 280 crores for carriage of passengers and cargo out of which Rs. 100 crores were received in Country Y Dollars for the passenger fare from Country Y to Delhi. Out of Rs. 100 crores, Country Y dollars equivalent to Rs. 40 crores is received in India. The total expenses for the year on operation of such flights were Rs. 11 crores. The company wants to know its income chargeable to tax in India for A.Y.2018-19 and the rate at which such income would be subject to tax.

Assignment 4 [Client – PQR Bank Ltd.]

PQR Bank Ltd. carrying on banking business is incorporated in Country Z. It has branches in different countries including India. During the financial year 2017-18, the Indian branch of the bank paid interest of Rs. 35 lakhs and Rs. 17 lakhs, respectively, to its head office in Country Z and to the branch office in Country N. It wants to know whether interest so paid shall be liable to tax in India in the hands of head office and Country N branch.

Assignment 5 [Client – Mahesh Sharma]

Mahesh Sharma, a citizen of India, is a musician deriving income of Rs. 12,00,000 from concerts performed in Country P. Tax of Rs. 3,36,000 was deducted at source in Country P. His income in India amounted to Rs. 45,00,000. He has deposited Rs. 75,000 in Public Provident Fund and paid medical insurance premium in respect of his father, aged 65 years, Rs. 32,000. He spent Rs. 50,000 on medical treatment of his handicapped sister, dependent on him. His father has not travelled outside India for the last 3 years. Mahesh Sharma visited Country P from 19th February, 2018 to 13th March, 2018 for giving concerts. He also visited Country S on a vacation from 2nd January, 2018 to 21st January, 2018. For the rest of the year he stays in India. He wants to know his tax liability for A.Y.2018-19.

Note - India does not have any double tax avoidance agreement with Countries L, N, P, X, Y & Z.

Based on the above facts, answer the following questions –

Multiple Choice Questions

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

1. In respect of income earned by Mr. Harry Smith in India –
 - (a) Tax is deductible at source at the rates in force under section 195
 - (b) Tax is deductible at source @30% plus cess on income from horse races and at the rates in force under section 195 on other income.
 - (c) Tax is deductible at source@30% plus cess on income from horse races and @20% plus cess on other income
 - (d) Tax is deductible at source@30% plus cess on income from horse races and income from advertisement of a product on TV, 20% plus cess on income from participation in international swimming competition in India and no tax is

- deductible at source on income from contribution of articles relating to swimming in India.
2. Assuming that the tax deductible at source, if any, has been fully deducted, does Mr. Harry Smith and Ms. Rita Smith have to file return of income in India for A.Y.2018-19?
 - (a) Yes, because they have earned income in India which is chargeable to tax as per the provisions of the Income-tax Act, 1961.
 - (b) No, because tax deductible at source has been fully deducted from income earned by them in India
 - (c) Harry Smith has to file his return of income but Rita Smith need not file her return of income
 - (d) Rita Smith has to file her return of income but Harry Smith need not file his return of income
 3. If Harry Smith had been a match referee instead of a swimmer, then, in respect of income earned by him in India (assuming the other facts remain the same) -
 - (a) Tax is deductible at source at the rates in force under section 195
 - (b) Tax is deductible at source @30% plus cess on income from horse races and at the rates in force under section 195 on other income.
 - (c) Tax is deductible at source@30% plus cess on income from horse races and @20% plus cess on other income
 - (d) Tax is deductible at source@30% plus cess on income from horse races and advertisement of a product on TV, 20% plus cess on income from participation in international swimming competition in India and no tax is deductible at source on income from contribution of articles in India.
 4. MNO Ltd. is a company -
 - (a) resident in India, since it has carried on the operation of purchase of goods in India
 - (b) non-resident in India, since its registered head office is in Country 'X'
 - (c) non-resident in India, since key management decisions are taken in Country 'X'
 - (d) non-resident in India, due to reasons stated in (b) and (c) above.
 5. The effective rate of income-tax applicable on total income of M/s. Pacific Airlines is –
 - (a) 42.024%
 - (b) 44.084%
 - (c) 43.26%
 - (d) 46.144%

6. Salary paid by M/s. Hari Om & Co. to its partners falls within the limits prescribed under section 40(b)(v). Does Hari Om & Co. have to deduct tax on salary paid to its partners?
- Yes; tax is deductible at source under section 192 on salary paid to its partners.
 - No; salary paid to partners is not subject to tax deduction at source
 - Yes; tax is deductible at source under section 192 on salary paid to resident partners and under section 195 on salary paid to the non-resident partner
 - Salary paid to resident partners is not subject to tax deduction at source; but tax has to be deducted under section 195 on salary paid to the non-resident partner
7. If Country L is a notified jurisdictional area (NJA), then, the rate at which interest receivable from India Infradebt Ltd. is taxable in the hands of Mr. Vallish and the rate at which tax has to be deducted at source on such income are –

| | Tax rate | TDS rate |
|-----|----------|----------|
| (a) | 5% | 30% |
| (b) | 5% | 5% |
| (c) | 30% | 30% |
| (d) | 30% | 5% |

Note – The above rates are exclusive of cess

8. Mr. Harish and Mr. Austin Smith have been appointed as senior officials of Country L embassy and Country Y embassy, respectively, in India in October, 2017. Mr. Harish and Mr. Austin Smith are subjects of Country L and Country Y, respectively, and are not engaged in any other business or profession in India. The remuneration received by Indian officials working in Indian embassy in Country L is exempt but in Country Y is taxable. The tax treatment of remuneration received by Mr. Harish and Mr. Austin Smith from embassies of Country L and Country Y, respectively, in India for the P.Y.2017-18 is:
- Exempt from income-tax under section 10
 - Taxable under the Income-tax Act, 1961
 - Remuneration received by Mr. Harish is exempt but remuneration received by Mr. Austin Smith is taxable
 - Remuneration received by Mr. Harish is taxable but remuneration received by Mr. Austin Smith is exempt.

9. On the subject of principles of interpretation of tax treaties, match the principles given in Column A with the description/examples given in Column B and choose the correct option:

| Column A | | Column B | |
|----------|---------------------------|----------|--|
| (i) | Subjective Interpretation | (I) | Such interpretation should not be done if it defeats the primary objective of the tax treaty as far as the particular item under consideration is concerned. |
| (ii) | Purposive Interpretation | (II) | Article 32 of Vienna Convention embodies this principle |
| (iii) | Contemporanea Expositio | (III) | Speeches of Finance Ministers of India can be relied upon to find out the common intent at the time of signing the treaties |
| (iv) | Liberal Construction | (IV) | The fact that treaties are entered into for promoting mutual trade and investment needs to be kept in mind while interpreting a treaty |
| | | (V) | Any term used in the treaty has to be interpreted according to their plain and natural meaning |
| | | (VI) | A treaty should be interpreted in a manner to have effect rather than to make it ineffective. |

| | | | | |
|-----|-----------|-----------|-------------|-----------|
| (a) | (i)→(VI) | (ii)→(V) | (iii)→(III) | (iv)→(I) |
| (b) | (i)→(III) | (ii)→(IV) | (iii)→(II) | (iv)→(VI) |
| (c) | (i)→(III) | (ii)→(IV) | (iii)→(II) | (iv)→(I) |
| (d) | (i)→(VI) | (ii)→(IV) | (iii)→(II) | (iv)→(I) |

10. On the subject of BEPS Action Plans, match the BEPS Action Plans given in Column A with the description/examples given in Column B and choose the correct option:

| Column A | | Column B | |
|----------|----------------|----------|--|
| (i) | Action Plan 5 | (I) | Controlled Foreign Corporation Rules not incorporated in the Income-tax law |
| (ii) | Action Plan 3 | (II) | Limitation of interest deduction incorporated in the Income-tax Act, 1961 |
| (iii) | Action Plan 13 | (III) | Special tax regime incorporated in the Income-tax Act, 1961 for taxation of royalty income from patents developed and registered in India |
| (iv) | Action Plan 4 | (IV) | New category "Receipt of Low Value-Adding Intra-Group services has been added in the newly notified safe harbour rules effective from A.Y.2018-19. |
| | | (V) | CBC Reporting requirement incorporated in the Income- tax Act, 1961 |
| | | (VI) | Limitation of Benefits Clause incorporated in select tax treaties for taxing capital gains on transfer of shares of an Indian company |
| | | (VII) | Equalisation Levy introduced in Indian tax regime. |
| | | (VIII) | Incorporation of secondary adjustment in transfer pricing regime |

| | | | | |
|-----|------------|----------|--------------|-----------|
| (a) | (i)→(VIII) | (ii)→(V) | (iii)→(IV) | (iv)→(II) |
| (b) | (i)→(III) | (ii)→(I) | (iii)→(V) | (iv)→(II) |
| (c) | (i)→(III) | (ii)→(I) | (iii)→(VIII) | (iv)→(II) |
| (d) | (i)→(III) | (ii)→(V) | (iii)→(VIII) | (iv)→(II) |

DESCRIPTIVE QUESTIONS

1. (a) Compute the income-tax liability of Mr. Harry Smith and Ms. Rita Smith for A.Y.2018-19.

(6 Marks)

(b) Let us suppose that there has been a failure to deduct tax at source on the amount of Rs.2 lakh paid by XYZ Ltd. to Mr. Harry Smith for advertisement of shaving cream. The Assistant Commissioner of Income-tax imposed penalty on the company for failure to deduct tax at source. The company seeks your advice on whether penalty is imposable for such failure and if so, in this case, whether such levy is in order. Examine.

(3 Marks)

2. (a) Examine whether the income of MNO Ltd. would be subject to tax in India. If so, compute the income chargeable to tax in India.

(2 Marks)

(b) Determine the income of M/s. Pacific Airlines chargeable to tax in India

(4 Marks)

(c) Examine whether the interest paid by Indian branch of PQR Bank to its head office in Country Z and branch office in Country N is liable to tax in India in the hands of the head office and Country N branch.

(3 Marks)

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

(6 Marks)

(b) Mr. Vallish is in receipt of income of Rs.2,45,000 being income distributed by a REIT. The components of income are as follows:

| | Particulars | Rs. |
|-------|---|----------|
| (i) | Rental Income from real estate property owned by REIT | 1,25,000 |
| (ii) | Interest Income of REIT from A Ltd. | 62,000 |
| (iii) | Dividend Income of REIT from A Ltd. | 58,000 |

A Ltd. is an Indian company in which the REIT holds controlling interest. The REIT holds 100% of shareholding of A Ltd.

Examine whether the above components of the income distributed by REIT would be chargeable to tax in the hands of Mr. Vallish. Also, examine whether the REIT is required to deduct tax at source on such income distributed to Mr. Vallish.

(6 Marks)

Question 2

Sigma Corporation Ltd. (SCL), is a company incorporated under the Companies Act, 2013, having factory and registered office in Mumbai. It is engaged in manufacture, purchase and sale of men's wear, selling various kinds of garment products according to the requirement of the buyers across the world. The company has sold different garment products in the Financial Year 2017-18 to different vendors in the Indian and outside Indian market, including sale of T-shirts to one its associated enterprises, namely, John Miller of UK, to whom it had sold 2,50,000 pieces at the rate of ₹ 1,000 per piece.

Major portion of the income of SCL is from sale of manufactured products. The company (SCL) maintains a gross profit margin of 30% on the selling price. However, it has purchased the T-shirts sold to its UK based associated enterprise John Miller from Mudra Garments Ltd. of Ahmedabad at a price of ₹ 840 per piece.

Following functional differences were noted between the transaction with the UK based customer and other parties:

- (a) Sales to third parties had been made with a specialized packaging for which 3% margin is included in the selling price.
- (b) Tagging on the product purchased is being required by the other clients for which cost was ₹ 3 per piece, whereas in case of sales made to John Miller of UK, no tagging is to be done.
- (c) Products sold to third parties involve a credit period of 6 months for which 0.5% per month margin on selling price is ensured by Sigma Corporation Ltd.

SCL, for the purpose of diversification, is now contemplating to expand its business operations by establishing an affiliate in the Mediterranean. Two countries under consideration of the Board of SCL are Spain and Cyprus. SCL intends to repatriate all after-tax foreign source income from the affiliate to India. In India, the corporate income/may be taken as 30 percent.

At this point, Sigma Corporation Ltd. is not certain whether it would be better to establish the affiliate operation in two countries as a branch operation or a wholly-owned subsidiary of the parent company.

In Cyprus, the marginal corporate tax rate is 20 percent and the foreign branch profits are also taxed at the same rate. In Spain, the corporate income is taxed at 25 percent and additionally, foreign branch income is also taxed at the same rate of 25 percent.

The withholding tax treaty rates with India on dividend income paid from Cyprus is 15 percent and when paid from Spain is 20 percent.

The Chief Financial Officer (CFO) of the company appraised the Board of Directors that the matters of the company pending before the tax authorities are involving several issues for which a show cause notice for A.Y. 2015-16 has been issued by the A.O. The issues of concern as has been raised in this notice in brief are:

- (i) The company has not maintained proper records of the international transactions required under the Income-tax Act, 1961 (Act) and has also defaulted in not obtaining the report of the auditors within the prescribed time.
- (ii) The transactions entered into with the associated enterprises during the previous year for determination of ALP have been referred by the AO to the TPO on 22.12.2017 for the reason of under-reporting.
- (iii) The total international transactions carried out by the company during the previous year were of ` 200 crores and why penal action should not be taken against the company for the defaults stated in para-1.

The CFO further informed that the TPO to whom a reference was made by the A.O., had of his own, selected one more, party M/s Sun Apparels for determination of the ALP, which is an un-related person and not an associated enterprise but based at UK and whether it is resident or non-resident is also not known.

SCL is contemplating to file an application for advance ruling with the Authority for Advance Ruling.

The Board of SCL now asked you to help them by advising in determination in the context of taxation provisions contained under the Act, relating to international business as prevailing

in India and other countries, as well as the expert opinion on the various issues raised in the show cause notice by the AO as appraised by the CFO.

Required:

- (a) (i) Determine the Arm's Length Price (ALP) of the transactions of sale of T-shirts during the year to the AE John Miller of UK and its probable impact on the income of the company for A.Y.2018-19.

(6 Marks)

(ii) Can TPO invoke his powers in relation to an international transaction not referred to him? Is the action taken by the TPO in relation to determination of ALP of the transactions undertaken by the company with M/s Sun Apparels of UK justified?

(4 Marks)

- (b) (i) Where and in which country should the new affiliate be situated and which organizational structure (i.e. wholly owned subsidiary or branch) is to be selected?

(7 Marks)

(ii) Discuss whether the total tax liability in Cyprus or in Spain would be the least for operating a foreign branch or a wholly owned subsidiary of the parent company.

(3 Marks)

- (c) (i) What will be the consequences for the defaults specified by the Assessing Officer in the show cause notice of not maintaining the records, not obtaining of the report from the auditors and under reporting of ALP of the international transactions?

(5 Marks)

(ii) What will be the impact on the time limit for completion of assessment by the AO because of reference so made to the TPO and if the company gets a stay for a period of 30 days over the proceedings, then, what will be the fate of the assessment proceedings?

(5 Marks)

- (d) Choose the most appropriate option for the following (option to be written in capital letters A, B, C or D)

(1) Two methods were found suitable for determination of the Arm's Length Price (ALP). As per CUP methods, it was found to be ` 1,200 per unit and as per resale price method, it was ` 1,250 per unit. The ALP per unit will be taken as

(A) ` 1,200 since it is more favourable to the assessee

(B) ` 1,250 since it is more favourable to the Department (C) ` 1,225

- (C) None of the above
- (2) An assessee having specified domestic transactions covered by section 92BA, should furnish audit report, if the value of such transactions exceeds
- (A) ` 2 crores
 - (B) ` 20 crores
 - (C) ` 10 crores
 - (D) None of the above
- (3) An assessee deriving income from profits of business of an eligible industrial undertaking for which 100% deduction is available u/s 80-1B has entered into international transactions with an associated enterprise for ` 200 crores. The TPO has made an addition of ` 15 crores in respect of the ALP. The normal GP margin is 10%. The additional deduction u/s 80-1B which can be claimed by the assessee on account of the increase in the ALP is
- (A) Nil
 - (B) ` 20 crores
 - (C) ` 25 crores
 - (D) ` 15 crores
- (4) The OECD member countries have accepted the concept of Arm's Length Price (ALP) for reaping the following benefit:
- (A) Minimises double taxation
 - (B) Real taxable profits can be determined
 - (C) Artificial price distortion is reduced
 - (D) All the three above
- (5) In the context of transfer pricing provisions, international transaction should be in the nature of
- (A) Purchase, sale or lease of tangible or intangible property
 - (B) Provision of service
 - (C) Lending or borrowing money
 - (D) Any of the above
- (6) Mr. Dhanush holds shares in both L Ltd., and M Ltd. In the context of transfer pricing provisions,
- (A) L Ltd. and M Ltd. can never be associated enterprises.
 - (B) L Ltd. and M Ltd. are deemed associated enterprises if Mr. Dhanush holds 26% or more of voting power in each of these companies.

- (C) L Ltd. and M Ltd. are deemed associated enterprises if Mr. Dhanush holds 26% or more of voting power in L Ltd., which in turn holds 26% or more of voting power in M Ltd.
- (D) L Ltd. and M Ltd. are deemed associated enterprises if Mr. Dhanush holds totally 52% or more combined voting power in both these companies.
- (7) The book value of assets of SCL is ` 200 crores, whereas the market value of the said assets is ` 80 crores. Sun Ltd. has advanced a loan of ` 45 crores. In the context of transfer pricing provisions, SCL and Sun Ltd. are
- (A) Not associated enterprises
 - (B) Associated enterprises, considering the book value of assets of SCL and its borrowings from Sun Ltd.
 - (C) Deemed to be associated enterprises, considering the book value of assets of SCL and its borrowings from Sun Ltd.
 - (D) Deemed to be associated enterprises considering the market value of assets of SCL and its borrowings from Sun Ltd.
- (8) J Ltd. is controlled by Rajeev (HUF). K Ltd. is controlled by Raghav (sole proprietor of RR & Co.), a close relative of Rajeev, a member of Rajeev (HUF). For the purpose of transfer pricing provisions,
- (A) J Ltd. and K Ltd. are deemed associated enterprises.
 - (B) Rajeev HUF, J Ltd. and K Ltd., are deemed associated enterprises.
 - (C) RR & Co., Rajeev HUF, J Ltd. and K Ltd., are deemed associated enterprises.
 - (D) There is no associate enterprise relationship involved in this.
- (9) There is an arrangement between SCL and Q Ltd., which are associated enterprises. Such arrangement is oral and is also not intended to be legally enforced. For transfer pricing purposes, such arrangement-
- (A) is not treated as a "transaction" because it is not in writing.
 - (B) is not treated as a "transaction" because it is not intended to be legally enforced.
 - (C) is treated as a "transaction".
 - (D) is not treated as a "transaction" for (A) and (B) above.
- (10) The ALP determined by the TPO for some product is ` 2,000 per unit sold by SCL. Considering the tolerance band permitted by the CBDT, the tolerated international transaction price for a transaction with an associated enterprise can be upto
- (A) ` 1,960

- (B) ` 2,040
 - (C) ` 2,060
 - (D) None of the above
- (11) Following can be an applicant for advance ruling:
- (A) Non-resident entering into a transaction
 - (B) Resident entering into a transaction with a non-resident
 - (C) Resident entering into a transaction with another resident
 - (D) (A) or (B)
- (12) An applicant for advance ruling may withdraw an application within days from the date of the application.
- (A) 30
 - (B) 60
 - (C) 90
 - (D) 120
- (13) Composition of AAR is as under:
- (A) A Chairman, Vice-Chairman and Revenue Member
 - (B) A Chairman, Vice-Chairman and Law Member
 - (C) A Chairman and such number of Vice-Chairman, Revenue Members and Law Members as the Central Government may, by notification, appoint.
 - (D) Chairman, Vice-Chairman, Law Member and Revenue Member
- (14) Following can make an application for advance ruling:
- (A) Department
 - (B) Applicant
 - (C) Central Government
 - (D) All above
- (15) Application for advance ruling is not allowed in the following situations:
- (A) When the question involved is already pending before any income-tax authority.
 - (B) Where it is for determining the fair market value of a property.
 - (C) Excepting in exceptions, where the transaction in question is designed for avoidance of tax.
 - (D) Any one of the above

(1 x 15 = 15 Marks)

- (e) Fill up blanks:
- (i) The applicant desiring roll back of the APA may furnish the request for rollback provision in Form No. 3CEDA with proof of payment of an additional fee of _____
 - (ii) The transfer pricing provisions contained in Section 92 shall not apply if the same has the effect of _____ chargeable to tax.
 - (iii) If there is an arrangement between SCL and TFL (an associate enterprise) for mark up of a semi-finished product and sale thereafter, the ideal method for determining the ALP is _____ method.
 - (iv) In a case where the aggregate value of international transactions exceeds ` _____ , it will be obligatory for the assessee to maintain the stipulated information and documents required for transfer pricing purposes.
 - (v) Where SCL has maintained proper records and documents, and the TPO has made some adjustments to the ALP, thereby increasing the total income by, say, ` 2.68 crores, the penalty leviable u/s 270A will be ` _____.

(1 x 5 = 5 Marks)

Question 3

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 INR 75,000, INR 82,000 and INR 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 straighteners 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 INR 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 straighteners and 1500 units of hair curlers to customers based in India. The hair dryer was priced at INR 2,500 while the hair curler was priced at INR 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.

Additional facts:

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 INR 30,00,000, which is paid to Google Inc. in March, 2018 for online advertising services.

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:

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 straighteners 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 INR 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 consent
 - (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

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 are 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 | INR 400 lakhs | INR 100 lakhs | INR 210 lakhs |
| Number of employees | 30 | 10 | 20 |
| Payroll expenses on employees | INR 160 lakhs | INR 35 lakhs | INR 65 lakhs |
| Number of Board Meetings | 10 | 2 | 4 |

| Particulars | INR |
|--|-----------|
| 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) Examine 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)