

ELECTIVE PAPER 6C: INTERNATIONAL TAXATION

CASE STUDY - 3

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?
 - (a) Yes; tax is deductible at source under section 192 on salary paid to its partners.
 - (b) No; salary paid to partners is not subject to tax deduction at source
 - (c) 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
 - (d) 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)	<i>Contemporanea Expositio</i>	(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)**