TAXATION OF NON-RESIDENTS

[Based on the law as amended by the Finance Act, 2020]

Committee on International Taxation

The Institute of Chartered Accountants of India

(*Set up by an Act of Parliament*)

New Delhi

First Edition	:	January, 2005
Second Edition	:	February, 2013
Third Edition	:	September, 2018
Fourth Edition	:	February, 2021
Committee / Department	:	Committee on International Taxation
E-mail	:	citax@icai.org
Website	:	www.icai.org
Price	:	₹ 330/-
ISBN No	:	978-81-87080-61-9
Published by	:	Publication Department on behalf of The Institute of Chartered Accountants of India, ICAI Bhawan, Post Box No. 7100, Indraprastha Marg, New Delhi-110002
Printed by	:	

Foreword to the Fourth Edition

Economic integration has the power to boost the cross border trade, reduction in cost, improving the supply chain systems and enhancing the living standards of society. It creates both opportunities and challenges. On one hand it has increased the level of presence and profits of multi-national enterprises and on the other hand it has opened up the new tax challenges to deal with. The traditional concept of capital export and capital import neutrality has now been outdated in the digital age. In the present situation mobility of capital has increased which helps the investor to change their investment very easily which is challenging for the certainty and simplicity of domestic taxation system. Every country is concerned with its own national interest and wants to tax fair share of profit to raise the revenue base.

Indian income-tax has witnessed notable amendments in past few years for improving revenue leakages and making tax laws more simplified and certain. With the increasing relevance of subject matter for our chartered accountants, the Institute of Chartered Accountants of India (ICAI) has made available various publications on the issues of international taxation. One of such publications is this fourth edition of "Taxation of Non-resident". The purpose of this revised edition is to provide comprehensive understanding on the subject of non-resident taxation which will enable the members to maintain the professional excellence.

I would like to express my gratitude to CA. Nandkishore Chidamber Hegde, Chairman and CA. G. Sekar, Vice-Chairman, Committee on International Taxation of ICAI for the initiative taken to revise the said publication.

I am sure that this publication would be of immense use for our members dealing with the issues of taxability of non-resident.

Best Wishes,

Place: New Delhi **CA. Atul Kumar Gupta**

Date : 5 February, 2021 ***President, ICAI***

Preface to the Fourth Edition

During the recent few decades international business has undergone paradigm changes. With the growth of multinationals as vehicle of international trade the business has become integrated. Globalisation of economy combined with digitalisation of business is impacting not only the way business is being and to be conducted but has impacted whole social framework. Pandemic of 2020 has expedited digitalisation beyond widest of expectations. Everything appears to become virtual. Work-from-home (WFH) has come closer to almost all homes. All these are and are going to impact the concepts of taxation which were till recent considered sacrosanct. The area of taxation which is impacted most is international taxation. This includes the typology of taxation for non-resident, which largely depends on business model which itself is changing. The ever changing business model has become necessity to build a competitive advantage mostly in this technology driven environment. A physical or representative presence-based on permanent establishment principle, has failed to keep pace with the evolving and ever-sophisticated business models that rely mostly on digital means to earn profits. Today a non-resident can carry out transactions in the source state without having any significant physical presence there. As there may not be central point, or physical location, for such a transaction and thus, it may not fall within any country's jurisdiction for taxation purposes. Multinational enterprises, due to their presence in multiple jurisdictions having various taxation models – ranging from tax havens to jurisdictions with tough tax laws and administrations – are able to structure their transactions with minimum possible effective taxation. Consequently, countries are concerned about their tax base being eroded due to shifting of profits. G-20 and the Organisation for Economic Cooperation and Development (OECD) have appreciated this and have come out with 15 Action Plans dealing with various aspects of taxation.

Considering the changing business model, taxation of business profits has become one of the key issues for policy makers and business leaders. There could not be a global uniform method for attribution of business profits of a PE. Thus, these business models opened up possibilities of double taxation or double non-taxation. Considering the recommendation made by OECD

under the BEPS Action Plans, India has gradually amended its domestic law to implement the actions under the BEPS project.

Bearing in mind the need the need to provide updated consolidated knowledge about taxation laws for non-resident in India, the Committee on International Taxation thought it fit to bring out the fourth revised edition of Taxation of Non-Resident. This publication provides an overall understanding of taxation of non-resident along with all the recent developments taken place.

I am sincerely thankful to CA. Atul Kumar Gupta, President, ICAI and CA. Nihar Niranjan Jambusaria, Vice-President, ICAI for being guiding force behind all initiatives being taken by the Committee.

I also whole heartedly acknowledge the efforts of CA. Nidhi Goyal, Co-opted member of the Committee and CA. Kriti Chawla Khanna, Special invitee in the Committee, who have thoroughly revised the publication. They were actively assisted by CA. Himanshu Mehta. I am also thankful to CA. Sachin Sastakar, Co-opted member who spared his valuable time in reviewing the revised publication.

I am also appreciative of the efforts undertaken by Mr. S.P. Singh, Ex-IRS in overall reviewing this publication with his insights of taxation. Notably, Mr. S.P. Singh participated in the international tax policy making during the early years of opening-up of the Indian economy, and then in its implementation as part of the tax department and later as a tax consultant. He has been a part of the team that conceptualized Transfer Pricing law introduced in India. I am also thankful to CA Sharad Goyal, with several years of experience in international taxation, who actively assisted Mr. S.P.Singh in this task, ensuring quality and duly considering all inputs. Without their dedicated efforts this publication could not have been released in a timely manner.

I am also grateful for the unstinted support provided by Vice-Chairman CA. G. Sekar and also other Committee Council members CA. Tarun Jamnadas Ghia, CA. Chandrashekhar Vasant Chitale, CA. Dayaniwas Sharma, CA. Rajendra Kumar P, CA. Sushil Kumar Goyal, CA. Anuj Goyal, CA. Kemisha Soni, CA. Satish Kumar Gupta, CA. Hans Raj Chugh, CA. Pramod Jain, CA. (Dr.) Sanjeev Kumar Singhal, CA. Charanjot Singh Nanda, Shri Manoj Pandey, Shri Chandra Wadhwa, Dr. Ravi Gupta; *Co-opted members*: CA. T.P.Ostwal; CA. Ujwal Nagnath Landge, CA. B.M.Agrawal, CA. Nidhi Goyal and *Special Invitees:* CA. Amar Deep Singhal .

Last, but not the least, I appreciate the efforts undertaken by CA. Mukta Kathuria Verma, Secretary, Committee on International Taxation and CA. Dhiraj Shrivastav, Project Associate for co-ordinating the project and for rendering secretarial assistance.

I am hopeful that this revised edition will be of immense use to the members.

Place: New Delhi
Date: 5 February, 2021

CA. Nandkishore Chidamber Hegde
Chairman,
Committee on International Taxation, ICAI

Foreword to the Third Edition

With the increased flow of technology and human capital across the borders, non-resident taxation has been throwing up a variety of issues. These issues have increased manifold over a period of time since there have been constant changes in domestic tax law and the Double Taxation Avoidance Agreements which majorly govern the non-resident taxation.

Considering the importance of the subject and also the need to update our members in respect of non-resident taxation, the Committee on International Taxation of ICAI has revised this publication. This publication provides an excellent insight into various aspects of taxation of non-residents.

I congratulate Chairman, Committee on International taxation and Vice-Chairman, Committee on International taxation for undertaking the task of revision of such an important publication. I am sure that in respect of complex laws pertaining to non-residents, this publication will provide the intended conceptual clarity to the readers.

Wishing all readers a delightful learning experience.

Place: New Delhi
Date : 05.09.2018

CA. Naveen N.D. Gupta
President, ICAI

Preface to the Third Edition

The first edition of the Taxation of Non-Residents was published in 2005 which was thereafter revised in February 2013. Given the significant increase in cross border investment and the changes made in the tax regime for non-residents, there was a need to revise the Publication. The Committee on International Taxation therefore, decided to bring out this revised edition for its members.

I sincerely appreciate the efforts put in by CA. Rajesh Patil, CA. Vidya Shetty, CA. Rakhi Thakkar, CA. Bhavishi Vichhi, CA Rushabh Barbhaya, CA Shuchi Ray, CA Amit Dattani, CA Parag Gor, CA Namratha Shenoy, CA Yash Karia, CA Hussain Udaipurwala and Khyati Saini in revising this publication comprehensively.

I also thank President, ICAI and Vice President, ICAI for being a guiding force all through.

I thank Vice Chairman, Committee on International Taxation and members of the Committee for the support and guidance provided by them.

I also appreciate the efforts of CA. Mukta Kathuria Verma, Deputy Secretary, CA. Vikas Kumar, Assistant Secretary and the entire Secretariat of Committee on International Taxation for providing editorial and administrative assistance in co-ordinating the project.

I am sure that the members of the profession will find this publication useful and hope that, this revised version will be able to meet its intended purpose.

CA. Nandkishore Chidamber Hegde
Chairman
Committee on International Taxation, ICAI

Place: New Delhi
Date: 05.09.2018

Foreword to the Second Edition

The advent of economic reforms in the form of globalization and liberalization in our country has resulted in the rapid growth of the economy in general and cross border transactions in particular. The process of globalization is set to gain further impetus with the good performance of the economy in recent past. There has been manifold increase in the cross border activities of Indian and MNCs business entities in the manufacturing and service sectors.

Realising the increasing importance of the issues relating to taxation of non-residents, the Committee on International Taxation has brought out this revised publication which gives a good insight into the various aspects of taxation of non-residents.

I express my gratitude and appreciation to CA. Mahesh P. Sarda, Chairman, Committee on International Taxation of ICAI for the initiative taken to revise the publication.

I am sure this book will be immensely useful and benefit all its readers by providing an insight into the complex aspects of taxation of non-resident with due clarity on the subject matter and in a simplified manner.

Place: New Delhi
Date: 11th February, 2013

CA. Jaydeep Narendra Shah
President, ICAI

Preface to the Second Edition

The first edition of the Taxation of Non-Residents was published in 2005. Thereafter, enacted as well as judge made law has undergone significant changes. With globalization and liberalization, movement of men and capital had also grown manifold. Therefore, urgent need to update the publication was widely felt.

The Committee on International Taxation therefore decided to bring out this revised edition for its members.

I am happy to state that CA. (Prof.) Tarun Chaturvedi readily accepted our request to revise the edition. The revised edition would not have seen light of the day without his untiring efforts. His contribution cannot be effectively appreciated through the medium of words. He has been ably supported by CA. Vandana Bhandari. I place on record our sincere appreciation of the contribution made by both of them.

My thanks are due to former Central Council Member CA. H.N. Motiwala for carrying out the vetting.

CA. Jaydeep N. Shah, President and CA. Subodh Kumar Agarwal, Vice-President have been the guiding and inspiring force.

I thank members of the Committee for immense support provided by them.

I appreciate the efforts made by Mr. Ashish Bhansali, Secretary of the Committee on International Taxation for co-ordination and CA. Govind Agarwal for rendering secretarial assistance.

I believe the efforts in bringing out this publication will get amply rewarded if it proves to be useful to members of the Institute.

Place: New Delhi
Date: 11th February, 2013

CA. Mahesh P. Sarda
Chairman,
Committee on International Taxation, ICAI

Foreword to the First Edition

Taxation is a dynamic area which moves in tandem with economic development. The economic policies framed by the Government from time to time have a great impact on taxation. Consequential changes are constantly being made in the taxation laws to cope with the rapid developments in the economy.

The opening up of the Indian economy and its globalisation has resulted in far reaching changes. The inflow of funds from foreign institutional investors and non-residents has led to the emergence of taxation of non-residents as an extremely important topic in the current context.

Realising the increasing importance of the issues relating to taxation of non-residents, the Fiscal Laws Committee has brought out this timely publication which gives a good insight into the various aspects of taxation of non-residents.

I congratulate Mr. H. N. Motiwalla, Chairman, Fiscal Laws Committee for the hard work put in by him for providing the basic draft and also the Fiscal Laws Committee for its initiative. I am sure that this publication will be of immense use to the readers.

Date: 4th January, 2005
Place: New Delhi

Sunil Goyal
President

Preface to the First Edition

The dimensions of the issues relating to taxation of non-residents of late have vastly expanded. The enormous increase in the cross border transactions, the inflow of funds from foreign institutional investors, the entry of multinational corporations in the Indian economy and the emergence of business process outsourcing have made the subject of taxation of non-residents extremely important and absorbing.

The scope of total income of a resident and ordinarily resident includes domestic income as well as income arising or accruing abroad. However, in the case of non-residents only that income which has a domestic connection is chargeable to tax. There are statutory provisions to determine the income that is taxable in the hands of a non-resident and also complex deeming provisions. A proper study of these provisions and of the important judicial decisions explaining the scope of these provisions is necessary for understanding the tax implications.

Considering the importance of the subject, the Fiscal Laws Committee decided to bring out this publication which comprehensively discusses the statutory provisions as well as important judicial decisions relating thereto for the benefit of the members.

It is my pleasure to say that Shri Sunil Goyal, President and Shri Kamlesh Vikamsey, Vice-President have been the guiding force behind the entire process. My sincere thanks for both of them for their constant encouragement.

On behalf of the Fiscal Laws Committee I thank Mr. H. N. Motiwalla, FCA, Mumbai for preparing the basic draft of the publication in the most competent manner covering all the facets of the law relating to taxation of non-residents. I also thank Mr. T. N. Manoharan, FCA, Chennai for his valuable suggestions. I thank the members of the Fiscal Laws Committee for their valuable cooperation in finalising this publication.

I also compliment Mr. R. Devarajan, Secretary, Fiscal Laws Committee for coordinating this project and Mr. Y.S. Rawat, Sr. Steno-typist for rendering secretarial assistance.

I am sure that the members of our profession will find this publication to be of immense use.

Date: 4th January, 2005. **Ved Jain**
Place: New Delhi. **Vice-Chairman**

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Residential Status

Scope of Total Income

The term "total income" has been defined in section 2 (45) of the Income-tax Act, 1961 ("the Act") as, "the total amount of income referred to in section 5, computed in the manner laid down in the Act". Therefore, while computing the total income, one has to have regard to the scope of income as specified in section 5 of the Act and then compute the income in the manner laid down in the Act. Section 5 prescribes scope of taxable total income for residents, not ordinarily residents and non-residents. Since the scope of taxable income and the tax liability varies with the residential status of the assessee it is important to determine the residential status of the assessee. The residential status has to be determined in accordance with section 6 of the Act.

Scope of Total Income – Residents – Section 5 (1)

Persons who are 'Resident" are charged to tax on –

(a) income received or deemed to be received in India in the accounting year, by or on behalf of such person, the date or place of its accrual being immaterial [section 5(1)(a)].

(b) Income which accrues or is deemed to accrue or arise in India during the accounting year, the date or place of its receipt being immaterial [section 5(1)(b)].

(c) Income which accrues or arise outside India during the accounting year, even if it is not received in or brought into India [section 5(1)(c)]

Scope of Total Income – Not Ordinarily Residents

Persons not ordinarily resident in India, are assessed exactly in the same manner as persons who are resident but subject to one special exemption. Persons who are not ordinarily resident are chargeable in respect of all the three items of income enumerated above, but they are exempt from tax in respect of income accruing or arising outside India unless it is derived from a business controlled in or a profession or vocation set up in India. [proviso to section 5 (1)]

Scope of Total Income – Non Residents

Persons who are not resident in India in the previous year are charged to tax on–

(a) income received or deemed to be received in India in the previous year, by or on behalf of such person, the date or place of its accrual being immaterial [section 5(2)(a)];

(b) income which accrues or arises or is deemed to accrue or arise in India during the previous year, the date or place of its receipt being immaterial [section 5(2)(b)];

To sum up, all assessees, whether resident or not, are chargeable in respect of income accruing or arising , or deemed to accrue or arise or received or deemed to be received, in India; while residents alone are chargeable in respect of income which accrues or arises and is received outside India.

Residence in India

Principle

The term "resident" as defined in section 2(42) of the Act, "means a person who is resident in India within the meaning of section 6"; while the term "non-resident" is defined in section 2 (30) as "a person who is not a "resident" and for purposes of section 92, 93, and 168, includes a person who is not ordinarily resident within the meaning of clause (6) of section 6". As noted in section 5 of the Act, the incidence of tax varies with the residential status of the taxable entity; therefore, the first step while determining the tax liability of an assessee is to determine its residential status in accordance with section 6.Individuals and HUF are divided into 3 residential categories - (i) Resident; (ii) Not ordinarily resident; (iii) Non-Resident. All other taxable entities can be either (i) Resident; or (ii) Non-Resident.

Clause (1) of section 6 lays down the tests for 'Resident'; all those who do not satisfy this test would be non-residents; as defined in section 2(30). Test of residence is applied in each previous year; the finding of the status of 'Resident' during one previous year does not automatically make one 'Resident' during the next year.

Test for Individual – Resident

Clause (1) of section 6 lays down two alternative tests for an individual to

qualify as 'Resident' in India; on satisfying either of them, an individual becomes Resident in India (excepting the cases covered by explanation):

Test 1: Clause (1)(a)

If during the relevant previous year, he is physically present in India for a period aggregating to 182 days or more; or

Test 2: Clause (1)(c)

If he is physically present in India for a period aggregating to 365 days or more in the 4 immediately preceding years and 60 days or more in the relevant previous year.

Meaning of India

As per section 2(25A) "India" means the territory of India as referred to in article 1 of the Constitution, its territorial waters, seabed and subsoil underlying such waters, continental shelf, exclusive economic zone or any other maritime zone as referred to in the Territorial Waters, Continental Shelf, Exclusive Economic Zone and other Maritime Zones Act, 1976 (80 of 1976), and the air space above its territory and territorial waters.

The aforesaid rule of residence is subject to exceptions. By virtue of Explanation 1 (a) to section 6(1) in the case of an Indian citizen who leaves India in the relevant previous year as a member of the crew of an Indian ship as defined in section 3(18) of the Merchant Shipping Act, 1958 or for the purpose of employment outside India, the period of 60 days referred to in section 6(1) (c) will be extended to 182 days.

Explanation 1 (b) grants a beneficial regime to Non-Resident Indians who come to visit India in any previous year. In such a situation, 60 days referred to in section 6 (1) (c) will be extended to 182 days. However, with effect from Financial Year starting on 1 April 2020, if the said persons have total income, other than the income from foreign sources, exceeding fifteen lakhs rupees during the previous year, then 60 days mentioned above will be substituted by 120 days.

As per Explanation 2 (inserted with effect from April 1, 2015), while, in the case of an Indian citizen and a member of the crew of a foreign bound ship leaving India, the period of stay in India shall in respect of such voyage, be determined in the manner and subject to such conditions as prescribed under Rule 126 of Income-tax Rules, 1962.

Clause 1A, added by the Finance Act, 2020, provides that notwithstanding anything contained in clause (1), an individual, being a citizen of India, having total income, other than the income from foreign sources, exceeding fifteen lakh rupees during the previous year shall be deemed to be resident in India in that previous year, if he is not liable to tax in any other country or territory by reason of his domicile or residence or any other criteria of similar nature.

An Explanation to clause 1A has been inserted by the Taxation and Other Laws (Relaxation and Amendment of Certain Provisions) Act, 2020, for the Financial Year starting from 1 April 2020, which provides that *"for the removal of doubts, it is hereby declared that this clause shall not apply in case of an individual who is said to be resident in India in the previous year under clause (1)*".

As per Rule 126, the period or periods of stay in India, in respect of an eligible voyage, will not include the period beginning on the date entered into the Continuous Discharge Certificate in respect of joining the ship by the individual and ending on the date entered into this certificate in respect of signing off by that individual from the ship in respect of that voyage. Terms viz. Continuous Discharge Certificate and eligible voyage in the context of shipping activities are also separately defined under the above Rules.

Therefore, an Indian citizen or a person of Indian origin (not having total income, other than the income from foreign sources, exceeding fifteen lakh rupees during the previous year) can stay in India upto 364 days in two years, if he plans his visit in such way.

For the purposes of this section, the expression 'income from foreign sources' means income which accrues or arises outside India (except income derived from a business controlled in or a profession set up in India) and which is not deemed to accrue or arise in India.

If the assessee's stay in India is of the requisite duration, he would be deemed to be a resident although he may put up at hotels, and not always at the same hotel, and never for long together.

Again, a person might well be compelled to reside here completely against his will, the exigencies of business often forbid the choice of residence, and though a man may make his home elsewhere and stay in this country only because business compels him nonetheless, if the conditions of section 6 are satisfied he must be held to be a resident. In law a man may be resident in

two different countries, in the same year, although he can have only one domicile.

As per the clarification issued by the CBDT on 08 May 2020, for determining the residential status during the previous year 2019-20, in respect of an individual will not include:

- the period of lockdown post March 22, 2020, in case he was unable to leave India
- his period of quarantine on or after March 1, 2020
- the period of stay in India from March 22, 2020 to his departure if he has departed on an evacuation flight on or before March 31, 2020,

Important Judicial Precedents & Board Circulars:

1. Indian members of the crew of a foreign going Indian ship would be non-resident in India, if they are on board such ship outside the territorial waters of India for 182 days or more during any year. Accordingly, such seaman will be charged to tax in India only in respect of earnings received in India or the earnings for the period when they are working within Indian waters on coastal ships etc [Circular No. 586, dated November 28, 1990]
2. While deciding the residential status of an assessee, the Assessing Officer should consider the provisions of both sections 6(1)(a) and 6(1)(c) and this is mandatory requirement of law [Vijay Mallya v. ACIT [2003] 263 ITR 41 (Calcutta HC)]. Each of the two tests requires the personal presence of the assessee in India in the course of the previous year.
3. The Bombay High Court in CIT v. Indo Oceanic Shipping Co. Ltd. [2001] 247 ITR 247 has, held that, merely because the contract is entered in India, it will not be the conclusive test to decide as to whether an employee was employed in India or outside India. The terms of the contract, the nature of the work, the nature of business and all other relevant facts are required to be considered to decide as to whether the employment was in India or outside India. There is no merit in the contention of the department that for the purposes of the Act, remuneration paid to an employee working on an Indian ship would show that the employee was employed in India and not outside India. There was also no merit in departments' contention that ship bearing Indian flag constitutes Indian territory and remains so even

when it goes outside territorial waters of the country. Indian ships operating beyond Indian territorial waters do not come within the term "India" as defined in section 2(25A).

4. For calculating period of stay in India for the purpose of determining residential status of an individual under section 6(1)(a) number of days during which he was present in India in a previous year including days of arrival and departure have to be taken into account. Even if for some hours on these dates a person can be said to have been out of India, it would have to be taken that, the person was in India on these dates however short the period may be. [See P. No. 7 of 1995, In re. [1997] 223 ITR 462 (AAR Delhi)]

5. The Delhi High Court in CIT v. Suresh Nanda [2015] 375 ITR 172 has held that in determining the residential status of assessee in India during relevant assessment year, number of days of his forced stay due to untenable impounding of assessee's passport were to be excluded while computing days of his stay in India for purposes of Section 6(1)(a) of the Act. This ruling does not seem to be consistent

6. As Rowlart J. observed in Levene V.I.R. (13 TC 468) a complete wanderer, an absolute tramp or a rich person of the same type wandering from hotel to hotel and never staying two nights in the same place may still be a resident although he cannot be called a resident in any particular spot. Stay on a yacht moved in the territorial waters of India would be stay in India for the purpose of section 6.

7. For the purpose of Explanation (a) to section 6(1)(c), 'employment' includes self employment like business or profession taken up by assessee abroad [CIT v. O. Abdul Razak [2011] 337 ITR 350 (Kerela HC) & ACIT v. Jyotinder Singh Randhawa [2014] 64 SOT 323 (Delhi Tribunal)]

8. Return to India after resigning from job abroad is not visit to India under explanation (b) to section 6(1)(c). [Mrs. Smita Anand, China In re [2014] 362 ITR 38 (AAR)]

9. A careful reading of Explanation (a) would show that the requirement of the Explanation is not leaving India for employment but it is leaving India for the purposes of employment outside India. For the purpose of the Explanation (a), an individual need not be an unemployed person who leaves India for employment outside India. [British Gas India (P.) Ltd., In re [2006] 285 ITR 218 (AAR)]

10. In K. Sambasiva Rao v. ITO [2014] 62 SOT 167, the Hyderabad Tribunal has held that for the purpose of determining residential status in India under section 6, the term 'going abroad for purpose of employment' means travelling abroad on business visa to take up any employment or for any business carried outside India.

Test for Individual- Not Ordinarily Resident

An individual is taxed as 'not ordinarily resident' if he fulfills any of the two alternative conditions laid down in clause (6)(a) of section 6 i.e.

(i) he has been non-resident in India in nine out of the ten previous years preceding the relevant previous year; or

(ii) he has during the seven previous years preceding that year been in India for a period aggregating to 729 days or less. Also, as inserted w.e.f. assessment year 01.02.2021, a citizen of India who is deemed to be resident in India under clause (1A) or as per Explanation 1 to clause (1), an Indian citizen or a person of Indian origin visiting India and having total income, other than income from foreign sources (except income derived from a business controlled in or a profession set up in India), exceeding INR 15 lakhs during the previous year shall qualify as NOR in India, if his/ her stay is 120 days or more but less than 182 days in India during the previous year.

In other words an Individual remains 'Resident' if both the conditions mentioned in section 6(6)(a) remain unsatisfied. Thus an Individual is classified as 'Resident' when in addition to any one of the conditions specified in section 6(1), both the following conditions are fulfilled:

(i) he has been resident in India in at least two out of the ten years preceding the relevant previous year; and

(ii) he has during the seven years preceding that year been in India aggregating to at least 730 days.

Important Judicial Precedents & Board Circulars:

1. Due to declaration of the lockdown and suspension of international flights owing to outbreak of Novel Corona Virus (COVID-19), people were required to prolong their stay in India. Concerns were expressed that this extra stay in India may make them a resident of India under section 6 of the Act.

In order to avoid genuine hardship in such cases, the Board, in exercise of powers conferred under section 119 of the Act, has decided that for the purpose of determining the residential status under section 6 of the Act during the previous year 2019-20 in respect of an individual who has come to India on a visit before March 22, 2020 and:

(a) has been unable to leave India on or before March 31, 2020, his period of stay in India from March 22, 2020 to March 31, 2020 shall not be taken into account; or

(b) has been quarantined in India on account of Novel Corona Virus (Covid-19) on or after 1 March, 2020 and has departed on an evacuation flight on or before 31 March, 2020 or has been unable to leave India on or before 31 March, 2020, his period of stay from the beginning of his quarantine to his date of departure or 31 March, 2020, as the case may be, shall not be taken into account; or

(c) has departed on an evacuation flight on or before 31 March, 2020, his period of stay in India from 22 March, 2020 to his date of departure shall not be taken into account. [Circular No. 11 dated 8 May 2020 on COVID-19 times]

2. Under the second part of sec 6(6)(a) the relevant condition is that the Individual's aggregate physical presence in India should not have exceeded 729 days; it cannot be construed to mean that absence from India for an aggregate period of over 729 days during the preceding 7 years qualified the assessee to be taxed as 'resident but not ordinarily resident' [Munibhai v CIT [1953] 23 ITR 27 (Bombay HC)]

3. The expression four years preceding should be taken as referring to the period of four years of 12 calendar months each, immediately preceding the commencement of the relevant accounting year and not to the period of four calendar years ending on 31Dec immediately preceding the commencement of such year. [CIT v Savumiamurthy [1946] 14 ITR 185 (Madras HC)]

Test for HUF/Firm/AOP etc. – Resident

A Hindu undivided family, firm, or association of persons etc is resident in India if the control and management of its affairs is situated wholly or partly in India. But if the control and management is situated wholly outside India,

then, a HUF, Firm, AOP etc is to be regarded as non-resident. Since partial control is sufficient for the purpose of being resident, these forms of person may have in law two places of residence.

The residence of partners or of individual members of a Hindu undivided family or association of persons is immaterial for the purpose of determining the residence of the firm or the family or AOP except in so far as such residence affects the control and management of the affairs of the firm or the family.

The residence of partners in India normally raises the presumption that the firm is resident in India, but the presumption may be rebutted by showing that the control and management of the affairs of the firm is situated wholly outside India.

Test for HUF – Not Ordinarily Resident

It may be noted that in order to determine whether a Hindu Undivided family is 'not ordinary resident', the residential status of the Karta of the family has to be considered on the basis of criteria laid down for individual under Clause (6)(b) to section 6.

Important Judicial Precedents & Board Circulars:

The leading case on the construction of section 6(2) is Subbayya Chettiar v. CIT, [1951] 19 ITR 168 (SC), which was concerned with the residence of a Hindu undivided family. In this case, the Supreme Court laid down the following proposition:

(i) Normally a Hindu undivided family is presumed to be resident in India unless assessee proves that the control and management of affairs is situated wholly outside India

(ii) The word "affairs" in sub section (2) means affairs which are relevant for the purpose of this Act and which have some relation to the income sought to be assessed.

(iii) The seat of the management and control of the affairs of the family may be divided and if so, the family may have more than one residence.

(iv) If the seat of management and control is abroad, it would need much more than have 'activities' in India to support a finding that the seat of management and control has been started in India. Occasional or sporadic visit of a non-resident karta to the place where the family

business is carried on in India, or causal directions given in respect of the business while on such visits would be insufficient to make the family resident in India.

So, the mere receipt in India, by the Karta or a partner of copies of the business books would not by itself amount to exercise of control. Nor is the business necessarily controlled and managed at the place where the accounts are submitted, and the division of profits decided on.

Test for Company

Two alternative tests are provided for determining the residence of a company. A company is resident in India: if (i) it is an Indian company [defined in sec 2(26)] or (ii) its place of effective management ('PoEM'), in that year, is in India.

Thus, each Indian company, as that expression is defined in section 2(26) is deemed to be resident in India even if its control and management is situated wholly or partly abroad, while a non-Indian company is deemed to be resident only if its PoEM is in India. The PoEM, criterial for the determination of residency has been made applicable for assessment years commencing on or after 1 April 2017.

POEM has been defined to mean a place where key management and commercial decisions that are necessary for the conduct of business of an entity as a whole are, in substance made.

The CBDT has issued the final Guidelines for the determination of PoEM vide Circular No.6 of 2017 dated 24 January 2017, which are summarized as below:

i. General principles

- The determination of PoEM depends on the facts and circumstances of a given case.
- It recognizes the concept of substance over form.
- The place of effective management differs from a place of management and an entity can have only one place of effective management at any point of time.
- The determination of PoEM shall be an annual exercise.

- The process of determining PoEM would be primarily based on the fact whether or not the company is engaged in active business outside India.

ii. Active business outside India

- A company is said to be engaged in active business outside India if the passive income is not more than 50% of its total income; and-

  a) Less than 50% of its total assets are situated in India; and

  b) Less than 50% of total number of employees are situated / resident in India; and

  c) Payroll expenses incurred on such employees is less than 50% of its total payroll expenditure

The said guidelines further explain the terms 'income', 'value of assets', 'number of employees', 'payroll' used for the determination of active business outside India.

- It has been clarified that any income by way of interest shall not be considered as passive income in case of company engaged in the business of banking or is a public financial institution (PFIs), and its activities are regulated as such under the applicable laws of the country of incorporation.
- In case of a company engaged in an active business outside India, the PoEM shall be presumed to be outside India if the majority of board meetings of the company are held outside India.
- Where it is established that such powers of management are exercised by the holding company / other person(s) resident in India, then the PoEM shall be in India.
- For this purpose, merely because the Board of Directors (BOD) follows general and objective principles of global policy of the group laid down by the parent entity which may be in the field of pay-roll functions, Accounting, Human resource (HR) functions, IT infrastructure and network platforms, Supply chain functions, Routine banking operational procedures, and not

being specific to any entity or group of entities per se; would not constitute a case of Board of Directors of the company standing aside.

iii. Other cases (i.e., Companies not engaged in active business outside India)

- In case of companies other than those engaged in active business outside India, the determination of PoEM would be a two stage process, namely:
  - a) Identification or ascertaining of person (s) who actually make the key management and commercial decisions for conduct of the company's business as a whole; and
  - b) Determination of place where these decisions are in fact being made.
- The place where the key management and commercial decisions are taken would be more important than the place where such decisions are implemented.

As regards the determination of PoEM in case of companies other than those engaged in active business outside India, specific guiding principles are provided such as location of Board meetings, location of Head office, etc., which are as covered below:

Location of Board Meeting

- The location where a company's Board meets regularly and makes decisions would be relevant provided that the Board:
  - i. Retains and exercises its authority to govern the company; and
  - ii. Does, in substance, make the key management and commercial decisions necessary for the conduct of the company's business as a whole.

Delegation by Board

- Where the Company's Board delegates some/all of its authority to a committee (s) consisting of key members of senior management, PoEM would be the location where the members of the committee are based and where it develops and

formulates the key strategies for mere formal approval by the full Board.

Location of Head Office

- The location of a company's head office will be a very important factor as it often represents the place where key decisions are made. The Guidelines provide for various points which are to be considered for determination of the location of Head office depending on whether the management is centralized or decentralized and cases where the members of the senior management participate in meetings via telephone or video conferencing.

Meetings through Video Conference / technology

- The use of modern technology may not necessitate persons taking decisions to be physically present at a particular location. Therefore physical location of board meeting or executive committee meeting or meeting of senior management may not be where the key decisions are in substance being made. In such cases, the place where the directors or the persons taking the decisions or majority of them usually reside may also be a relevant factor.

Circular resolution or round robin voting

- In case decisions are made through circular resolutions or round robin voting, the frequency with which it is used, the type of decisions made in that manner and where the parties involved in those decisions are located etc. needs to be considered. The location of the person who has the authority and who exercises the authority to take decisions would be more important in determination of PoEM.

Shareholders activity

- Decisions taken by the shareholder, which are reserved for them under the company law, which typically affect the existence of the company itself or the rights of the shareholders as such (rather than the conduct of the company's business from a management or commercial perspective) are not relevant for the determination of PoEM.

- Whether the shareholder involvement is crossing the line into that of effective management is one of fact and has to be determined on case-to-case basis only.

Secondary factors

- If the above factors do not lead to clear identification of PoEM, secondary factors such as place where main and substantial activity of the company is carried out or place where the accounting records of the company are kept can be considered.

Non-relevant factors

- Day to day routine operational decisions in relation to oversight of the day-to-day business operations and activities of a company undertaken by junior and middle management shall not be relevant for the purpose of determination of PoEM.

The Guidelines emphasize that the determination of PoEM is based on all the relevant facts rather than on isolated facts. The following examples illustrate where PoEM is not established based on isolated facts-

- the fact that a foreign company is completely owned by an Indian Company
- the fact that there exist a Permanent Establishment of a foreign company in India
- cases where one / some of the directors of a foreign company reside in India
- the fact of local management situated in India in respect of activities carried out by a foreign company in India
- the existence of support function in India that are preparatory and auxiliary

Additional clarifications provided

- The place where management decisions are taken would be more important than the place where such decisions are implemented.

- The principles for determining PoEM are only for guidance purposes and no principle is decisive in itself.
- The activities performed over a period of time, during the previous year, needs to be considered. A 'snapshot' approach is not to be adopted.
- In cases where PoEM is determined to be in India and also outside India, then the PoEM shall be presumed to be in India if it has been mainly / predominantly in India.

Administrative safeguards

Administrative safeguards have been incorporated in the Guidelines by mandating that the Assessing Officer ('AO') before initiating inquiry for PoEM in the case of a taxpayer, shall seek approval from Principal Commissioner / Commissioner. The AO shall also obtain approval from Collegium of Principal Commissioners of Income-tax before holding that PoEM of a non-resident Company is in India. The collegium so constituted shall provide an opportunity of being heard to the company before issuing any directions in the matter.

Illustrations

The Guidelines also includes illustrations on interpretation and determination of PoEM. Specifically, the illustration clarifies that,

i. Only transactions where both purchase and sale is from/to associated enterprise needs to be considered in computing passive income;

ii. All conditions viz. income, value of assets and number of employee in India and payroll expenses needs to be seen on a collective basis.

iii. For a company engaged in active business outside India, even in a case wherein all the directors are Indian residents, the PoEM shall be presumed to be outside India if the majority of the board meetings have been held outside India.

iv. In case shareholders involvement results in effective management of the Company, then the same needs to be considered in determination of PoEM.

v. Merely because the PoEM of an intermediate holding company is in India, the PoEM of its subsidiaries shall not be taken to be in India. Each subsidiary needs to be examined separately.

Thus, the Guidelines provide more clarity on,

- Transactions with associated enterprises;
- Shareholder activity;
- Adoption of global policy laid down by the parent company;
- Circular resolutions / round robin voting;
- Scope of operational decisions;
- Interest income of Banks/ Public Financial Institutions for determination of passive income;
- Examination of certain terms used in the determination of active business outside India.

The CBDT vide press release dated 24 January 2017 read with circular no.8 of 2017 dated 23 February 2017 stated that the aforementioned guidelines shall not apply to companies having turnover or gross receipts of INR 50 crore or less in a financial year. Further, the CBDT vide circular no. 25 of 2017 dated 23 October 2017 clarified that so long as the regional headquarter in India operates for subsidiaries/group companies in a region within the general and objective principles of global policy of the group laid down by the parent entity in the field of pay roll functions, accounting, human resource functions, IT infrastructure and network platforms, supply chain functions, routine banking operational procedures, and not being specific to any entity or group entities per se; it would, in itself, not constitute a case of PoEM. For a company engaged in active business outside India, the POEM will be presumed to be outside India if a majority of the meetings of the board of directors of the company are held outside India. However, if it is established that the board of directors are standing aside and not exercising their powers of management, and such powers are being exercised by either the holding company or any other person resident in India, then the POEM shall be considered to be in India. Thus, a parent company laying down the standard policies and guidance for support of its group entities will not trigger PoEM.

As per section 115JH of the Act, computation mechanism for computing total income, treatment of unabsorbed depreciation, set-off or carry forward and set-off of losses, collection and recovery and special provisions relating to avoidance of tax in respect of such foreign company said to be resident in India were to be notified. In this connection, CBDT has issued notification no. 29/2018 dated June 22, 2018.

Important Judicial Precedents:

1. In AB Holdings In re [2018] 90 taxmann.com 177 (AAR - New Delhi), the findings of the AAR which may be relevant for determination of PoEM are:

   - Mr. S was the MD in C Group and a director in the applicant and other group companies. Hence, his persuasive influence on the investment decisions of the company, irrespective of his location was logical.
   - With advancement of technology, it cannot be expected that all directors would be physically present for all meetings.
   - Nevertheless, Mr. S had visited India and Mauritius few times during period of decision making.
   - Control and management wasn't solely dependent on Mr. S. Other directors were qualified enough.
   - Minutes of Board meetings were signed by the Mauritian resident Directors, which showed that meetings were held in Mauritius.
   - When a Director signs an agreement or a resolution, it has to be assumed that he is in the know of things and represents a company decision regarding purchase of shares, unless something is amiss in the document itself or is done on hindsight, is backdated or is deduced from some unwritten clauses.
   - Certificate from tax authorities, address in returns and conduct of Board meetings showed that office/ place of management of the Applicant was in Mauritius.
   - in the case of Investment companies, investment decisions do not require huge offices and staff.

- Applicant was the legal and beneficial shareholder in the investee companies.
- Held, in favour of the assessee.

2. In AB Mauritius, In Re [2018] 90 taxmann.com 182 (AAR – New Delhi), the findings of the AAR which may be relevant for determination of PoEM are:

- No independent decisions taken regarding where and in which sector the investments were to be made, leave alone the quantum and the source thereof.
- The BoD merely reiterated what the holding company had decided. Similarly, the FIPB approval at best only shows the intent of the holding company
- SPA was a tripartite agreement between C Group, the sellers (AB Inc. and US Inc.) and the applicant. SPA signed by the MD of C group and not by any directors of applicant.
- No mention in SPA of how the applicant was going to fund the acquisition. This showed that applicant was not a party to the investment decision making.
- Letter of Authorisation for Mr. S was produced for the first time in 2016 which made it obvious that it was to plug the loophole of absence of authorization for Mr. S at the time of actual investment.
- Investment decisions are made after appropriate deliberation by BoD. SPA should have complete details about consideration paid and in whose name shares are transferred.
- Inspite of the significant investment by the assessee, there was no mention on the liability incurred by it for this acquisition.
- This makes it clear that the applicant's name was only superimposed in the SPA
- Point of time of acquisition to be seen and not subsequent events.
- On facts, no connection between loan agreement and SPA.

- The BoD of the applicant were informed about the investment decision by Mr. S, a year after it was done.
- Hence, BoD was neither managing nor controlling its crucial investment decisions, for which it was stated to be set up.

Different Sources of Income

Sec 6(5) provides that, if a person is resident in India in a previous year relevant to an assessment year in respect of any source of income, he shall be deemed to be resident in India in the previous year relevant to the assessment year in respect of each of his other sources of income.

Chapter 2
Income Deemed to Accrue or Arise in India

Under section 5(1), a resident is chargeable to income tax in respect of income from whatever source derived which is received or is deemed to be received in India in such previous year by or on behalf of such person, or which accrues or arises or is deemed to accrue or arise to him in India during such year or accrues or arises to him outside India during such year.

As per section 5(2) a non-resident is chargeable to income tax in respect of income from whatever source derived which is received or is deemed to be received in India in such previous year by or on behalf of such person, or which accrues or arises or is deemed to accrue or arise to him in India during such year.

Section 9(1) deems certain income, in the circumstances mentioned therein, as income accruing or arising in India. The provisions do not apply to the income which actually accrues or arises to the assessee in India.

Sub section (1) to section 9 has clauses (i) to (vii) enumerating various categories of incomes which shall be deemed to accrue or arise in India. Clause (i) states: "all income accruing or arising, whether directly or indirectly, through or from any business connection in India, or through or from any property in India, or through or from any asset or source of income in India, or through the transfer of a capital asset situate in India". It provides four different sources, from which if income accrues or arises, directly or indirectly, is deemed to accrue or arise in India:

a) through or from any business connection in India, or

b) through or from any property in India, or

c) through or from any asset or source of income, in India; or

d) through the transfer of a capital asset situate in India.

Specific Cases when Income shall not be deemed to Accrue or Arise under Clause (i)

1) Clause (a) to explanation 1 restricts the scope of taxability in the case of business (other than the business having business connection in India on account of significant economic presence) of which all the operations are not carried out in India, to only such part of income as is reasonably attributable to the operations carried out in India.

   Therefore, in case of business of which some operations are carried outside India (other than those having business connection on account of significant economic presence), the income attributable to operations carried outside India shall not be taxed in India.

2) in the case of a non-resident, no income shall be deemed to accrue or arise in India to him through or from operations which are confined to the purchase of goods in India for the purpose of export;

3) in the case of a non-resident, being a person engaged in the business of running a news agency or of publishing newspapers, magazines or journals, no income shall be deemed to accrue or arise in India to him through or from activities which are confined to the collection of news and views in India for transmission out of India;

4) in the case of a non-resident, being—

   (a) an individual who is not a citizen of India ; or

   (b) a firm which does not have any partner who is a citizen of India or who is resident in India ; or

   (c) a company which does not have any shareholder who is a citizen of India or who is resident in India,

   no income shall be deemed to accrue or arise in India to such individual, firm or company through or from operations which are confined to the shooting of any cinematograph film in India

5) In the case of a foreign company engaged in the business of mining of diamonds, no income shall be deemed to accrue or arise in India through or from the activities which are confined to the display of uncut and unassorted diamond (without any sorting or sale) in the

special zone notified by the Central Government in the Official Gazette in this behalf.

Business Connection

Explanation 2 has been inserted to section 9(1)(i) of the Income tax Act, 1961 with effect from assessment year 2004-05, to define the term business connection. Clause (a) to the said Explanation has been amended by the Finance Act 2018 w.e.f 1.4.2019. Now, therefore, the term 'business connection' shall include any business activity carried out through a person if:

(i) the person is acting on behalf of the non-resident; and

(ii) the person:

(a) has and habitually exercises in India an authority to conclude contracts on behalf of the non-resident or habitually concludes contracts or habitually plays the principal role leading to conclusion of contracts by that non-resident and the contracts are-

- in the name of the non-resident or
- for the transfer of the ownership of, or for the granting of the right to use, property owned by that non-resident or that non-resident has the right to use; or
- for the provision of services by the non-resident; or

(b) has no such authority, but habitually maintains in India a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the non-resident; or

(c) habitually secures orders in India, mainly or wholly for the non-resident and other non-residents controlling, controlled by or subject to the same common control, as that non-resident.

It appears that the aforesaid amendments are effected to align the provisions to those in the tax treaties, which will shortly be subject to modification by India through a Multi-Lateral Instrument ('MLI') route.

The 'business connection', however, shall not be held to be established in cases:

(i) where the non-resident carries on business through a broker, general commission agent or any other agent of an independent status; and

(ii) if such broker, general commission agent or any other agent of an independent status is acting in the ordinary course of his business.

For this purpose, it is further provided that where such broker, commission agent or any other agent works mainly or wholly on behalf of a non-resident (hereafter in this proviso referred to as the principal non-resident) or on behalf of that non-resident and other non-resident which are controlled by the principal non-resident or have a controlling interest in the principal non-resident or are subject to the same common control as the principal non-resident, he shall not be deemed to be a broker, general commission agent or an agent of an independent status.

A reference of this definition has been given in section 163 of the Act also. Thus, for the purpose of section 163 of the Act business connection shall also include the aforesaid agent.

Business connection can exist in number of ways e.g., branch, agency, subsidiary, local assistance etc; there cannot be laid down an exhaustive list of the business arrangements between the entities giving rise to business connection.

Explanation 2A to section 9(1)(i) of the Income tax Act, 1961 has been omitted w.e.f. FY 2020-21 and replaced with new Explanation 2A by the Finance Act 2020 w.e.f 1.4.2022 (i.e. assessment year 2022-23) that the significant economic presence of a non-resident in India shall constitute "business connection" in India and "significant economic presence" for this purpose, shall mean-

(a) transaction in respect of any goods, services or property carried out by a non-resident with any person in India including provision of download of data or software in India, if the aggregate of payments arising from such transaction or transactions during the previous year exceeds such amount as may be prescribed; or

(b) systematic and continuous soliciting of business activities or engaging in interaction with such number of users in India, as may be prescribed:

Provided that the transactions or activities shall constitute significant economic presence in India, whether or not-

(i) the agreement for such transactions or activities is entered in India; or

(ii) the non-resident has a residence or place of business in India; or

(iii) the non-resident renders services in India:

Provided further that only so much of income as is attributable to the transactions or activities referred to in clause (a) or clause (b) shall be deemed to accrue or arise in India.

Explanation 3 restricts the scope of taxability in case of business carried on in India through a person referred to in clause (a) or clause (b) or clause (c) of Explanation 2 to only so much income as is attributable to the operations carried out in India.

Explanation 3A has widened the concept of income attributable to the operation carried out in India by including the following income w.e.f. 1.4.2021 (assessment year 2021-22):

(i) such advertisement which targets a customer who resides in India or a customer who accesses the advertisement through internet protocol address located in India;

(ii) sale of data collected from a person who resides in India or from a person who uses internet protocol address located in India; and

(iii) sale of goods or services using data collected from a person who resides in India or from a person who uses internet protocol address located in India.

Provided that the provisions contained in this Explanation shall also apply to the income attributable to the transactions or activities referred to in Explanation 2A [this has been inserted w.e.f. 1.4.2022 (Assessment year 2022-23)].

The standard corporate income tax rate is 40% for foreign companies and branches of foreign companies. Taking into account any applicable surcharge and cess, the effective rate is 43.68% for foreign companies.

Foreign companies may be eligible for a lower rate of tax with respect to income like royalty, fee for technical services and interest under the applicable double taxation avoidance treaties.

Important Judicial Precedents & Board Circulars:

1. The meaning of the expression 'business connection' is not restricted by the definition of 'business' contained in section 2(13) of the Act. 'Business connection' is not equivalent to carrying on a business. A

business connection involves a relation between a business carried on by a non-resident which yields profits or gains and some activity in India which contributes directly or indirectly to the earning of those profits or gains. It predicates an element of continuity between the business of the non-resident and the activity in India. The expression 'business connection' in this section is an expression of wide import and it is both exclusive and inclusive. The term business connection predicates an element of continuity between the business of the non-resident and the activity in the taxable territories: A stray or isolated transaction is normally not to be regarded as a business connection. Business connection may take several forms: it may include carrying on a part of the main business or activity incidental to the non resident through an agent or it may merely be a relation between the business of the non resident and the activity in the taxable territory which facilitates or assists the carrying on of that business. A relation to be a business connection must be real and intimate. [CIT v. R. D. Aggarwal and Co. [1956] 56 ITR 20 (SC)]

2. The Apex Court in GVK Industries Ltd. v. ITO [2015] 371 ITR 453 reiterating the principles laid down in R.D. Aggarwal and also while affirming the decision of Andhra Pradesh High Court has laid down the following principles of business connection:

   i. Whether there is a business connection between an Indian person and a non-resident is a mixed question of fact and law which has to be determined on the facts and circumstances of each case;

   ii. The expression business connection is too wide to admit of any precise definition; however, it has some well known attributes;

   iii. The essence of business connection is the existence of close, real, intimate relationship and commonness of interest between the non-resident and the Indian person;

   iv. Where there is control or management or finances or substantial holding of equity shares or sharing of profits by the non-resident of the Indian person, the requirement of principle (iii) is fulfilled;

   v. To constitute business connection there must be continuity of activity or operation of the non- resident with the Indian party and a stray or isolated transaction is not enough to establish a business connection.

3. The Apex Court in Anglo-French Textile Co. Ltd. v. CIT [1953] 23 ITR 101 has held that activities which are not well-defined or are of a casual or isolated character would not ordinarily fall within the ambit of the words "Business Connection". An isolated transaction between a non-resident and a resident in British India without any course of dealings such as might fairly be described as a business transaction does not attract the application of section 42, but when there is a continuity of business relationship between the person in British India who helps to make the profits and the person outside British India who receives or realizes the profits, such relationship does constitute a business connection.

4. In CIT v. National Mutual Life Association of Australasia [1933] 1 ITR 350, the Bombay High Court noted that a relation to be a 'business connection' must be real and intimate and through or from which income must accrue or arise whether directly or indirectly to non-resident. All that is necessary is that, there should be (i) a business in India, (ii) a connection between non-resident person or company and that 'business' and (iii) that the non-resident person or company has earned income through such connection.

5. The distribution income earned by the assessee cannot be taxed in India because Taj India does not constitute an agency Permanent Establishment under the terms of Article 5(4) of the DTAA. [Commissioner of Income Tax (It) -4 Versus Taj TV Limited 2020 (3) (Bombay HC)]

6. It is not necessary that the profit or gain should directly flow from the business connection; it is deemed to be the income of the assessee, who may well be a non-resident, even if it has arisen indirectly through the business connection in India [CIT v. Evans Medical Supplies Ltd. [1959] 36 ITR 418 (Bombay HC)].

7. The word 'business' in the expression 'business connection' of widest import and an inclusive one and it means an activity carried on continuously and systematically by a person by the application of his labour or skill, with a view to earn income. It does not necessarily mean trade or manufacture only. It is used as including within its scope profession, vocations and callings from a fairly long time. Professions are generally regarded as business. Thus, it also include 'professional connection' [Barendra Prasad Ray v. ITO [1981] 129 ITR 295 (SC)].

8. To conform with the requirements of the expression 'business connection', it is necessary that a common thread of mutual interest must run through the fabric of the trading activity carried on outside and inside India and the same can be described as 'real and intimate connection'. The commonness of interest may be by way of management control or financial control or by way of sharing of profits. It may come into existence in some other manner but there must be something more than mere transaction of purchase and sale between principal and principal in order to bring the transaction within the purview of 'business connection' [CIT v. Hindustan Shipyard Ltd. 109 ITR 158 (Andhra Pradesh HC)].

9. In CIT v. Nike Inc. [2014] 264 CTR 508, Karnataka High Court laid down that Nike USA was not carrying on any business & activities of India. Liaison Office (LO) was not taxable in India under section 5 as well as under section 9. Contract between manufacturer and Nike USA entered into outside India, no income accrued or arose in India. Mere activity of purchase from India confined to exports also does not create deeming charge under section 9.

10. The assessee company had entered into two agreements with a foreign company for the latter's supply of machinery, equipment, instruments and spare parts and rendering technical co-operation during the construction of the former plant at Vishakhapatnam. The technical co-operation spread over a period of years, involved, inter-alia, rendering services for constructions of the plant, deputation of foreign experts to India, assigning production rights, continued exchange of information, supply of personnel and training of local personnel. The Andhra Pradesh High Court in Bharat Heavy Plate & Vessels Ltd., [1979] 119 ITR 986, held that the two agreements in question secured a continuous and intimate business relation of two parties, thereby establishing non-resident's business connection in India. Further, the assessee could be treated as an agent of the non-resident.

11. Similarly, in Great Lakes Carbon Corporation v. CIT [1993] 202 ITR 64 (Calcutta HC), under an agreement, the assessee, a non resident company, agreed to erect a plant for an Indian company in India for the production of graphite and rendering services in connection therewith. Employees of the assessee company were deputed for work in India. An agreement between the assessee – company and

its employees showed that the employees who had been sent to India continued to the assessee company's employees. Certain amounts were received by the assessee company from an Indian company for the services rendered by the former's employees. It has been held that a part of the amounts so received by the assessee company could be deemed to accrue or arise in India.

12. In order to constitute a 'business connection' there must be some continuity of relationship between a person who receives them. [Bangalore Woollen Cotton & Silk Mills Co. Ltd. v. CIT [1950] 18 ITR 423 (Madras HC)]

13. Maintaining in India branch office for the purchase or sale of goods or transacting other business [Roger's Pyan Shellac & Co. v. Sea of State (11 TC 363)].

14. Appointing an agent, who may not be the sole agent, in the country for systematic and regular purchase of raw materials or other commodities or for sale of the non-resident's goods or for other purposes. [Anglo French Textile Co. Ltd. v. CIT [1953] 23 ITR 101 (SC)].

15. Close financial association between a resident and or non-resident company [CIT v. Bombay Trust Corp. Ltd. AIR 1930 PC 54]

16. The Indian company was a subsidiary to an American company. In respect of profits made by the American company through the Indian company by sale of the machines sent by the former to the latter, as also in respect of the dividends received by the American company from its shareholding in the Indian company, it was held that a "business connection" did exist so as to make the Indian company liable as a statutory agent to pay tax on these incomes of the American company [CIT v. Remington Typewriter Co. (Bombay) Ltd. [1930] 5 ITC 177 (PC)].

17. In Blue Star Engineering Co. (Born) P. Ltd. v. CIT [1969] 73 ITR 283, the Bombay High Court held that the assessee's activity corresponded to an organization set up by the foreign company in India for the purpose of ensuring a regular and proper supply of raw, material and part played by the assessee in the activity of procurement of raw material was real and intimate part which contributed to the improvement of the profits of the foreign company.

18. The assessee company was appointed as an agent of a German firm, a non-resident, for mediating export transactions of the products of the German firm manufactured in Germany. It was held that there was a business connection between the assessee and the German firm [Biyani & Sons P. Ltd. v. CIT [1979] 120 ITR 887 (Calcutta HC)].

19. In view of the continue process in respect of the series of purchase and sale transactions undertaken by the applicant and its subsidiary in India there exist an intimate and continuous relationship which constitutes a business connection for the purpose of section 9(1)(c). [Advance Ruling Application No. P-8 of 1995, In re [1997] 223 ITR 416 (AAR)].

20. An Indian exporter sold tobacco abroad through non-resident sales agents (assessees). Sales agents were entitled to commission, as per agreement, sale price received on sale abroad was remitted wholly to Indian exporter who debited commission account and credited amount of commission payable to non-resident agents (i.e. assessees). Amount of commission was later remitted to non-resident agents. It was held the non-resident assessees did not carry on any business operations in the taxable territories. They acted as selling agents outside India. The receipt in India of the sale proceeds of tobacco remitted or caused to be remitted by the purchasers from abroad did not amount to an operation carried out by the assessee in India as contemplated by clause (a) of the Explanation to section 9(1)(i). The commission amounts which were earned by the non-resident assessees for services rendered outside India could not, therefore, be deemed to be incomes which had either accrued or arisen in India. [CIT v Toshoku Ltd [1980] 125 ITR 525 (SC)]

21. The entire transaction having been completed on the high seas, the profits on sale did not arise in India. Only such part of income, as is attributable to the operations carried out in India can be taxed in India as contemplated in Explanation 1(a) of section 9(1)(i);.....Since all parts of the transaction in question, i.e. the transfer of property in goods as well as the payment, were carried out outside the Indian soil, the transaction could not have been taxed in India;.... The fact that the contract was signed in India is of no material consequence, since all activities in connection with the offshore supply are carried outside India, and therefore cannot be deemed to accrue or arise in India;... Clause (a) of Explanation 1 to section 9(1)(i) states that only

such part of the income as is attributable to the operations carried out in India, are taxable in India. [Ishikawajma-Harima Heavy Industries Ltd [2007] 288 ITR 408 (SC) followed by Delhi HC in DIT v. LG Cable Ltd. [2011] 237 CTR 438 and DIT v. Ericsson A.B [2012] 343 ITR 470]

22. In Asia Satellite Telecommunication Co. Ltd. [2010] 232 CTR 177 (Delhi HC), the assessee, a non-resident company engaged in operating telecommunication satellites, under an agreement, leased out transponder capacity to TV channel companies and was broadcasting various programmes in India via its satellite. The revenue's argument was that the relaying of the programmes in India amounted to the operations carried out in India and sought to tax it u/s 9(1)(i)/(iv). The hon'ble HC held that argument was not sustainable. Merely because the footprint area included India and the ultimate consumers/viewers were watching the programmes in India, even when they were uplinked and relayed outside India, would not mean that the assessee was carrying out its business operations in India. No man, material or machinery or any combination thereof was used by the assessee in the Indian territory, therefore amount cannot be taxed u/s 9(1)(i)

23. In Carborandum Co. v. CIT [1977] 108 ITR 335 (SC), an American company rendered service to the Indian company for the starting of a factory in India in the shape of examination of the factory design and layout prepared by the latter, and sending its advice by post. The pamphlets and bulletins incorporating the result of research made by the American company were also furnished to the Indian company by post. The American company made the services of the foreign technical personal available to Indian company. The Indian company employed such personnel in India on the basis of various agreements of employment entered into between the Indian company and such personnel. They were employees of the Indian company for their day to day work. It was held that the services rendered by the American company were wholly and solely rendered outside India and, therefore, the technical services fees paid by the Indian company to the American company did not accrue or arise in India nor could it be deemed to have accrued or arisen in India.

24. Similarly, in CIT v. Navbharat Ferro Alloys Ltd. [2000] 244 ITR 261 (Andhra Pradesh HC), an Indian company purchased machinery from

a foreign company. The foreign company had no other interest in the Indian company except that the sale of machinery, accessories and deputation of personnel for the erection of the same and putting into operation. It could not be said that there was a business connection between the foreign company and Indian company within the meaning of section 9.

Property, Asset or Source of Income in India

The next limb of section 9(1)(i) is that, all income accruing or arising directly or indirectly through or from any property in India shall be deemed to accrue or arise in India.

The third limb of section 9(1)(i) is, income through or from any asset or source in India, shall be deemed to accrue or arise in India.

In Cairn UK Holdings Ltd. v. DCIT (Intl. Taxation) [2017] 79 taxmann.com 128, Delhi Tribunal held that as the Indian Wholly owned subsidiary ('WOS'), which controls the oil and gas sector in India, will be regarded as the property in which the shareholders have the right to manage and control the business in India. Therefore, any income arising through or from any property in India shall be chargeable to tax as income deemed to accrue or arise in India in terms of the indirect transfer provisions under section 9(1)(i) of the Act.

The Delhi High Court in the case of CUB pty Limited (formerly known as Foster's Australia Ltd.) vs. UOI & Ors [2016] 388 ITR 617 held that the location of IPRs to be determined based on the location of its owner. Accordingly, the income was held to be not taxable in India.

In the above case, IPRs such as logos, brands, trademarks, which were capital assets (intangible assets) were used in India. AAR considering the said fact pattern held that the IPRs pertain to India as they were used in India, nurtured in India and some of them were registered in India. Thus, the same had taken roots in India and were therefore completely situated in India. These observations of the AAR were overturned by the Delhi High Court.

The Bombay High Court in Kusumben D. Mahadevi v. CIT [1963] 47 ITR 214 has held that expression "source" in section 9(1)(i) and the expression "heads of income' in section 14 are used in one and the same sense and it means property, movable or immovable, belonging to an assessee or the

activity of an assessee that yields or brings income to him, within the meaning of that Act.

Further, the court has also pointed out that the word "source" used in relation to a dividend income can have more than one meaning. In the sense as pointed out above, the source of dividend income is the packet of shares held by an assessee which brings the said income to him. Speaking generally, the source of dividend income may mean the fund out of which the dividend is paid to an assessee.

Even if there is no known or disclosed source of income, the income may still be deemed to have accrued to a non-resident in India from undisclosed source if it is actually found in the hands of statutory agent having nexus or relationship, with the non-resident principle [Hazoora Singh v. CIT, 160 ITR 746 (Punj)].

Transfer of Capital Asset Situated in India

In terms of section 9, the transfer of capital asset situated in India is deemed income.

Important Judicial Precedents & Board Circulars:

1. In terms of section 9 the transfer of capital asset situated in India has been brought within the purview of the deemed income under section 9 and rule 10(2), it is clear that the intention of the Parliament was not to bring within its purview any income derived out of sale or purchase of a capital asset effected outside India. The profits therefore, arising from the sale of capital assets located outside India were to be excluded from the income of the assessee. Thus, profits arising to the assessee from the sale of capital assets outside India were to be excluded from the assessee's income. [CIT v. Quantas Airways Ltd. [2002] 256 ITR 84 (Delhi HC)].

2. Transfer of shares of a foreign company which has an Indian Company as its subsidiary does not amount to transfer of any capital asset situated in India within meaning of 4th limb of section 9(1)(i). Legal fiction in section 9(1)(i) does not mean that if a foreign company has a subsidiary in India, shares of foreign company are deemed to be situated in India. Section 9(1)(i) is not a 'look through' provision and, thus, it cannot by a process of interpretation be extended to cover indirect transfers of capital assets/property situated in India. Source in relation to an income is construed to be where

transaction of sale takes place and not where item of value, which was subject of transaction, was acquired or derived from.

Even otherwise, since there was an offshore transaction between two non-resident companies, and, subject-matter of transaction was transfer of another non-resident company, Indian tax authorities had no territorial tax jurisdiction under section 9(1)(i) to tax said offshore transaction. [Vodafone International Holdings B.V v. UOI [2012] 341 ITR 1 (SC)]

Board's Clarifications

The Central Board of Direct Taxes has clarified vide its circular no. 23 [F. No. 7A/38/69-IT (A-II)] dated July 23, 1969, the applicability of provisions of section 9 as under:

(i) Non-resident exporters selling goods from abroad to Indian importers:

No liability will arise on accrual basis to the non-resident on the profits made by him where the transactions of sale between the two parties are on a principal to principal basis.

(ii) Non-resident company selling goods from abroad to its Indian subsidiary:

In such a case, if the transaction are actually on a principal to principal basis and are at arm's length and the subsidiary company functions and carries on business on its own instead of functioning as an agent of the parent company, the mere fact that the Indian company is a subsidiary of the non-resident company will not be considered a valid ground for invoking section 9 for assessing the non-resident.

(iii) Sale of plant & machinery to an Indian importer on installment basis:

Where the transaction of sale and purchase is on a principal to principal basis and the exporter and the importer have no other business connection, the fact that the exporter allows the importer to pay for the plant and machinery installments will not, by itself, render the exporter liable to tax on the ground that the income is deemed to arise to him in India.

(iv) Foreign agents of Indian exporters:-

Where a foreign agent of Indian exporter operates in his own country and his commission is usually remitted directly to him and is, therefore, not received by him or on his behalf in India. Such an agent is not liable to income in India on the commission.

(v) Sales by a non-resident to Indian customers either directly or through agents:

(a) Where non-resident allows an Indian customer facilities of extended credit for payment, there would be no assessment merely for this reason provided that (i) the contracts to sell were made outside India; and (ii) the sales were made on a principal to principal basis.

(b) Where a non-resident has an agent in India and makes sales directly to Indian customers, section 9 of the Act will not be invoked, even if the non-resident pays his agent an overriding commission on all sales to India, provided that (i) the agent neither performs nor undertakes to perform any service directly or indirectly in respect of these direct sales: (ii) the contracts to sell are made outside India, and (iii) the sales are made on a principal to principal basis.

(c) Where a non resident's sales to Indian customers are secured though the services of an agent in India, the assessment in India of the income arising out of the transaction will be limited to the amount of profit which is attributable to the agents's service, provided that (i) the non-resident principal's business activities in India are wholly channeled through his agents, (ii) the contracts to sell are made outside India, and (iii) the sales are made on a principal to principal basis.

(d) Where a non-resident principal's business activities in India are not wholly channeled through his agent in India the assessment in India will be on the sum total of the amount of profits attributable to his agent's activities in India, and the amount of profit attributable to his own activities in India less the expenses incurred in making the sales.

(vi) Extent of the profit assessable under section 9:

If a non resident has a business connection in India, it is only the portion of the profit which can be reasonably be attributed to the operations of the business carried out in India, which is liable to income tax.

The above circular no. 23 dated July 23,1969 and subsequent circulars providing clarification on circular no. 23 viz circular no. 163 dated May 29, 1975 and No. 786, dated February 7, 2000 have been withdrawn by CBDT by Circular no. 7/2009 [F. NO. 500/135/2007-FTD-I], dated October 22, 2009 with the reasoning that interpretation of the Circular by some of the taxpayers to claim relief is not in accordance with the provisions of section 9 of the Income-tax Act, 1961 or the intention behind the issuance of the Circular.

It should be noted that circular no. 23 was only clarificatory in nature therefore withdrawal of the same does not impair the interpretation of the provisions of the Act.

Further, the Board vide its circular no. 382 [F.No. 484/12/78FD] dated May 4, 1984 has clarified that where shares in Indian companies are allotted to non-resident in consideration for machinery and plant, the income embedded in payment would be received in India as the shares in the Indian companies are located in India and would accordingly attract liability to income tax as income received in India.

The Finance Act 2012 has inserted explanation 4 and 5 to section 9(1)(i). The explanation 4 clarifies that the expression "through" used in section 9(1)(i) mean and include "by means of", "in consequence of" or "by reason of".

The object of adding this explanation is to avoid frivolous arguments adopted by the assessee that income deemed to accrue or arise is not through business connection or source of income in India.

Explanation 5 to section 9(1)(i) clarifies that an asset or a capital asset being any share or interest in a company or entity registered or incorporated outside India shall be deemed to be and shall always be deemed to have been situated in India, if the share or interest derives, directly or indirectly, its value substantially from the assets located in India;

These amendments will take effect retrospectively from April 1, 1962 and will, accordingly, apply in relation to the assessment year 1962-1963 and subsequent assessment years

However, the said explanation 5 shall not apply to the below mentioned categories-

i. To an asset or capital asset which is held by a non-resident by way of investment, directly or indirectly in a Foreign Institutional Investor ('FII') as referred to in explanation to section 115AD of the Act (for assessment years falling in between April 1, 2012 and April 1, 2015)

ii. To an asset or capital asset, which is held by a non-resident by way of investment, directly or indirectly, in Category-I and Cateogry II Foreign portfolio investor ('FPI') under the Securities and Exchange Board of India ('SEBI') [FPI] Regulations, 2014 made under the SEBI Act, 1992 (inserted with effect from April 1, 2015)

iii. To an asset or capital asset, which is held by a non-resident by way of investment, directly or indirectly, in Category-I foreign portfolio investor under the Securities and Exchange Board of India (Foreign Portfolio Investors) Regulations, 2019, made under the Securities and Exchange Board of India Act, 1992." (15 of 1992.)

Circular no. 28 of 2017 dated November 7, 2017 provides that explanation 5 shall not apply in respect of income accruing or arising to a non-resident on account of redemption or buyback of its share or interest held indirectly (i.e. through upstream entities registered or incorporated outside India) in the specified funds if such income accrues or arises from or in consequence of transfer of shares or securities held in India by the specified funds and such income is chargeable to tax in India. However, the above benefit shall be applicable only in those cases where the proceeds of redemption or buyback arising to the non-resident do not exceed the pro-rata share of the non-resident in the total consideration realized by the specified funds from the said transfer of shares or securities in India.

Circular no.4/2015 dated March 26, 2015 provides that declaration of dividend by a foreign company outside India in respect of shares which derive their value substantially from assets situated in India would not be deemed to be income accruing or arising in India by virtue of the provisions of Explanation 5 above.

Further, explanation 6 to section 9(1)(i) provides that the share or interest shall be deemed to derive its value substantially from the assets (whether tangible or intangible) located in India, if on the specified date, the value of such assets exceeds the amount of ten crore rupees and represents at least 50% of the value of all the assets owned by the company or entity as the case may be.

The same has been reiterated by the AAR while analyzing the exception mentioned in explanation 6 in the case of GEA Refrigeration Technologies GmbH, In re [2018] 401 ITR 115

The value of an asset shall be the fair market value as on the specified date, without reduction of liabilities, if any, in respect of the asset, determined in such manner as may be prescribed. CBDT vide notification no. 55/2016 [F.No. 142/26/2015-TPL]/SO 2226 (E), dated June 28, 2016 has notified Income-tax (19th Amendment), Rules, 2016 ('Indirect transfer rules'), which prescribes the manner of determination of fair market value in various cases and also reporting requirement for Indian concern viz. insertion of rules 11UB, 11UC, 114DB, Form no. 3CT and Form no. 49D. These rules were to

come into effect from June 28, 2016. These rules basically prescribe the rules for computation of FMV of tangible and intangible assets of an Indian company or entity held directly or indirectly by a foreign company or entity on the specified date as well as for computation of FMV of all the assets of a foreign company or an entity on the specified date. Similarly, the said rules also provide for determination of income attributable to assets in India. Rule 114DB lays down the information and documents to be furnished by the Indian concern for reporting the indirect transfer under section 285A of the Act. The transferor of the share of, or interest in, a company or an entity that derives its value substantially from assets located in India, shall obtain and furnish along with the return of income a report in Form No.3CT duly signed and verified by an accountant providing the basis of the apportionment in accordance with the formula and certifying that the income attributable to assets located in India has been correctly computed. The Indian concern whose shares have been indirectly transferred is required to report the same in the Form 49D within 90 days of the end of the financial year in which any transfer of the share of, or interest in "foreign company or entity" has taken place and where the transaction in respect of the share or the interest has the effect of directly or indirectly transferring the rights of management or control in relation to the Indian concern, the information shall be furnished in the said Form within 90 days of the transaction. The notified details will help the tax authority in ascertaining the functional profile of the Indian concern and the factual details in respect of the transaction. Similar other details are prescribed under the notification.

Meaning of accounting period provided to be each period of twelve months ending on 31st March. A period of twelve months ending on day other than 31st March would be considered, if it has been so adopted for complying with the provisions of the tax laws of the territory, of which it is a resident for tax purposes; or it has been adopted for the purpose of reporting to persons holding the share or interest.

Further, the first accounting period of the company or of an entity shall begin from the date of its registration or incorporation and end with the 31st March or such other day as the case may be following the date of such registration or incorporation. Later accounting period shall be the successive period of twelve months.

If the company or entity ceases to exist before the end of accounting period, then the accounting period shall end immediately before the company or as the case may be, the entity ceases to exist.

Under explanation 6, further, meaning of specified date is provided as the date on which the accounting period of the company or of the ends preceding the date of transfer of a share or interest or it could be the date of transfer, if the book value of the assets of the company or of the entity on the date of transfer exceeds 15% compared to the book value of the assets as on date on which the accounting period of the company or of the entity ends preceding the date of transfer of a share or an interest.

Explanation 7, however, provides a carve out from the applicability of Explanation 5 to small investors holding no right of management or control of such company/entity and holding less than 5% of the total voting power/share capital/interest of the company/entity that directly or indirectly owns the assets situated in India. As per clause (b) to the said explanation, where all the assets owned, directly or indirectly by a company or by entity registered or incorporated outside India, the income of the non-resident transferor from the transfer of share or interest outside India shall be deemed to accrue or arise in India only such part of the income as is reasonably attributable to assets located in India and determined in such manner as may be prescribed.

CBDT vide circular no.41 of 2016 on December 21, 2016 had provided answers to 19 specific questions raised on the applicability of indirect transfer provisions to FPI and their investors.

Circular no.4 of 2017 dated January 20, 2017 states that the operation of circular no.41/2016, dated December 21, 2016 kept in abeyance for time being in force in view of representations received from Foreign Portfolio Investors ('FPIs'), FIIs, Venture Capital Funds etc.

Salaries

Section 9(i)(ii) provides that any income which falls under the head "salaries" if it is earned in India would be deemed to accrue or arise in India. Finance Act, 1999 introduced Explanation to section 9(1)(ii), w.e.f. Assessment Year 20-21, as follows:

"Explanation.—For the removal of doubts, it is hereby declared that the income of the nature referred to in this clause payable for—

(a) service rendered in India; and

(b) the rest period or leave period which is preceded and succeeded by services rendered in India and forms part of the service contract of employment,

shall be regarded as income earned in India ;"

Important Judicial Precedents & Board Circulars:

1. In CIT v S. G. Pgnatale [1980] 124 ITR 391 (Gujarat HC), the facts were "the assessee was an employee of French company which had entered into an agreement with the Gujrat State Fertilizer Co. Ltd. for rendering certain services in Europe and also providing back up service and other assistance in installing a plant in India. The Indian company agreed to pay a lump sum for all these services. The assessee accordingly worked in India and rendered services in India in the shape of supervisory and advisory assistance to the Gujarat State Fertilizers Co. In lieu of the said services, the assessee was to be paid outside India by the French Company certain fixed emoluments. On these facts, the question was whether the Tribunal was right in holding that the income computable under the head "salaries" had been earned in India?

   The Court observed that the word "earned" has two meanings. One is the narrow meaning of rendering of services etc. The word 'earned' is also used in the wide sense treating income as earned only if the assessee has contributed to its accrual or arisal by rendering services and in respect of which a debit is created in his favour. Unless there is a debt in favour of the assessee by reason of his rendering services it cannot be said to be "income earned " in the wide sense.

   The Court, therefore, held that in view of the clear indication given by the Legislature itself by using a different phraseology in clause (iii) as compared with clause (ii), the words "earned in India" occurring in clause (ii) must be interpreted as "arising" or "accruing in India" and not "from service rendered in India". So long as the liability to pay the amount under the head "salaries" arises in India, clause (ii) can be invoked. If the liability to pay arises outside India and amount is payable outside India clause (ii) cannot be invoked.

2. In ACIT v. Robert Arthur Keltz, [2013] 59 SOT 203, the Delhi Tribunal has held that only proportionate amount of stock option benefit relating to the period of services rendered in India during the grant period would be taxable in India. As an employee had not rendered any services in India for part of the grant period before he came to India, only a proportionate amount of the stock option benefit relating to Indian assignment would be taxable in India.

3. In CIT v. Goslino Maria [2000] 241 ITR 312 (SC), the assessee was technician who come to India to work with the Fertilizer Corporation of India Ltd. (FCI). The service of the assessee technician was obtained by the FCI under an agreement with the Italian concern Mentecatini Edison (subsequently called Technimont) which deputed them to work with the FCI. Under the agreement the salaries of the assessee were to be paid by the FCI in Italian Lira to the said Italian concern. The question was as to whether the payment towards salary made to the foreign company Technimout was an income deemed to accrue or arise in India.

   The Supreme Court held that in view of the Gujarat High Court decision in CIT v. S. G. Pgnatale (supra) as in the present case, the liability to pay salary to the assessee arose outside India in view of the contract between the FCI and Technimout, and as the salary was payable outside India, section 9(i)(ii) did not apply.

   Further, the Supreme Court also agreed with the view of the Gujarat High Court in Pgnatale's case (Supra) that living allowance paid to foreign technician is exempt in his hands under section 10(14) of the Act.

   To overcome these decisions, a new Explanation to section 9(1)(ii) was introduced by the Finance Act 1983, with retrospective effect, from assessment year 1979/80. The Explanation declares, that income chargeable under the head "salaries' payable for 'services rendered in India' will be regarded as income earned in India

4. The Delhi Tribunal in Addl. CIT v. Hughes Services (Far East) P. Ltd. [2003] 87 ITD 137, after considering the decision of the Supreme Court in CIT v. Podar Cement (P) Ltd [1997] 226 ITR 625, has held that the said amendment cannot be considered either as declaratory or clarificatory since it enlarges the scope of the main section by including new item of income and therefore it cannot have retrospective effect.

5. In CIT v. Sedco Forex International Drilling Co. Ltd. [2003] 264 ITR 320 (Uttaranchal HC), the assessee entered into a contract of employment with a foreign company. He was the resident of the U.K. Under the contract he was required to work on oil rigs in Bombay High as per alternating time schedule of 35/28 days i.e. on period followed by 35/28 days of off period in U.K. Before the Assessing Officer it was contended on behalf of the assessee, that off period

salary was not eligible to tax under section 9(i)(ii) as it was not earned in India. It was argued that the field break which followed the on period was not a rest period. The Assessing Officer rejected that contention.

The High Court held that the contract provided for on-period and off-period. The contract was for two years. It referred to alternating time schedule. It covered both the periods. The off-period followed the on-period. Therefore, both the periods formed an integral part of the contract. It was not possible to give separate tax treatment to on-period and off period salaries.

Further, the payment which he received was for his services in India. The Explanation to section 9(i)(ii) introduced by the Finance Act 1983 with effect from April 01,1979, refers to what constitutes 'income earned in India'. It explains the expression 'income earned in India' to mean payment for the services in India even if the contract is executed outside India or amount is payable outside India. Therefore, the payment of salary for off-period was income earned in India i.e. for services rendered in India under section 9(i)(ii). Hence, the entire salary for both the periods was taxable in India under section 9(i)(ii).

Furlough Pay

In Grindlays Bank Ltd. v. CIT [1992] 193 ITR 457 (Calcutta HC), the assessee bank had an expatriate Officer working in India. These officers were entitled to proceed on furlough on completion of a specific period of service in India and while on furlough they were entitled to furlough pay to be disbursed outside India. Consequently, furlough pay was disbursed in pound sterling in the U.K. The Calcutta High Court after referring to section 9(1)(ii) held that, the labour or service which entitled the employees to the furlough pay was rendered in India and liable to tax in India.

Again, the Explanation to section 9(1)(ii) of the Act, was amended by the Finance Act, 1999 with effect from assessment year 2000-01 to provide that not only furlough pay is taxable in the hands of the employee but any salary payable for the rest period or leave period which is preceded and succeeded by service in India, is also taxable.

Salaries and Perquisites Payable by the Government to Citizen of India

Salaries payable to citizen of India for service rendered to Government at

any place outside India are, by section 9(i)(iii), deemed to have accrued or arisen in India irrespective of the place of services or the place of salary payment.

However, by virtue of section 10(7), any allowance or perquisite paid or allowed outside India by the Government to a citizen of India for rendering services outside India, is fully exempt from tax.

Dividend

Under section 9(1)(iv), any dividend paid by an Indian company outside India is deemed to accrue or arise in India and therefore, such dividend falls within the scope of total income as defined in section 5, both in the case of resident as well as non-resident assesses.

Important Judicial Precedents & Board Circulars:

1. In Pfizer Corporation v. CIT [2003] 259 ITR 391 (Bombay HC), an Indian Company having a registered office in India issued shares, the situs of the shares is the place where the register is kept, that is, in India. But in cases where the question arises of taxing income and not the corpus, one has to consider the place of accrual of the dividend income and the situs of the shares will have no importance. A dividend declared by an Indian company, therefore, would be deemed to accrue in India if the source of income is situated in India. But what happens when dividend is declared in India and paid to a non-resident out of India. To cover such a situation, section 5(2)(b) has to be read with section 9(1)(iv). Under section 9(1)(iv), it is clearly stipulated that a dividend paid by an Indian company outside India will constitute income deemed to accrue in India on effecting such payment. In section 9(1)(iv), the words used are 'a dividend paid by an India company outside India'. This is in contradistinction to section 8 which refers to a dividend declared, distributed or paid by a company. The words 'declared or distributed' occurring in section 8 do not find place in section 9(1)(iv). Therefore, it is clear that dividend income paid to non-resident is deemed to accrue in India only on payment and not on declaration.

   Thus, where the dividend was declared by the Indian company but the permission of the RBI to remit it to the non-resident was obtained later, dividend became taxable in the year when the RBI granted

approval and not in the year when the dividend was declared by the company.

Interest

Under section 9(1)(v), interest income is deemed to accrue or arise in India in the following circumstances:

(a) Interest payable by the Government; or

(b) Interest payable by a resident except:

(i) interest payable by a resident, in respect of a any money borrowed and used for the purpose of business or profession carried on by such person outside India or

(ii) interest payable by a resident in respect of any debt incurred or any money borrowed and used for the purpose of making or earning any income from any source outside India.

It may be noted that where money borrowed by a resident for the purpose of a business or profession carried on by him outside India are actually used for any other purpose, interest payable thereon will be deemed to accrue or arise in India. (Refer circular no. 202 of July 5, 1976)

Similarly, interest payable on money borrowed by a resident for the purpose of making or earning any income from any source outside India will be deemed to accrue or arise in India if the moneys are actually used for any purpose in India (Refer circular no. 202 of July 5, 2000)

(c) Interest payable by a person who is non-resident, if it is in respect of any debt incurred or money borrowed and used for purposes of a business or profession carried out by such person in India

It may be noted that interest payable by a non resident in respect of any debt incurred, or moneys borrowed and used for the purposes of making or earning any income from any source, other than a business or profession carried on by such person in India, will not be deemed to accrue or arise in India, (Refer. Circular no. 202 of July 5, 1976).

It may be noted that in the case of a non-resident, being a person engaged in the business of banking, any interest payable by the permanent establishment in India of such non-resident to the head

office or any permanent establishment or any other part of such non-resident outside India shall be deemed to accrue or arise in India and shall be chargeable to tax in addition to any income attributable to the permanent establishment in India and the permanent establishment in India shall be deemed to be a person separate and independent of the non-resident person of which it is a permanent establishment and the provisions of the Act relating to computation of total income, determination of tax and collection and recovery shall apply accordingly;

Important Judicial Precedents & Board Circulars

1. In J. K. Synthetics Ltd. v. ACIT [1990] 185 ITR 540 (Delhi HCs)], the interest payable by the petitioner to its foreign supplier of raw materials had been held to be covered by the deeming provision of section 9(1)(v).

Royalty

Under section 9(1)(vi), royalty income shall be deemed to accrue or arise in India if:

(a) Royalty payable by the Government;

or

(b) Royalty payable by a resident, except where the royalty is payable in respect of any right, property or information used or services utilized:

(i) for the purpose of business or profession carried on by such person outside India; or

(ii) for the purpose of making or earning any income from any source outside India;

or

(c) Royalty payable by a non-resident, where the royalty is payable in respect of any right, property or information used or services utilized

(i) for the purposes of a business or profession carried on by such person in India or

(ii) for the purposes of making or earning any income from any source in India;

Royalty income consisting of lump sum consideration for the transfer outside India of or the imparting of information outside India in respect of any data, documentation, drawings or specification relating to any patent, invention, model, design, secret formula or process or trade mark or similar property will ordinarily be chargeable to tax in India.

Subsequently, two provisos were added as below:

Provided that nothing contained in this clause shall apply in relation to so much of the income by way of royalty as consists of lump sum consideration for the transfer outside India of, or the imparting of information outside India in respect of, any data, documentation, drawing or specification relating to any patent, invention, model, design, secret formula or process or trade mark or similar property, if such income is payable in pursuance of an agreement made before the 1st day of April, 1976, and the agreement is approved by the Central Government :

Provided further that nothing contained in this clause shall apply in relation to so much of the income by way of royalty as consists of lump sum payment made by a person, who is a resident, for the transfer of all or any rights (including the granting of a licence) in respect of computer software supplied by a non-resident manufacturer along with a computer or computer-based equipment under any scheme approved under the Policy on Computer Software Export, Software Development and Training, 1986 of the Government of India.

For the purpose of the aforesaid source rule "royalty' has been defined in Explanation 2 to section 9(1)(vi). It will be seen that the definition is wide enough to cover both industrial royalties as well as copyright royalties. The definition specifically exclude income which would be chargeable to tax under the head "capital gain" and accordingly such income will be charged to tax as capital gains on a net basis under the relevant provisions of the law.

"Royalty" means consideration for –

(i) the transfer of all or any right (including granting of license) in respect of a patent, invention, model, design, secret formula or process or trade mark or similar property;

(ii) the imparting of any information concerning the working of, or the use of, a patent, invention, model, design secret formula or process or trade mark or similarly property;

(iii) the use of any patent, invention, model, design secret formula or process or trade mark or similar property;

(iv) the imparting of any information concerning technical, industrial commercial or scientific knowledge, experience or skill;

(v) the use or right to use, any industrial, commercial or scientific equipment but not including the amounts referred to in section 44BB

(vi) transfer of all or any rights (including the granting of a license) in respect of any copyright ,literary, artistic or scientific work including films or video tapes for use in connection with television or tapes for use in connection with radio broadcasting but excluding consideration for the sale, distribution or exhibition of cinematographic films, or

(vii) the rendering of any services in connection with the aforesaid activities.

Explanation 3 to section 9(1)(vi) defines "computer software" to mean any computer programme recorded on any disc, tape, perforated media or other information storage device and includes any such programme or any customized electronic data.

The Finance Act 2012 has inserted Explanation 4, 5 & 6 to clause (vi) of section 9(1) applicable w.r.e.f June 1, 1976.

Explanation 4 clarifies that the transfer of all or any rights in respect of any right, property or information includes and has always included transfer of all or any right for use or right to use a computer software (including granting of a licence) irrespective of the medium through which such right is transferred.

Explanation 5 clarifies that the royalty includes and has always included consideration in respect of any right, property or information, whether or not—

(a) the possession or control of such right, property or information is with the payer;

(b) such right, property or information is used directly by the payer;

(c) the location of such right, property or information is in India.

Explanation 6 clarifies that the expression "process" includes and shall be deemed to have always included transmission by satellite (including up-linking, amplification, conversion for down-linking of any signal), cable, optic fibre or by any other similar technology, whether or not such process is secret

Exceptions to the Royalty Income

In the following two cases income shall not be deemed to accrue/arise in India.

(i) Approved agreements made before April 1, 1976- In order to ensure that foreign suppliers of technical know-how who had finalized proposals for the receipt of lump sum royalties with the approval of the Central Government on the understanding that such payment would be exempt from income tax, it has been provided that such lump sum payment received under approved agreement made before April 1, 1976 is not deemed to accrue or arise in India.

If an agreement is made on or after April 1, 1976 it will be deemed to have been made before that date, if the following conditions are fulfilled:

(a) in the case of a taxpayer other than a foreign company, if the payment is made in accordance with proposals approved by the Central Government before that date;

(b) in the case of foreign company, if the agreement is made in accordance with proposals approved by the Central Government before that date and the company exercise an option by furnishing a declaration in writing to the Assessing Officer that the agreement may be regarded as having been made before April 1,1976

The option in this behalf has to be exercised before the expiry of the time allowed under section 139(1) or section 139(2) (whether fixed originally or on extension) for furnishing the return of income for the assessment year 1977-78 or the assessment year in which the royalty income first become chargeable to tax, whichever assessment year is later. For option so exercised is final not only for the assessment year in relation to which it is made but also for every subsequent year.

(ii) Computer software

With effect from the assessment year 1991-92 onwards so much of the income by way of royalty as consists of lump sum payment made by a person, who is resident, for the transfer of all or any rights (including the granting of a licence) in respect of computer software supplied by a non resident manufacturer along with computer hardware under any scheme approved under the Policy on Computer software Export, Software

Development and Trading 1986 of the Government of India shall not be deemed to accrue or arise in India.

For the purposes of meaning of Royalty, “computer Software” means any computer programme recorded on any disc, tape, perforated media or other information storage device and including any such programme or any customized electronic data.

Important Judicial Precedents & Board Circulars:

1. The term ‘royalty’ normally connotes the payment made to a person who has exclusive right over a thing for allowing another to make use of that thing which may be either physical or intellectual property or thing. The exclusivity of the right in relation to the thing for which royalty is paid should be with the grantor of that right. [CIT v Neyveli Lignite Corporation Ltd. [2000] 243 ITR 459 (Madras HC)].

2. Royalty received by the assessee foreign company under a collaboration agreement with Indian company, according to which Indian company was to manufacture certain machines and pay royalty to foreign company on products manufactured, would be income deemed to accrue or arise in India. [CIT v. Ruti Machinery Works Ltd. [2000] 243 ITR 442 (Madras HC)].

3. Consideration paid by the Indian customers or end users to the assessee a foreign supplier, for transfer of the right to use the software/computer programme in respect of the copyrights falls within the mischief of 'royalty' as defined under sub-clause (v) to Explanation 2 to clause (vi) of section 9(1) of the Income-tax Act, 1961 [CIT v Samsung Electronics Co. Ltd [2012] 345 ITR 494 (Karnataka HC)]

   This decision is followed by the Karnataka HC in the case of Synopsis International Ltd. vs. DDIT [2016] (76 taxmann.com 118). The Special leave petition has been granted by the Supreme Court [2016] 76 Taxmann.com 138.

   The decision is followed by the Bangalore ITAT in the case of Tejas Networks Ltd. v. DDIT [2015] 64 Taxmann.com 439 (Bangalore Tribunal).

4. Payment made by assessee to a non-resident in order to obtain licence to use database maintained is to be regarded as royalty. [CIT v Wipro Ltd [2013] 355 ITR 284 (Karnataka HC)]

5. Receipt for sale of shrink-wrap software products to clients in India through its distributor / reseller cannot be treated as 'royalty' - 'sale of copyrighted article' OR 'transfer of copyright right'. [Dassault Systemes Solidworks Corporation Vs. Dy. Director Of Income Tax [2020] (Itat Mumbai)]

6. The assessee-company was engaged in the manufacture of audio magnetic sound heads. It entered into an agreement with a Singaporean company whereby the foreign company was to supply plant know-how and product know-how to the assessee and, if required, would also make available the services of trained technicians for setting up the plant and machinery in accordance with the printed material and data. The documents and the agreement clearly showed that the assessee had purchased the entire drawings, sketches, designs, etc. It might be true that the foreign company was required to provide technical assistance, if required, but the fact was that no such technical assistance was ever required nor was provided. The payment of 15 million yen was the price of the documents purchased and would not fall within the meaning of royalty. [CIT v. Maggronic Devices (P.) Ltd [2010] 329 ITR 442 (Himachal Pradesh HC)]

7. The main service rendered by the assessee to its clients-hotels was advertisement, publicity and sales promotion, the use of trademark, trade name or the stylized 'S' or other enumerated services referred to in the agreement with the assessee were incidental to the said main service. It was held that payment was neither in the nature of royalty under section 9(1)(vi), read with the Explanation 2, nor in the nature of fee for technical services under section 9(1)(vii). [DIT v. Sheraton International Inc. [2009] 313 ITR 267 (Delhi HC)]

8. In Asia Satellite Telecommunications Co. Ltd v DIT [2011] 332 ITR 340, Delhi HC has clarified that the term 'royalty' in respect of the copyright, literary, artistic or scientific work, patent, invention, process, etc., does not extend to the outright purchase of the right to use an asset. In the case of 'royalty' the ownership of the property or right remains with the owner and the transferee is permitted to use the right in respect of such a property. In this case the assessee was deriving income from the lease of the transponder capacity of its satellites. It was amplifying and relaying the signals in the footprint area after having been linked up by the TV channels. It also remained

in the control of the satellites. It had not leased out the equipments to the customers. Where the operator has entered into an agreement for lease of the transponder capacity and has not given any control over parts of the satellite/transponder, the provisions of clause (vi) would not apply. [Ruling of the AAR in ISRO Satellite Centre (ISACT), In re [2008] 307 ITR 59 (New Delhi) followed]

9. In the case of CIT v. HEG Ltd. [2003] 263 ITR 230 (Madhya Pradesh HC), the question whether subscribing to a journal which gave information on a particular industry, and which was commercial in nature could be termed royalty came up for consideration. Rejecting the CIT's contention that the since the journal was of a commercial nature, payments made for it would be royalty, the High Court held that the mere characteristic of being commercial in nature would not make it a thing for which royalty would be payable. Some sort of expertise or skill was required. So, in the absence of such skill in the journal, payments made to it would not be royalty.

10. In the case of DIT v. v Infrasoft Ltd., [2014] 264 CTR 329 (Delhi HC), it was held that the amount received by a non-resident company for granting license to use its copyrighted software for licencee's own business purpose only, could not be brought to tax as 'royalty' under article 12(3) of India-US DTAA. Decision was rendered applying the provisions of section 9(1)(vi) of the Act vis-à-vis provisions of DTAA.

11. This decision is followed by the Mumbai Tribunal in the case of ADIT v. First Advantage (P.) Ltd. [2017] 163 ITD 165.

12. In the case of CIT v. CGI Information Systems & Management Consultants (P.) Ltd. [2014] 226 Taxman 319 (Karnataka HC), it was held that intranet facility is similar to availing the leased line facilities. Therefore, the cost sharing agreement cannot be considered as reimbursement of cost and payments made for utilizing the said facilities is royalty under section 9(1)(vi) read with Explanation 4 of the Act and under Article 12 of the India-Canada DTAA.

13. In the case of Bharti Airtel Ltd. v. ITO [2016] 47 ITR(T) 418 (Delhi Tribunal), it was held that Inter-connect Usage Charges paid by a telecommunication service provider in India to Foreign Telecom Operators in connection with its International Long Distance telecom service business, was not royalty under the Act as well as under the DTAA.

14. In the case of, B4U International Holdings Ltd vs. DCIT [2012] 52 SOT 545, Mumbai Tribunal held that the amendments made by the Finance Act, 2012 does not change the position regarding taxability of payment by TV broadcaster, of hiring charges for transponder and charges for facilities in relation to reception and transmission of signals under Section 9(1)(vi) as there is no change in the DTAA between India and USA and a taxpayer can opt for DTAA or Act whichever is more favourable.

15. This decision is affirmed by the Bombay High Court (ITA No. 1274 of 2013).

16. In the case of Taj TV Ltd. v. ADIT [2017] 162 ITD 674, Mumbai Tribunal held that Payment of transponder fee to US based company for utilizing its transponder facilities in India cannot be treated as a consideration for 'use' or 'right to use' any copyright of various terms used in para 3(a) of India-USA DTAA. It is also not use or right to use any industrial, commercial, or scientific equipment. Hence, the payment do not fall within ambit of royalty in terms article 12 of India-USA DTAA. The amended definition of 'royalty' as given in section 9(1)(vi) of the Act, will not affect Article 12 of the DTAAs. In the case of PCIT v M. Tech India (P.) Ltd. [2016] 381 ITR 31, Delhi HC held that payment made for purchase of software as a product would be treated as purchase of software rather than payment made for use or right to use software to be treated as royalty under section 9(1)(vi) of the Act.

17. In The Case of Digite Inc. Versus ADIT Circle- 1 (1) ITAT Delhi (2019), it was upheld that Payment made by assessee to US company for use of software owned by US company, when assessee would use software only for internal business operations and would not sub-license or modify same, could not be considered as royalty within meaning of article 12(4) of DTAA.

18. In the case of CIT vs. Vinzas Solutions India (P.) Ltd. [2017] 392 ITR 155, Madras HC held that the provisions of section 9(1)(vi) dealing with and defining 'royalty' cannot be made applicable to a situation of outright purchase and sale of a product. Income from purchase and sale of software is not in the nature of royalty under section 9(1)(vi) of the Act as it amounts to a transaction for sale of ‘copyrighted article’ and not of ‘copyright’ itself. Regarding the retrospective amendment inserting Explanation 4 and 7 to section 9(1)(vi), the High Court held

that Explanations 4 and 7 relied by the authorities would thus have to be read and understood only in that context and cannot be expanded to bring within its fold transaction beyond the realm of the provision.

19. In the case of Capgemini Business Services (India) Ltd. v. ACIT [2016] 158 ITD 1, Mumbai Tribunal held that 'Computer software' has neither been included nor is deemed to be included within the scope or definition of 'literary work' in any definition or Explanation provided under the Act. The term 'literary work' has been separately mentioned under clause (v) to Explanation 2 to include the consideration paid for the same within the scope of royalty, whereas, the term 'computer software' has been recognized as a separate item not only in 2nd proviso to clause (vi) but in Explanation 4 also and has been included in the definition and within the scope of the words 'right', 'property' or 'information'.

20. In the case of Atos Information Technology HK Ltd. V. DCIT [2017] 79 taxmann.com 26, the assessee provided services/facilities for data processing through computer hardware and software to Standard Chartered Bank (SCB).The Mumbai Tribunal held as under:

- There is absolutely no transfer of any technology, information, knowhow or any of the terms used in Explanation 2 or any kind of providing of technology in the form of data centre, infrastructure, connectivity and application technology to fall within the definition of 'royalty' under section 9(1)(vi) of the Act.
- Explanation 5 is to be read with section 9(1)(vi) which was there on the statute as on 1-4-1976. Clause (iva) to Explanation 2 was inserted from 1-4-2002. Thus, retrospective effect of clause (iva) cannot be deemed from 1-6-1976 and hence it cannot be held that Explanation 5 also applies to the said clause.

21. In the case of DDIT v. IMG Media Ltd. [2016] 67 taxmann.com 343, Mumbai Tribunal held that Consideration received for live audio and visual coverage of cricket matches is neither ‘fees for technical services’ nor ‘royalty’. It was held that the concept of make available was not satisfied in case of production of ‘program content’ by using technical expertise and the consideration was not taxable as ‘fees for technical services’. Further, it was also held that live coverage of events and broadcast does not have a ‘copyright’ and hence not royalty.

22. In the case of CIT v Delhi Race Club (1940) Ltd. [2015] 273 CTR 503, Delhi HC examined in detail provisions of clause (v) of Explanation 2 to section 9(1)(vi) and also the provisions of Copyrights Act, 1957. The High Court held that the provisions of clause (v) of Explanation 2 to section 9(1)(vi) would be more meaningful if the word 'in' is read by implication in between the words 'copyright' and 'literary.' The High Court also held that live broadcasting of a live sports event is not a copyright and therefore does not amount to royalty under section 9(1)(vi) of the Act. The High Court also held that broadcasting also does not amount to use or right to us 'scientific work.'

23. In the case of Qad Europe B. V. v. DDIT [2017] 53 ITR(T) 259, Mumbai Tribunal held that , where Indian company has paid the consideration for 'use of computer software' and not 'copyright of the computer software', the payment do not fall within the ambit of 'Royalty' defined in article 12(4) of the India-Netherlands DTAA. Decision was rendered after considering the provisions of section 9(1)(vi) of the Act read with the provisions of DTAA.

24. In the case of ADIT vs. Baan Global BV [2016] 49 ITR(T) 73, Mumbai Tribunal held that the consideration received for pure sale of 'shrink wrapped software' off shelf, cannot be considered as a 'royalty' within meaning of Article 12(4) of India-Netherlands DTAA. Further, 'Royalty' has been specifically defined in the treaty and amendment to the definition of such term under the Act would not have any bearing on the definition of such term in the context of DTAA since, a treaty which has entered between the two sovereign nations, then one country cannot unilaterally alter its provision.

25. Mumbai Tribunal in the case of Lucent Technologies GRL LLC vs. ADIT(Int. tax) [ITA Nos. 7001 to 7004/Mum/2010], order dated 2 May 2018 following the decision in the case of tax deductor – Reliance Communications Ltd., held that the consideration received by the assessee from the supply of software is not royalty under the Act as well as under India – US DTAA and not liable to tax in India. The Tribunal while deciding the case has taken into consideration the specific observations in Reliance's case (ITA No. 837 and others) that the use of software is for operation of wireless network only viz. software is not meant for commercial purposes.

26. In the case of Google India (P.) Limited v. ACIT [2017] 86 taxmann.com 237 (Bangalore ITAT), Google India Private Limited

["Google India"] is a wholly-owned subsidiary of Google International LLC, US. Google India had been appointed by Google Ireland Ltd. ["GIL"] as a non-exclusive authorized distributor of "Adwords Programs" to advertisers in India.

The Adwords Program Distribution Agreement allows Google India to access all intellectual property and confidential information which is used for activities related to the Distribution Agreement.

Google India is also having access to the IP address of the desktop / laptop / tablet, photographs of users and the time spent on websites, eating habits, wearing preferences, etc. Further, the Google search engine has access to data pertaining to the user of the website in the form of name, sex, age, city, state, religion, etc.

Accordingly, the Tribunal observed that the Distribution Agreement is not merely an agreement to provide advertisement space but is also an agreement for facilitating display and publishing of an advertisement to the targeted customer.

Further, the Tribunal observed that the IP of Google vests in the search engine, technology, associated software and other features, and hence use of these tools for performing various activities, including accepting advertisements, providing before / after sales services, clearly falls within the ambit of royalty.

The Tribunal also noted that as per the terms of the Distribution Agreement, Google India was permitted to use tradename, trademarks, service marks, domains or other distinctive brand features of GIL solely for the use under the Distribution Agreement, on a non-exclusive, non-sub-licensable basis for the purposes of marketing and distribution of the Adwords Program.

Accordingly, it was held that the payments made by Google India under the agreement were not only for marketing and promoting the Adwords Program but was also for the use of Google brand features. Thus, payment made by Google India to GIL was royalty chargeable to tax in India under the Act as well as India Ireland DTAA.

27. In the case of Godaddy.com LLC v. ACIT [2018] 92 taxmann.com 241, the Mumbai Tribunal held that Rendering of services for domain registration is rendering of services in connection with use of an intangible property which is similar to trademark and therefore,

charges received by assessee for said services is royalty within meaning of clause (iii) of Explanation 2 to section 9(1)(vi).

Fees for Technical Services

Under section 9(1)(vii), following incomes by way of "fees for technical services" shall be deemed to accrue or arise.

(a) Payable by the Government; or

(b) Payable by resident, except where the fees are payable in respect of services utilized in a business or profession

  (i) carried on by such person outside India; or

  (ii) for the purposes of making or earning any income from any source outside India;

  or

(c) Payable by a non resident, where the fees are payable in respect of services utilized in a business or profession

  (i) carried on by such person in India; or

  (ii) for the purposes of making or earning any income from any source in India;

The term "fees for technical services:" means any consideration (including any lump sum consideration) for rendering any managerial, technical or consultancy services (including the provision of services of technical or other personnel) but does not include consideration for any construction, assembly, mining or like project undertaken by the recipient or consideration which would be income of the recipient chargeable under the head "salaries".

Important Judicial Precedents & Board Circulars:

1. In G.V.K. Industries Ltd. v. ITO [1998] 228 ITR 564 (Andhra Pradesh HC), the success fee was payable by the petitioner company to the non-resident company. The question before the Andhra Pradesh High Court was in respect of nature of payments. The court held that, from a combined reading of section 9(1)(vii)(b) and Explanation 2 thereto, it becomes clear that any consideration whether lump sum or otherwise, paid by a person who is resident in India to a non resident for running any managerial or technical or consultancy service, would be income by way of fees for technical service and would, therefore, be within the ambit of "income deemed to accrue or arise in India".

Affirmed by the Supreme Court in GVK Industries Ltd. v. ITO [2015] 371 ITR 453.

2. From a combined reading of clause (vii)(b) of section 9(i) and Explanation 2, thereto, it becomes abundantly clear that any consideration, whether lump sum or otherwise paid by a person who is resident in India to a non-resident for rendering any managerial or technical or consultancy service would be income by way of fees for technical services and would, therefore be within the ambit of 'income deemed to accrue or arise in India. It is also to be noted that under section 9(1)(vii)(b), the expression used is "fees for services utilized in India" and not the expression 'fees for services rendered in India". It may be that some of the services are rendered abroad by the personnel employed or deputed by non-resident company under collaboration agreement with the Indian company. But, if the fees are paid for services utilized by the Indian company, in its business carried on by it in India, irrespective of the place where the services were rendered, the amounts of the fees should be deemed to accrue or arise in India. [Elkem Technology v. DCIT [2001] 250 ITR 164 (Andhra Pradesh HC)]

3. In CIT v. Sundwiger EMFG & Co. [2003] 262 ITR 110 (Andhra Pradesh HC), the fact were, Midhani, a resident company entered into a contract with a non-resident company for supply of various capital equipment in connection with setting up of special metal and alloy projects. Further, a supplementary contract was also entered into between the parties for providing technical services covering supervision of erection, start-up, etc. for which the non-resident had to send on deputation their employees who were specialist, to India. Apart from payment on per day basis, Midhani had to meet the expenses of travel, living and pocket expenses of the specialist coming to India. It was also further agreed that all payments to the contractor and the specialists under the contract would be without deduction of taxes, assessment, duties etc., and if leviable, would be assumed to be paid by the purchaser only.

   On these facts, the Andhra Pradesh High Court held that Midhani, as one principal had entered into an agreement with another principal, the non-resident company in respect of purchasing of machinery. The supplementary contract was only by way of an abundant caution and it did not mean that the payment was either to be taxable or would be

tax free. All that it meant was that in case the payment was taxable the same would be borne by Midhani. The expenses met by the Midhani under the supplementary contract were part of the consideration for setting up of the machinery. The expenses met could not be viewed in isolation from the main contract and if that was so, whether the payment were made on daily basis or not for any technical services rendered, they would form part and parcel of consideration for the purchase of machinery. Thus, the provisions of section 9(i)(vii) would not be applicable. On the other hand, such payments were exempted under Explanation 2 to section 9(i)(vii)

4. Where the object of the preparation of designs and drawings is to bring home point as to how the manufactured equipments is required to be erected, same should also be considered as technical advise rendered except where it could be proven that the design and drawings were part of plant and machinery purchased and were therefore required to be added to the cost of plant and machinery. [AEG Aktiengesllschaft v. CIT [2004] 267 ITR 209 (Karnataka HC)]

5. For section 9(1)(vii) to be applicable, it is necessary that services provided by a non-resident assessee under a contract should not only be utilized within India, but should also be rendered in India. [Ishikawajma-Harima Heavy Industries Ltd v DIT [2007] 288 ITR 408 (SC)]

   This decision stands nullified for the limited purposes of place business or place of rendering of services in connection with "fees for technical services" since s 9(1)(vii) has been amended by the Finance Act 2010 w.r.e.f 1.06.1976 which provided that where the income is deemed to accrue or arise in India under clauses (v), (vi) and (vii) of s 9(1) such income shall be included in the total income of non-resident whether or not the non-resident has a residence or place of business or business connection in India; or the non-resident has rendered services in India

6. Delhi High court in CIT v Havells India Ltd [2013] 352 ITR 376 has put at rest the doubts surrounding the application of exception provided by section 9(1)(vii)(b). The court clarified that the export activity having taken place or having been fulfilled in India, the source of income was located in India and not outside. Mere fact that the export proceeds emanated from persons situated outside India did not constitute them as the source of income. The manufacturing

activity is located in India. The source of income is created at the moment when the export contracts are concluded in India. Thereafter, the goods are exported in pursuance of the contract and the export proceeds are sent by the importer and are received in India. The importer of the assessee's products is no doubt situated outside India, but he cannot be regarded as a source of income. The receipt of the sale proceeds emanate from him from outside. He is, therefore, only the source of the monies received. The income component of the monies or the export receipts is located or situated only in India. There is a distinction between the source of the income and the source of receipt of the monies. In order to fall within the second exception provided in section 9(1)(vii)(b), the source of the income, and not the source of receipt, should be situated outside India.

7. In the case of Siemens Ltd. v. CIT(A) [2013] (142 ITD 1), Mumbai Tribunal held that any technology or machinery is developed by human and put to operation automatically, wherein it operates without much of human interface or intervention, then usage of such technology cannot per se be held as rendering of 'technical services' as contemplated in Explanation 2 to section 9(1)(vii).

8. In Akamai Technologies Inc. (Authority For Advance Rulings-New Delhi) upheld that a human element is a pre-requisite for characterizing a service as a technical service and consequently treating payments for the same as fees for technical services. The Solutions provided by the Applicant without human intervention cannot be treated as provision of technical services.

9. In the case of DDIT v. A.P. Moller Maersk [2014] 64 SOT 50 (Mumbai Tribunal), facts were that the assessee engaged in business of operation of ships developed software for running of shipping business globally in a more effective and efficient manner and access of such software was provided to various agents/group companies all over the world who used this software for facilitating the freight receipts from shipping, for which they reimbursed the cost to the assessee without any mark-up. It was held that Such recovery of cost cannot be taxed as FTS or royalty independently as the assessee is not rendering any service of managerial, technical or consultancy to its agent or group entities by allowing its group companies to be usage of software.

Affirmed by the Supreme Court in DIT v. A.P. Moller Maersk A S [2017] 392 ITR 186.

10. Payment made for utilizing standard facilities which were provided by way of use of technical gadgets, since it did not involve technical services, payments made for utilizing such services was not in nature of fee for technical services. [ITO v. Primenet Global Ltd. [2016] 48 ITR(T) 451 (Delhi Tribunal)]

11. Technical services" & "Managerial and Consultancy service" denotes services that cater to special & exclusive needs of the consumer/user. A "facility", even if termed as a service, which is available to all users, does not come within the ambit of "technical services" in Explanation 2 of s. 9(1)(vii) [*CIT v. Kotak Securities Ltd (2016) 383 ITR (001) (Supreme Court)]*

12. The words "technical services" have got to be read in the narrower sense by applying the rule of noscitur a sociis, particularly, because the words "technical services" in section 9(1)(vii) read with Explanation 2 comes in between the words "managerial and consultancy services". "Managerial and consultancy services" and, therefore, necessarily "technical services", would obviously involve services rendered by human efforts (CIT vs. Bharati Cellular Ltd (2011) 330 ITR 239 (Supreme Court).

Exception to Fee for Technical Service Income

The aforesaid provisions of section 9(1)(vii) shall not apply in relation to any income by way of fees for technical services payable in pursuance of an agreement made before April 1,1976 and approved by the Central Government.

An agreement made on or after April 1, 1976 shall be deemed to have been made before that date if the agreement is made in accordance with proposals approved by the Central Government before that date.

Important Judicial Precedents & Board Circulars:

1. In Meteor Soctellite Ltd. v. ITO [1980] 121 ITR 311, the Gujarat High Court has pointed out that clause (vi) of section 9(1) deals with a specific type of income, viz. income by way of royalty, whereas the first limb of clause (i) of that section is a more general provision which deals with all incomes accruing or arising whether directly or indirectly through or from any business connection in India. Income

by way of royalty is a species or one of the categories of a larger class mentioned in clause (i), of section 9(1). When once one comes across the question of royalty one has only to look at clause (vi) and not to the more general provisions of clause (i). Similarly, income by way of fees for technical services, which is covered by clause (vii) is more general category as compared to the royalty which is covered by clauses (vi). On the principle that the particular excludes the general, clause (vii) or clause (i) cannot be applied to royalty income which is covered only under clause (vi).

2. In another case, the Madras High Court in CIT v. Copes Vulcan Inc. [1987] 167 ITR 884 has also noted that, having regard to the language used in section 9(1)(vii) by way of fees for technical services arising out of even a business connection should be taken to have been covered by section 9.(i)(vii) and not section 9(1)(i), section 9 (1)(vii) being a special provision for that type of income.

3. In Central Mine, Planning& Design Institute Ltd. v. DCIT [1998] 67 ITD 195, the Patna Tribunal held that there is no mentioned of the words "business connection" under section 9(1)(vii)(b). Hence, there is no requirement for the Assessing Officer to establish the existence of business connection for the purpose of this clause. Where the contracts were for rendering technical assistance in preparation of design drawings and project reports and the payments made to the foreign company were of the nature of fees for technical services rendered, the payments in question would have to be considered as falling under section 9(1)(vii)(b) and there would be no need to establish existence of business connection.

4. The Central Board of Direct Taxes vide its circular no. 384 dated May 4,1984, has clarified that where shares are issued of an Indian Company in consideration for the transfer abroad of technical know-how or services or delivery abroad machinery and plant, the payment is taxable, as income is deemed to accrue or arise in India.

Place of Residence or Business or Business Connection and Place of Rendering Services Immaterial

The Finance Act 2007 introduced an explanation to section 9 applicable w.r.e.f June 1, 1976 which provided that where the income is deemed to accrue or arise in India under clauses (v), (vi) and (vii) of section 9(1), such income shall be included in the total income of non-resident whether or not

the non-resident has a residence or place of business or business connection in India.

The above explanation was replaced by the Finance Act 2010 w.r.e.f June 1, 1976 which provided that where the income is deemed to accrue or arise in India under clauses (v), (vi) and (vii) of sec 9(1), such income shall be included in the total income of non-resident whether or not:

(i) non-resident has a residence or place of business or business connection in India; or

(ii) the non-resident has rendered services in India

Any sum of money paid by resident Indian to non-corporate non-resident or foreign company

Section 9(1)(viii) provides that income arising outside India, being any sum of money paid without consideration by a person resident in India to a non-resident, not being a company, or to a foreign company would be deemed to accrue or arise in India.

Taxability of Pension

Under section 9(2) pension payable outside India to a person residing permanently outside India shall not be deemed to accrue or arise in India, if:

(a) the pension is payable to a person referred to in article 314 of the constitution ; or

(b) the pension is payable to a person who, having been appointed before the August 15,1947, to be a judge of Federal Court or of a High Court within the meaning of the Government of India Act, 1935, continues to serve on or after the commencement if the constitution as a Judge in India.

Important Judicial Precedents & Board Circulars:

The Board vide its circular no 4 dated February 20, 1969 has clarified that, pensions received in India from abroad by pensioners residing in the country for past services rendered in foreign countries, will be income accruing to the pensioners abroad and will not be liable to tax in India on the basis of accrual, if the residential status of the pensioner is either “Non-resident” or “Not Ordinarily Resident”. However, it will be chargeable if the residential status is “Resident”.

Profit Attribution Principles in India

Introduction

The issue of attribution of income to a taxable presence of an entity in another State, or Permanent Establishment (PE), has been the subject of considerable controversy over the last several years. The business connection/PE concept as it is understood in international tax law sets the basic threshold limit beyond which a multinational enterprise ought to be taxed in the country of source of business activity.

Tax treaties, which provide for avoidance of double taxation and related matters are normally negotiated on the basis of the OECD model, the UN model, and the US model.

The UN model was developed mainly to counter-balance the OECD model, which was considered to be tilted in favour of residence based taxation since OECD mainly comprises of developed countries. UN Model seeks to reflect and voice the concerns of developing nations, which sought to establish source-based taxation on the basis that developing countries were importers of equipment and technology were, thus, the source of the income of developed nations.

Although similar to the OECD model, the UN model uses a lower PE threshold and includes additional situations in which a PE can be created, for example, Service PE, i.e. on account of services of employees in the source state. Similarly, UN Model contains force of attraction clause for attribution of profits, thus, seeking to attribute profits arising from not only operations of the PE but also from sale or supply of similar goods and services in the source State, even though PE may not be directly involved in such supply.

Need for attribution

The concept of attribution of profits is closely linked to the concept of PEs. Typically PEs are hypothesized as entities separate from their parent in economic terms, though not necessarily legally. For example, an agent or a branch office may constitute a PE of a foreign enterprise, though the agent may have any legal form other than that of the foreign enterprise and the branch is legally the same legal entity as the head office of the overseas enterprise. The need for appropriate attribution of profits arises in order to allow the source state to eliminate subjectivity and mitigate the effect of

external and internal influencing factors in taxing the economic activity carried on by the foreign enterprise on its soil.

Profit attribution under the Income Tax Act, 1961

Where a nonresident has a business connection in India and its business is not exclusively carried out in India, the taxable income is limited to the profits attributable to the business activities taking place in India, based on the books of account and financial statements maintained in India. If no books of accounts are maintained or the tax authorities' opinion is that it is not possible to determine actual income from the books of account, the assessing officer may calculate the taxable income in accordance with Rule 10:

- As a percentage of revenue accruing or arising considered reasonable by the tax authorities;
- As a proportion of the total business profits (from trading and other sources) of the non-resident based on the ratio of revenue (accruing or arising) in India to total revenue; or
- In any other manner the tax authorities deem suitable.

The current method, therefore, allows the tax authorities considerable discretion without any clear or specific guidance.

The domestic law provides for applying a profit rate to the India-specific turnover of the foreign company for ascertaining the profits attributable to the operations carried out in India. Applying a global profit rate on India specific turnover would result in estimation of total profits from Indian turnover, though the entire activities giving rise to such profits, e.g. research and development, manufacturing, marketing and selling may not have been carried out in India. For example, in some cases, certain marketing activities as well as negotiation and conclusion of sale contracts may have been carried out in India, but all other activities, e.g. research and development, manufacturing, technical services etc. may have been carried out outside India.

In such cases, the Courts have, in the past, used an ad hoc basis for estimating the profits attributable to India specific activities, based on facts of each case.

In the case of Anglo French Textile Company Ltd. v. CIT: 25 ITR 27, the Supreme Court returned a finding that in the facts of the case, 10% of profits were to be attributed to operations carried out in India.

Again, in Hukum Chand Mills Ltd. v. CIT: 103 ITR 548, the Supreme Court found that attribution of 15% of profits was reasonable in the facts of that case. More recently, in case of Motorola Inc: 95 ITD 269, the Special Bench of the Income Tax Appellate Tribunal, ('ITAT') held that attribution of 20% of profits was sufficient for role played by the PE in negotiation and conclusion of contracts and supply of equipment in India by the PE of the taxpayer. Similarly, in case of Galileo International Inc. 114 TTJ 289, 15% of total revenues were considered to be attributable to the Indian PE on the basis that the PE played a role in negotiating contracts.

While the Courts have in the past followed an ad hoc approach in determining profits attributable to PE, more recently, it is seen that the judicial view is veering towards more scientific and systematic way of attribution of profits, by relying on FAR analysis, using transfer pricing principles.

The Central Board of Direct Taxes ('CBDT'), vide circular no. 5 dated September 28, 2004, provided, inter alia, that profits to be attributed to a PE should be those which the PE would have made if, instead of dealing with the head office, it had been dealing with a separate enterprise under prevailing market conditions, thus bringing in the arm's length concept in profit attribution.

The Supreme Court, in Morgan Stanley & Co. v DIT: 292 ITR 416, categorically stated that profits attributable to a PE shall have to be determined based on FAR analysis, i.e. functions performed, assets employed and risks assumed, based on arm's length principles. This view has been upheld in a number of decisions.

Profit attribution under the Double Taxation Treaties and OCED

The relevant provisions in India's DTAs dealing with business profits are based on article 7 of the OECD and UN model tax conventions. Article 7 allocates the right to tax the PE between the contracting jurisdictions and states that the business profits of an enterprise of one contracting state may be taxed in the other state only to the extent that the profits are attributable to the PE in that other state. India is not a member of the OECD and is not bound by OECD conventions and commentary. However, it has persuasive value and has been used/quoted in many decisions by various appellate authorities.

Committee to examine the issues related to Profit Attribution to Permanent Establishment (PE) in India and Amendment of Rule 10 of Income-tax Rules, 1962 was *constituted by* the Central Board of Direct Taxes (CBDT), The committee observes in its report that currently there are three standard versions of article 7:

Article 7 in the pre-2010 versions of the OECD model convention: In the 2008 version, the OECD recognized and acknowledged the apportionment of profits based on one of the following criteria: receipts (or sales revenue), expenses or working capital. The OECD also provided guidance on where one basis could be considered preferable to another;

Revised article 7 in the 2010 OECD model convention: In the modified article and new commentary, the OECD mandates the authorized OECD approach (AOA) as the preferred approach for the attribution of profits to a PE. The AOA requires attribution of profits to the PE on the basis of a functions performed, assets used and risks assumed (FAR) analysis in accordance with the OECD transfer pricing guidelines; and

Article 7 of the UN model convention: This broadly is similar to the pre-2010 version of article 7 in the OECD model and includes the option of attributing profits to a PE by way of apportionment available in the pre-2010 OECD model convention.

The PE provisions in India's DTAs broadly are similar to the UN model and the committee observes that in accordance with these provisions, profits are to be attributed to a PE as if it were a "distinct and separate entity," using either:

A direct accounting method based on the separate accounts of the PE; or an indirect apportionment method under Indian domestic legislation (Rule 10), where detailed and accurate accounts are not available.

Regarding the significant amendments made in the 2010 update of the OECD model convention, the committee observes that these:

- Introduce a FAR analysis as the basis for the attribution of profits to a PE;
- Reinforce taxation of profits solely on the basis of contributions made by supply side factors irrespective of sales, and thereby do not take account of contributions made by the maintenance of markets and demand side factors to the profitability of the nonresident enterprise; and
- Omit the option to determine attributable profits by way of apportionment as permitted under the pre-2010 OECD and UN model conventions.

The Committee comments that one of the main implications of the changes is that in cases where business profits cannot readily be determined on the basis of accounts, income now has to be determined by undertaking a FAR analysis, ignoring the demand side factors. The committee notes that India has consistently objected to the FAR-based AOA approach and has demonstrated this not only by reserving its right not to adopt the revised article in its DTAs but also by documenting its rejection of the approach and conveying its view that the attribution of profits using a FAR analysis overlooks the role of demand side factors in determining an enterprise's profitability. Since India has not incorporated the OECD's revised article 7 in any of its DTAs, the question of applying the AOA for profit attribution does not arise.

Contribution of demand and supply side factors in profit attribution

The Committee proposes rules for profit attribution based both on demand and supply side factors, instead of a FAR analysis. The rationale underlying the proposal is that the tax base is business profits, which is a factor of both the demand for and supply of goods. Production and sales both are essential for the generation of profits and neither should be ignored when determining

the profits that should be taxable in a jurisdiction. Both production and market jurisdictions are justified in taxing part of the profits to which their economies have contributed, and profits should be allocated in a manner that ensures no double taxation.

The Committee states that there are three possible approaches to profit attribution:

- purely supply side approach,
- purely demand side approach and
- mixed approach.

The Committee's conclusion from its analysis of international practices is that the mixed approach is the most common, there are a few instances of a purely demand approach but the purely supply side approach does not appear to have been adopted by any jurisdiction.

Recognizing the wide scope of discretion accorded to the AO under Rule 10 of the IT Rules in terms of the apportionment method for attribution of profits, the Committee has observed that this creates uncertainties for taxpayers and results in protracted tax disputes. Clear, simple and universally applicable rules for apportionment based profit attribution to a PE are needed in the domestic law.

The Committee observes that a number of rulings on profit attribution in the Indian context have been made by Courts/ Tribunal by adopting different methods for apportionment based attribution of profits, owing to a lack of guidance under the current Rule 10.

Multiple Options Considered by The CBDT Committee for Profit Attribution

After noting that existing Rule 10 gives wide discretion to the AO, Committee discusses following approaches:

Formulary apportionment: - This option involves attribution of consolidated profit of MNC based on three factors namely sales, manpower and assets giving equal weightage (i.e. 33 per cent). However, there is a limitation on availability of country wise information pertaining to sales, assets and manpower. It also notes that Country-by-Country ("CbC") reporting is only

applicable to MNCs having high turnover and hence, smaller turnover cases cannot be catered through it.

Fractional apportionment: - In this option, though equal weightage (i.e. 33 per cent) is assigned to sales, manpower and assets, it restricts its application to data pertaining to India specific operations and negates necessity of having consolidated global turnover and profit data. Committee finds considerable merit in this approach.

Demand and supply based approach: - The Committee notes that in cases where PE is created due to existence of subsidiary in India, supply side is taken care of in the taxation of Indian entity and further tested on arm's length principle. In such case, additional profit to be attributed based on sales can be determined by assigning it 33 per cent weightage. The same result can be achieved through computing total profits from Indian operation and deducting therefrom profits already taxed in the hands of Indian subsidiary. Thus, as per Committee in cases where PE arises due to existence of subsidiary, a minimum of 33 per cent of the profits derived from sales in India will invariably be attributable to the PE on the basis of sales.

Final recommendations of the CBDT Committee

Based on its observations, the committee recommends amendments to Rule 10 to provide for an apportionment-based computation as follows:

- Profits attributable to operations in India would be determined as:
    - Profits derived from India x [(SI/(3 x ST)) + (NI/(6 x NT)) + (WI/(6 x WT)) + (AI/(3 x AT))]
- Profits derived from Indian operations would be the higher of the following amounts:
    - Revenue derived from India x the global operational profit (EBITDA) margin; or
    - 2% of the revenue derived from India;
- Where a business connection is primarily constituted through the existence of an SEP, income attributable to the operations carried out in India would be:

- For digital models with low and medium user intensity, users would be assigned a weighting of 10% and the other three factors a weighting of 30%: Profits derived from India x [((0.3 x SI/ST) + (0.15 x NI/NT) + (0.15 x WI/WT) + (0.3 x AI/AT)) + 0.1];
- For digital models with high user intensity, users would be assigned a weighting of 20%, sales 30%, and assets and employee costs each 25%: Profits derived from India x [((0.3 x SI/ST) + (0.125 x NI/NT) + (0.125 x WI/WT) + (0.25 x AI/AT)) + 0.2];

- No further profits would be attributable to the Indian operations where the business connection of an enterprise in India is represented by the activities of an associated enterprise resident in India; and
  - Any payments on account for sales/services paid by the associated enterprise to the non resident enterprise do not exceed INR 1 million or no payment is made; and
  - The associated enterprise receives full arm's length remuneration for its activities from the non resident; and
- Where the payments received by the non resident enterprise on account of sales/services from associated enterprises resident in India exceed INR 1 million, the profits attributable to the operation of the enterprise in India would be derived based on the general rules and the profits already taxed in the hands of the associated enterprise would be deducted.

Alternatively, an amendment to domestic tax legislation to incorporate a provision for profit attribution to PEs may be considered.

The terms are defined as:

SI = Sales revenue derived by Indian operations from sales in India;

ST = Global sales revenue;

NI = Number of employees located in India in respect of Indian operations;

NT = Total number of employees in respect of Indian operations inside or outside India;

WI = Wages paid to employees employed in India in respect of Indian operations;

WT = Total wages paid to employees in respect of Indian operations inside or outside India;

AI = Assets used for Indian operations and located in India; and

AT = Total assets used for Indian operations, located both inside and outside India.

Chapter 3
Income not to be Included in the Total Income

Section 10 exempts from tax various income. The incomes enumerated in this section are not only excluded from the taxable income of the assessee but also from his total income. In other words, they are not to be taken into computation for the purpose of determining either the taxable income or to the rate of tax. The following incomes are specifically exempt in the hands of the non-resident/foreigners.

Interest to non-resident

The following interest incomes are exempt from tax under section 10(4), 10(4B), 10(4C) and 10(4D) of the Act.

(a) In case of a non-resident, interest on bonds or securities, notified by the Central Government i.e. 43/4 % National Defence Loan 1968 and 3/4% National Defence Loan 1972, including income by way of premium on redemption of such bonds, before June 1, 2002. [Section 10(4)]

(b) In case of a person resident outside India under section 2(w) of the Foreign Exchange Management Act, 1999, (FEMA), interest on Non-Resident (External) Account in any bank in India. [Section 10(4)]

(c) In the case of an Indian citizen or a person of Indian origin who is a non-resident, the interest from notified Central Government securities i.e. National Saving Certificates VI & VII issue, if such certificates were issued before June 1,2002 and were subscribed in convertible foreign exchange remitted from outside through official channels. [Section 10(4B)]

d) In case of non-resident, not being a company, or to a foreign company, Interest payable by any Indian company or business trust in respect of monies borrowed from a source outside India by way of issue of rupee denominated bond, as referred to in clause (ia) of sub-section (2) of section 194LC, during the period beginning from the 17th day of September, 2018 and ending on the 31st day of March, 2019; [Section 10(4C)]

(e) any income accrued or arisen to, or received by a specified fund as a result of transfer of capital asset referred to in clause (viiab) or section 47, on a recognised stock exchange located in any International Financial Services Centre and where the consideration for such transaction is paid or payable in convertible foreign exchange or as a result of transfer of securities (other than shares in a company resident in India) or any income from securities issued by a non-resident (not being a permanent establishment of a non-resident in India) and where such income otherwise does not accrue or arise in India or any income from a securitisation trust which is chargeable under the head "profits and gains of business or profession", to the extent such income accrued or arisen to, or is received, is attributable to units held by non-resident (not being the permanent establishment of a non-resident in India) computed in the prescribed manner. [Section 10(4D)]

A person shall be deemed to be of Indian Origin if he, or either of his parents or any of his grandparents, was born in undivided India.

'Convertible foreign exchange' means foreign exchange which is for the time being treated by the Reserve Bank of India (RBI) as convertible foreign exchange for the purpose of FEMA 1999.

The Board has clarified that the joint holders of Non-resident (external) Account do not constitute an "association of persons" by merely having these accounts in joint names. The benefit of exemption will be available to such joint account holders subject to fulfillment of other conditions contained in that section by each of the individual joint account holder [CBDT Circular No. 592 dated February 04, 1991]

In Rambhai L. Patel v. CIT [2001] 252 ITR 846, the Gujarat High Court held that the legislative intent underlying the provisions is to provide exemption in respect of interest earned only on funds which are repatriable outside India. It is further clear that the exemption will be available in respect of moneys credited in 'Non-resident (External) Account' in case of 'non-resident' and such account has to be maintained in accordance with FERA and Rules made thereunder and such Rules are to be made and notified by the RBI.

In CIT v. Asandas Khatri [2006] 283 ITR 346, the Madhya Pradesh High Court held that the interest earned on fixed deposits made out of money deposited in Non-resident (External) Account is also exempt under section 10(4)(ii) of the Act.

Salary of Diplomatic Personnel

Section 10(6)(ii) provides for exemption in respect of remuneration received by foreign citizen as an official by whatever name called of an embassy, high commission, legation, commission, consulate or trade representation of foreign state, or a member of staff of any of that official, if corresponding Indian official in that foreign country enjoys a similar exemption. Further such members of the staff are subjects of the country represented and are not engaged in any other business or profession or employment in India.

Salary of Foreign Employee

The remuneration received by a foreign national as an employees of a foreign enterprises, for services rendered by him during his stay in India, is totally exempt under section 10(6)(vi) from tax, provided:

(a) the foreign enterprise is not engaged in any business or trade in India

(b) his stay in India does not exceed a period of ninety days in such previous year and

(c) such remuneration is not liable to be deducted from the income of the employer chargeable under the Income tax Act.

Salary Received by a Crew of Foreign Ship

Section 10(6)(viii) provides for exemption in respect of salary received by or due to, a non-resident foreign national as a member of a crew of foreign ship provided his total stay in India does not exceed ninety days during the previous year.

Remuneration of a Foreign Trainee

Under section 10(6) (xi) remuneration received by a foreign national as an employee of a foreign Government during his stay in India, is exempt from tax, if remuneration is received in connection with training in an undertaking owned by

(a) the Government, or

(b) any company owned by the Central Government or any State Government or

(c) any company which is subsidiary of a company referred to in (b) above, or

(d) any statutory corporation; or

(e) any co-operative society, wholly financed by the Central Government; or any State Government.

Tax Paid on Royalty/Fees for Technical Services of Foreign Company

Under section 10(6A) any tax paid by the Government or Indian concern in respect of income by way of royalty or fees for technical services of foreign company is exempt, if such payment is received from Government or an Indian concern in pursuance of an agreement made between April 01,1976 and May 31,2002 and

(a) such agreement relates to a matter included in the industrial policy for the time being in force, of the Government of India and the agreement is in accordance with the policy; or

(b) in any other case, the agreement is approved by the Central Government.

Tax Paid on Behalf of Non-Resident

Section 10(6B) exempts the amount of tax paid by the Government or an Indian concern on behalf of a non-resident or a foreign company in respect of its income, (other than salary, royalty or fee for technical services). Where such income arises to a non resident or a foreign company in pursuance of an agreement entered into before June 1, 2002 between the Central Government and the Government of a foreign state or an international organization under the terms of that agreement or any related agreement made before that date which has been approved by the Central Government.

Tax Paid by Foreign States/Foreign Enterprise

Under section 10(6BB) the tax payable by the Indian Company under an agreement to the Central Government on behalf of the Government of foreign states or foreign enterprise deriving income from an Indian company engaged in the business of operation of air craft as a consideration of acquiring an aircraft or an aircraft engine (other than payment for providing spares, facilities or services in connection with the operation of leased air craft) on lease under an agreement entered after March 31,1977 but before April 1,1999 or entered after March 31, 2007 and approved by the Central Government.

Technical Fees Received by a Notified Foreign Company

Income by way of royalty or fees for technical services received by notified foreign company is exempt under section 10(6C), if such income is received in pursuance of an agreement entered into by the Central Government with the Government of foreign state to provide in or outside India in project connected with security of India

CBDT vide notification no. 74/2015 [200/18/2014-ITA-I] dated September 22, 2015 has notified M/s Thales Systemes Aeroportes SAS, having its office at S.A. au capital de 81 007 176 Euros RCS Paris B 712 042 as a notified foreign company.

Similarly, section 10(6D) provides an exemption to income by way of royalty or fees for technical services arising to the National technical research organization.

Income of a Foreign Government Employee under Co-Operative Technical Assistance Programme

Section 10(8) provides for exemption in respect of income of an individual serving in India in connection with any co-operative technical assistance programme in accordance with an agreement entered into by the Central Government and a foreign Government, if:

(a) the remuneration received by him directly or indirectly from the foreign Government; and

(b) any other income of such individual which accrue or arises outside India, provided that such individual is required to pay any income or social security tax to the foreign Government.

Remuneration or Fees Received by Non-resident Consultants and their Employees and Family Members

Under section 10(8A), the following incomes in case of a consultant are exemption from tax

(a) any remuneration is received by him or it, directly or indirectly, out of the funds made available to an international organization (hereinafter

referred to as the agency) under the technical assistance grant agreement between the agency and the Government of a foreign state; and

(b) any other income which accrues or arise to him or it outside India, and is not deemed to accrue or arise in India in respect of which such consultant is required to pay any income or social tax to the Government of the country of his or its origin.

The expression "consultant" has been defined to mean:

(a) any individual who is either not a citizen of India or being a citizen of India, is not ordinarily resident in India

or

(b) any other person being a non resident; engaged by the agency for rendering technical services in India in accordance with the agreement entered into by the Central Government and the said agency and the agreement relating to the engagement of the consultant is approved by the Department of Economic Affairs in Ministry of Finance, Government of India.

The remuneration received by an employees of the consultant referred to in the aforesaid para is exempt from Income tax provided such employees is either not a citizen of India or, being a citizen of India is not ordinarily resident in India and the contract of his service is approved by the prescribed authority before the commencement of his service [Section 10(8B)].

Any family member of an employee, mentioned above, accompanying him to India enjoys tax exemption in respect of foreign income or an income not deemed to accrue or arise in India, if the family member is required to pay income tax or social security tax to the foreign Government.[Section 10(9)].

Interest

(a) On Bonds: Section 10(15)(iid) exempts interest received by a non resident Indian from notified bonds (notified before June 1, 2002) i.e. NRI Bonds, 1988 and NRI Bonds (Second series) issued by the State Bank of India or an individual owning such bonds by virtue of being nominee or survivor of such non-resident Indian or by individual to whom the bonds have been gifted by a non resident Indian.

This exemption is available only if the bonds are purchased by a non-resident Indian in foreign exchange. The interest and principal received in

respect of such bonds, whether on their maturity or otherwise is not allowable to be taken out of India.

If an individual who is a non-resident Indian in the previous year in which the bonds were acquired becomes a resident in India in any subsequent year, the interest received on such bonds will continue to be exempt in the subsequent years as well.

If the bonds are encashed in a previous year prior to their maturity by an individual who is so entitled, the exemption in relation to the interest income shall not be available to such individual in the assessment year relevant to such previous year in which the bonds have been en-cashed.

(b) On any deposits: Interest payable to any bank incorporated in a country outside India and authorised to perform central banking functions in that country on any deposits made by it, with the approval of the Reserve Bank of India, with any scheduled bank. [Section 10(15)(iiia)]

(c) On loan for projects approved by central government: Interest payable to the Nordic Investment Bank, being a multilateral financial institution constituted by the Governments of Denmark, Finland, Iceland, Norway and Sweden, on a loan advanced by it to a project approved by the Central Government in terms of the Memorandum of Understanding entered into by the Central Government with that Bank on November 25, 1986 [Section 10(15)(iiib)].

(d) On loan in pursuance of financial co-operation agreement: Interest payable to the European Investment Bank, on a loan granted by it in pursuance of the framework-agreement for financial co-operation entered into on November 25, 1993 by the Central Government with that Bank [Section 10(15)(iiic)].

(e) On foreign currency deposits: Interest payable by a scheduled bank to a non-resident or to a person who is not ordinarily resident with the meaning of section 6(6) on deposits in foreign currency and where the acceptance of deposits is approved by RBI is exempt under section 10(15)(iv)(fa).

(f) On deposits in an offshore Banking Unit of SEZ: Any income by way of interest received by a non-resident or a person who is not ordinarily resident, in India on a deposit made on or after the April 1, 2005, in an Offshore Banking Unit referred to in clause (u) of section 2 of the Special Economic Zones Act, 2005 [Section 10(15)(viii)]

Income of the Non-resident from Lease of Aircraft etc.

Any payment made, by an Indian company engaged in the business of operation of aircraft, to acquire an aircraft or an aircraft engine (other than a payment for providing spares, facilities or services in connection with the operation of leased aircraft) on lease from the Government of a foreign State or a foreign enterprise under an agreement not being an agreement entered into between the April 1, 1997 and March 31, 1999 and approved by the Central Government in this behalf

This clause shall not apply to any agreement entered into on or after April 1, 2007

The expression "foreign enterprise" means a person who is a non-resident [Section 10(15A)]

Income of the European Economic Community

Section 10(23BBB) exempts any income of the European Economic Community derived in India by way of interest, dividends or capital gains from investments made out of its funds under such scheme as the Central Government may notify in this behalf. European Community International Institutional Partners (ECIP) Scheme, 1993 was notified by Notification no. SO 115(E) dated February 2, 1995.

European Economic Community means such Community established by the Treaty of Rome of March 25, 1957.

Income of SAARC Fund

Section 10(23BBC) exempts any income derived by the SAARC fund for Regional Projects set up by Colombo Declaration of December 21, 1991 by the heads of state or Government of the Member Countries of South Asian Association for Regional Co-operation established on December 8, 1985 by the charter of the South Asian Association for Regional Co-operation.

Income of the Secretariat of Asian Organization of Supreme Audit Institutions

Income of the secretariat of the Asian Organization of the Supreme Audit Institutions which has been registered as “ASOSAI – SECRETARIAT” under

the Societies Registration Act, 1960 was exempt from the assessment year 2001-02 to assessment year 2010-11. [Section 10(23BBD)]

Income from Specified Services chargeable to equalisation levy

Section 10(50) exempts any income from specified services covered by the provisions of Chapter VIII of the Finance Act, 2016 , comes into force or arising from any e-commerce supply or services made or provided or facilitated on or after the 1st day of April, 2021 (assessment year 2020-21) (vide Finance Act 2020) 1 which are chargeable to equalisation levy.

'Specified services' as covered by section 164(i) of Chapter VIII – Equalisation levy means online advertisement, any provision for digital advertising space or any other facility or service for the purpose of online advertisement and includes any other service as notified by the Central Government.

Other Income Exempt from Total Income

Even following incomes are exempt in the hands of non-residents, like any other assessee, on fulfillment of conditions mentioned in the respective sub sections:

(a) Agricultural income [Section 10(1)].

(b) Receipts by a members from a Hindu Undivided family [Section 10(2)].

(c) Share of profits from partnership firm [Section 10(2A)].

(d) Leave travel concession to Indian citizen [Section 10(5)].

(e) Allowance to Government employees out of India [Section 10(7)].

(f) Gratuity [Section 10(10)].

(g) Pension and leave salary [Section 10(10A)/(10AA)].

(h) Retrenchment compensation [Section 10(10B)].

(i) Compensation received by victims of Bhopal leak disaster [Section 10(10BB)].

(j) Payment from an approved public sector company and other entities at the time of voluntary retirement [Section 10(10C)].

(k) Tax on perquisites paid by employer [Section 10(10CC)].

(l) Amount received under Life Insurance Policies [Section 10(10D)]

(m) Payment from provident fund [Section 10(11)/(12)]

(n) Payment from National Pension Trust on closure / opting out of the scheme and on partial withdrawal [Section 10(12A) and 10(12B)]

(o) Payment from an approved superannuation fund [Section 10(13)].

(p) House rent allowance [Section 10(13A)].

(q) Special allowances [Section 10(14)]

(r) Income by way of interest on premium etc on redemption of notified securities [Section 10(15)(i)].

(s) Interest on notified capital investment bonds [Section 10(15)(iib)].

(t) Interest on notified relief bonds [Section 10(15)(iic)].

(u) Interest on Gold Deposit Bond Scheme, 1999 or deposit certificates issued under the Gold Monetisation Scheme, 2015 [Section 10(15)(vi)].

(v) Interest on notified bonds issued by a local authority [Section 10(15)(vii)]

(va) Interest income to a non-resident by a unit located in an International Financial Services Centre in respect of monies borrowed by it on or after the 1st day of September, 2019 [Section 10(15)(viii)].

(w) Scholarship granted to meet cost of education [Section 10(16)].

(x) Daily allowance of members of Parliament [Section 10(17)].

(y) Payment in cash/kind as award instituted by Central/State Government or award instituted by the Central Government approved body [Section 10(17A)].

(z) Pension to gallantry award winners [Section 10(18)].

(za) Income received from specified funds / charities under section 10(23C)

(zb) Any distributed income, referred to in section 115UA, received by a unit holder from the business trust, not being that proportion of the income which is of the same nature as the income referred to in section 10 (23FC)(a) or section 10(23FCA) [Section 10(23FD)]

(zc) any income accruing or arising to, or received by, a unit holder from a specified fund or on transfer of units in a specified fund.

(zd) Subsidy received by planters [Section 10(31)].

(ze) Income of minor [Section 10(32)].

(zf). Income arising to a shareholder on buy-back of shares (as referred to in section 115QA) [Section 10(34A)]

(zg). Income of an investor by way of distributed income (section 115TA) received from a securitization trust [Section 10(35A)]

(zh) Long term capital gains on transfer of eligible equity shares [Section 10(36)].

(zi) Capital gains arising by way of compulsory acquisition [Section 10(37)].

(zj) LTCG on transfer of equity shares in a company or a unit of an equity oriented fund where such transaction of sale is entered into on or after 1.10.2004 and is subjected to securities transaction tax (STT) [Section 10(38)]

Proviso to section 10(38), as inserted by the Finance Act, 2016, provides that exemption may also be available to a transaction undertaken on a recognized stock exchange located in any International Financial Services Centre and where the consideration for such transaction is paid or payable in foreign currency.

Third proviso to section 10(38) as inserted by the Finance Act, 2017 further provides that exemption under this section will not be available in respect of capital gains arising from the transfer of equity shares, where such equity shares were acquired on or after October 1, 2014, however, which were not subjected to STT earlier.

The above exemption is withdrawn w.e.f. 1 April 2018 after the introduction of section 112A in the Act.

(zk) Any income received in India in Indian currency by a foreign company on account of sale of crude oil to any person in India [Section 10(48)].

(zl) Any income accruing or arising to a foreign company on account of storage of crude oil in a facility in India and sale of crude oil therefrom to any person resident in India [Section 10(48A)]

(zm) Any income accruing or arising to a foreign company on account of sale of leftover stock of crude, if any, from the facility in India after the

expiry of the expiry of agreement or arrangement referred to section 10(48A) of the Act or on termination of the agreement subject to the prescribed conditions [Section 10(48B)]

Special provisions in respect of Newly Established units in Special Economic Zones [Section 10AA]

This section provides deduction in computing the total income of an assessee, being an entrepreneur as referred to in clause (j) of section 2 of the Special Economic Zones Act, 2005, from his Unit, who begins to manufacture or produce articles or things or provide any services during the previous year relevant to any assessment year commencing on or after April 1, 2006 but before April 1, 2021, a deduction of—

(i) hundred per cent of profits and gains derived from the export, of such articles or things or from services for a period of five consecutive assessment years beginning with the assessment year relevant to the previous year in which the Unit begins to manufacture or produce such articles or things or provide services, as the case may be, and fifty per cent of such profits and gains for further five assessment years and thereafter;

(ii) for the next five consecutive assessment years, so much of the amount not exceeding fifty per cent of the profit as is debited to the profit and loss account of the previous year in respect of which the deduction is to be allowed and credited to a reserve account (to be called the "Special Economic Zone Re-investment Reserve Account") to be created and utilized for the purposes of the business of the assessee in the manner laid down in sub-section (2).

Explanation to section 10AA as inserted by the Finance Act 2017 provides that the amount of deduction under this section shall be allowed from the total income of the assessee computed in accordance with the provisions of this Act, before giving effect to the provisions of this section and the deduction under this section shall not exceed such total income of the assessee. Rationale for introducing the explanation was provided as to overcome the controversy, wherein courts on various occasions including the ruling of Supreme Court in the case of Yokogawa India Ltd. [2017] 391 ITR 274 in respect of a similar issue with respect to section 10A, have taken a view that such deduction is to be allowed at the stage of computing the gross

total income of the undertaking and not at the stage of computation of total income.

As per section 10AA(2) the deduction under clause (ii) of sub-section (1) shall be allowed only if the following conditions are fulfilled, namely :—

(a) the amount credited to the Special Economic Zone Re-investment Reserve Account is to be utilised—

  (i) for the purposes of acquiring machinery or plant which is first put to use before the expiry of a period of three years following the previous year in which the reserve was created; and

  (ii) until the acquisition of the machinery or plant as aforesaid, for the purposes of the business of the undertaking other than for distribution by way of dividends or profits or for remittance outside India as profits or for the creation of any asset outside India;

(b) the particulars, as may be specified by the Central Board of Direct Taxes in this behalf, under clause (b) of sub-section (1B) of section 10A have been furnished by the assessee in respect of machinery or plant along with the return of income for the assessment year relevant to the previous year in which such plant or machinery was first put to use.

Sub section (3) provides that where any amount credited to the Special Economic Zone Re-investment Reserve Account under clause (ii) of sub-section (1),—

(a) has been utilised for any purpose other than those referred to in sub-section (2), the amount so utilised; or

(b) has not been utilised before the expiry of the period specified in sub-clause (i) of clause (a) of sub-section (2), the amount not so utilised,

shall be deemed to be the profits,—

(i) in a case referred to in clause (a), in the year in which the amount was so utilised; or

(ii) in a case referred to in clause (b), in the year immediately following the period of three years specified in sub-clause (i) of clause (a) of sub-section (2),

and shall be charged to tax accordingly :

Provided that where in computing the total income of the Unit for any assessment year, its profits and gains had not been included by application of the provisions of sub-section (7B) of section 10A, the undertaking, being the Unit shall be entitled to deduction referred to in this sub-section only for the unexpired period of ten consecutive assessment years and thereafter it shall be eligible for deduction from income as provided in clause (ii) of sub-section (1).

Explanation.—For the removal of doubts, it is hereby declared that an undertaking, being the Unit, which had already availed, before the commencement of the Special Economic Zones Act, 2005, the deductions referred to in section 10A for ten consecutive assessment years, such Unit shall not be eligible for deduction from income under this section :

Provided further that where a Unit initially located in any free trade zone or export processing zone is subsequently located in a Special Economic Zone by reason of conversion of such free trade zone or export processing zone into a Special Economic Zone, the period of ten consecutive assessment years referred to above shall be reckoned from the assessment year relevant to the previous year in which the Unit began to manufacture, or produce or process such articles or things or services in such free trade zone or export processing zone :

Provided also that where a Unit initially located in any free trade zone or export processing zone is subsequently located in a Special Economic Zone by reason of conversion of such free trade zone or export processing zone into a Special Economic Zone and has completed the period of ten consecutive assessment years referred to above, it shall not be eligible for deduction from income as provided in clause (ii) of sub-section (1) with effect from the April 1, 2006.

Section 10AA(4) lays down the undertakings to which this section applies. This section applies to undertakings which fulfill the following conditions:—

(i) it has begun or begins to manufacture or produce articles or things or provide services during the previous year relevant to the assessment year commencing on or after the April 1, 2006 in any Special Economic Zone;

(ii) it is not formed by the splitting up, or the reconstruction, of a business already in existence:

Provided that this condition shall not apply in respect of any undertaking, being the Unit, which is formed as a result of the re-

establishment, reconstruction or revival by the assessee of the business of any such undertaking as is referred to in section 33B, in the circumstances and within the period specified in that section;

(iii) it is not formed by the transfer to a new business, of machinery or plant previously used for any purpose.

Explanation.—The provisions of Explanations 1 and 2 to sub-section (3) of section 80-IA shall apply for the purposes of clause (iii) of this sub-section as they apply for the purposes of clause (ii) of that sub-section.

Where any undertaking being the Unit which is entitled to the deduction under this section is transferred, before the expiry of the period specified in this section, to another undertaking, being the Unit in a scheme of amalgamation or demerger [Section 10AA(5)],—

(a) no deduction shall be admissible under this section to the amalgamating or the demerged Unit, being the company for the previous year in which the amalgamation or the demerger takes place; and

(b) the provisions of this section shall, as they would have applied to the amalgamating or the demerged Unit being the company as if the amalgamation or demerger had not taken place.

(6) Loss referred to in sub-section (1) of section 72 or sub-section (1) or sub-section (3) of section 74, in so far as such loss relates to the business of the undertaking, being the Unit shall be allowed to be carried forward or set off.

For the purposes of sub-section (1), the profits derived from the export of articles or things or services (including computer software) shall be the amount which bears to the profits of the business of the undertaking, being the Unit, the same proportion as the export turnover in respect of such articles or things or services bears to the total turnover of the business carried on by the undertaking [Section 10A(7)]:

Provided that the provisions of this sub-section [as amended by section 6 of the Finance (No. 2) Act, 2009 (33 of 2009)] shall have effect for the assessment year beginning on April 1, 2006 and subsequent assessment years.

Section 10AA(8) provides for the applicability of the provisions of sub-sections (5) and (6) of section 10A to the articles or things or services referred to in sub-section (1) as if—

(a) for the figures, letters and word "1st April, 2001", the figures, letters and word "1st April, 2006" had been substituted;

(b) for the word "undertaking", the words "undertaking, being the Unit" had been substituted.

Section 10AA(9) provides for the applicability of the provisions of sub-section (8) and sub-section (10) of section 80-IA shall, so far as may be, apply in relation to the undertaking referred to in this section as they apply for the purposes of the undertaking referred to in section 80-IA.

Section 10AA(10) provides that where a deduction under this section is claimed and allowed in respect of profits of any of the specified business, referred to in section 35AD(8)(c), for any assessment year, no deduction shall be allowed under the provisions of section 35AD in relation to such specified business for the same or any other assessment year.

Explanation 1.—For the purposes of this section,—

(i) "export turnover" means the consideration in respect of export by the undertaking, being the Unit of articles or things or services received in, or brought into, India by the assessee but does not include freight, telecommunication charges or insurance attributable to the delivery of the articles or things outside India or expenses, if any, incurred in foreign exchange in rendering of services (including computer software) outside India;

(ii) "export in relation to the Special Economic Zones" means taking goods or providing services out of India from a Special Economic Zone by land, sea, air, or by any other mode, whether physical or otherwise;

(iii) "manufacture" shall have the same meaning as assigned to it in clause (r) of section 2 of the Special Economic Zones Act, 2005;

(iv) "relevant assessment year" means any assessment year falling within a period of fifteen consecutive assessment years referred to in this section;

(v) "Special Economic Zone" and "Unit" shall have the same meanings as assigned to them under clauses (za) and (zc) of section 2 of the Special Economic Zones Act, 2005.

Explanation 2.—For the removal of doubts, it is hereby declared that the profits and gains derived from on site development of computer software (including services for development of software) outside India shall be deemed to be the profits and gains derived from the export of computer software outside India.

Chapter 4
Presumptive Taxation

Taxation of Shipping Profits Derived by Non Residents [Section 44B]

Section 44B provides that profits or gains of a non-resident from the business of operation of ships are to be taken @ 7.5% of the aggregate of the following amounts:

(a) paid or payable, whether in or out of India, to the assessee or to any person on his behalf on account of carriage of passengers, livestock, mail or goods shipped at any port in India.

(b) received or deemed to be received in India by or on behalf of the assessee on account of the carriage of passengers, livestock mail or goods shipped at any port outside India.

Explanation to Section 44B provides that the amounts referred to above will also include the amount paid or payable or received or deemed to be received by way of demurrage charges or handling charges or any other amount of similar nature.

Important Judicial Precedents & Board Circulars:

1. The amounts paid or payable or the amounts received or deemed to be received will also include the amount paid or payable or received or deemed to be received by way of demurrage charges or handling charges or any other amount of similar nature [CIT v. Japan Lines Ltd. [2003] 260 ITR 656 (Madras HC)].

   Thus 7.5% of the gross amounts mentioned above would be liable to tax and no deduction would be allowed for any expenditure, (i.e. the provisions of section 28 to 43A are not to be taken into account) however carried forward losses would be allowed to be set off from such income.

2. Service tax a statutory liability would not involve any element of profit and a service provider collects same from its customers, therefore the same cannot be included in total receipt for determining presumptive income under section 44B [Islamic Republic of Iran Shipping Lines v DCIT (Intl Taxation) [2011] 46 SOT 101 (Mumbai Tribunal)]

3. Once it is accepted that assessee is into a shipping business, then either the provisions of DTAA shall apply or section 44B of the Act. [A.P.Moller Maersk v. DDIT [2014] 149 ITD 434 (Mumbai Tribunal)].

4. In Anchor Line Ltd. v. ITO, [1990] 32 ITD 403, the Mumbai Tribunal has observed that, "set off of carry forward of losses" has been discussed in sections 70 to 80 and these provisions have to be applied in the case of a non resident when profits and gains of shipping business are computed under the special provision viz. section 44B. Therefore, business loss would be allowed to be carried forward and set off irrespective of provisions of section 44B, subject to limitation that it could not be allowed to be carried forward and set off beyond period of eight years.

Comparison with Section 172

At this juncture, it is appropriate to compare section 172 on this topic which is placed under chapter XV, "Liability in special cases". The heading of the section is "Shipping business of non-residents". It creates a tax liability in respect of occasional shipping by making a special provision for the levy and recovery of tax in the case of a ship belonging to or chartered by a non resident which carries passengers, livestock, mail or goods shipped at any port in India.

The object of the section is to ensure the levy and recovery of tax in the case of ships belonging to or chartered by non-residents. The section brings to tax the profits made by them from occasional shipping by means of summary assessment in which 7.5% of the gross amount received by them is deemed to be assessable profit.

It is significant to note that there is a difference between section 44B and section 172. In section 44B, no procedure for assessment and collection of tax is provided.

The incidence of tax under section 44B is on a non-resident engaged in the business of operation of ships or chartered by him or it, and if such income constituted the amount paid to payable on account of the carriage of passengers, livestock, mail or goods shipped to any port in India.

While section 172 refers to levy and recovery of tax in the case of any ship belonging to or chartered by a non-resident which carries passengers, livestock, mail or goods shipped from any port in India.

The difference between section 44B and section 172 has been explained by the Karnataka High Court in V. M. Salgaocer & Bros Ltd. v. Deputy Controller [1991] 187 ITR 381. Those who do regular shipping business are covered by section 44B and they will be assessed in accordance with the provision of the Act applicable to the rates specified in section 44B, while causal visit of Indian port is covered by section 172.

Section 172(3) imposes an obligation on the master of the ship to prepare and furnish to the Assessing Officer a return of the full amount paid or payable to the owner or charterer or any person on this behalf, on account of the carriage of all passenger, livestock, mail or goods shipped at any port in India since the last arrival of the ship thereat. Such return is, ordinarily, to be furnished by the master of the ship before the departure, from that port in India, of the ship.

The proviso to section 172(3) however, provides that a return may be filed by the person authorized by the master of the ship within 30 days of the departure of the ship from the port, if:

(a) the Assessing Officer is satisfied that it is not possible for the master of the ship to furnish the return required by section 172(3) before the departure of the ship from the port and

(b) the master of the ship has made satisfactory arrangement for the filing of the return and payment of tax by any other person on this behalf.

Section 172(4) provides for a summary procedure of assessment. On receipt of the return filed by the master of the ship or by any person on this behalf, the Assessing Officer has to determine the taxable income by virtue of provision of section 172(2), the taxable income is a sum equal to 7.5% of the amount paid or payable on account of carriage of passengers etc. to the owner or charterer or to any person on his behalf, whether that amount is paid or payable in or out of India. The tax payable on such taxable income is to be calculated at the rate or rates in force applicable to the total income. The master of the ship is liable for payment of such tax.

Under section 172(4A), it is incumbent on the AO to pass the order of assessment within 9 months from the end of the financial year in which the return of income under section 172(3) is filed.

Section 172(5) empowers the Assessing Officer, for the purpose of determining the tax payable, to call for such accounts and documents as he may require.

Section 172(6) prohibits grant of a port clearance to the ship until the Collector of customs or other authorized officer, is satisfied that the tax assessable under section 172 has been duly paid or that satisfactory arrangements have been made for the payment thereof.

Under section 172(7), the owner or charter has option to claim before the expiry of the assessment year relevant to the previous year in which the date of departure of the ship from the Indian port falls, that an assessment in respect of his total income for the previous year may be made in the normal course under section 143. In such a case, any payment made under section 172 is to be treated as a payment in advance of the tax leviable for that assessment year and the difference between the sum so paid and the amount of tax found payable by him on such assessment is to be paid by him or refunded to him as the case may be.

Under section 172(8) the sum chargeable to tax includes amounts payable by way of demurrage charge or handling charge or any other amount of similar nature.

Profits and gains in connection with the business of exploration etc. of mineral oils [Section 44BB]

Section 44BB provides for determination of income of taxpayer being a non resident engaged in the business of providing services or facilities in connection with, or supplying plant and machinery on hire used or to be used in the exploration for and exploitation of mineral oils.

In such case, income shall be calculated @ 10% of the amounts paid or payable to the taxpayer or to any person on his behalf whether in or out of India, on account of the provisions of such services or facilities or supply of plant & machinery on hire for the aforesaid purposes. This amount also includes the amounts received or deemed to be received in India on account of such service or facilities or supply of plant and machinery used or to be used in the exploration for and exploitation of mineral oils.

The proviso to section 44BB(1) makes it clear that the section shall not apply in case where the provisions of the following sections apply:

(i)	Section 42	Special provision for deductions in the case of business for prospecting etc. for mineral oil, or
(ii)	Section 44D	Special provision for computing income by way of

		royalties etc. in the case of foreign companies, or
(iii)	Section 44DA	Special provision for computing income by way of royalties etc. in the case of non-residents.
(iv)	Section 115A	Tax on dividends, royalty and fees for technical services in the case of foreign companies, or
(v)	Section 293A	Power to make exemption etc., in relation to participation in the business of prospecting for, extraction etc., of mineral oil.

For the purpose of this section, “plant" includes ships, aircraft, vehicles, drilling units, scientific apparatus and equipment, used for the purposes of the said business and "mineral oil" includes petroleum and natural gas.

Important Judicial Precedents & Board Circulars

1. In Advance Ruling Petition no. P6 of 1995, In re [234 ITR 371 (AAR)], has been held that section 44BB deals with non-resident assessee which may be Indian or foreign nationals, hence, the concessional treatment under this section would be available to both.

2. In DCIT v. Geoservices Eastern Inc., [1995] 55 ITD 227, the Mumbai Tribunal has observed that as per the scheme of section 44BB the assessee is not required to maintain regular books of account. It is open to the assessee to adopt the system of accounting of his choice only when he maintains the books of account. If there are no books of account, no question arises in regard to the choice of methods. Section 145 is, therefore, not relevant for deciding such case.

3. The Delhi Tribunal in MC Dermott International Inc v. DCIT, [1994] 49 ITD 590, held that amount of tax paid on behalf of the assessee is to be added to the receipts of the assessee and aggregate amount would be treated as total receipts and the factor of income have to be limited to 10% of this aggregate.

4. Similar view has been expressed by the Orissa High Court in Oil India Ltd. v. CIT [1995] 212 ITR 225. The Court held that the tax liability of the non-resident, firm which had been undertaken and paid by the Indian firm would be a perquisite arising from the business of oil exploration under the agreement entered into by the non resident firm with the Indian firm and would be taxable as such. The computation of the same would have to be made under sub section (2) of section

44BB and, therefore, only 10% of the same would be deemed to be the profits of such business chargeable to tax.

5. In CIT v. Oil & Natural Gas Commission [2002] 255 ITR 413, the Rajasthan High Court held that no provisions of sections 28 to 41 as a whole and sections 43 and 43A could be resorted to for the purpose of computing the income from business of exploration of mineral oil.

6. In OHM Ltd In re [2011] 335 ITR 423, AAR has held that scheme of computation of income under section 44BB does not provide any leeway to apply both sub-section (1) and (3) of section 44BB to income arising from business activities falling under ambit of section 44BB(1). Even if part of the income falls under 'Royalties' or 'Fees for Technical Services', there is no scope to assess such receipts under these heads, once it is held that income is from oil exploration and production activities as envisaged under section 44BB.

7. In Global Geophysical Services Ltd, In re [2011] 332 ITR 418, AAR has held that where seismic survey and data acquisition activities are performed with the aim to increase the chances of success of oil and gas exploration and increasing the production; the amount payable towards such services is chargeable to tax under section 44BB

8. Reimbursement of catering charges is liable to be included in amount chargeable under section 44BB. CIT v Ensco Maritime Ltd [2009] 317 ITR 14 (Uttaranchal HC)

9. Mobilisation charges received by the assessee for mobilizing equipment from outside India to a site in India is includible in the amounts chargeable to tax under section 44BB. Sedco Forex International Inc. v CIT [2008] 214 CTR 192 (Uttaranchal HC). This view has been confirmed by the Supreme Court in 2017 in 399 ITR 1 (SC).

10. The Supreme Court in the case of Oil & Natural Gas Corporation Ltd. v. CIT [2015] 376 ITR 306, held that payment for providing various services in connection with prospecting, extraction or production of mineral oil, would be assessed under section 44BB, and not under section 44D. The Supreme Court while arriving at above conclusion observed that Explanation (a) to section 44D, specifies that 'fees for technical services' as mentioned in section 44D would have the same meaning as in Explanation 2 to clause (vii) of section 9(1) and has taken cognizance of the Circular dated 22 October 1990.

11. The Jaipur Tribunal in the case of National Oil Well Maintenance Company [2018] 89 taxmann.com 24 has held that where consideration for provision of comprehensive cementing services in respect of exploratory and development wells planned to be drilled through equipment, material and personnel will qualify for exclusion from fee for technical services under Explanation 2 to section 9(1)(vii) and, in such a case, provisions of section 44BB being more specific, shall be applicable and provisions of section 44DA are not applicable.

12. The Delhi High Court in the case of DIT v. OHM Ltd. [2013] 352 ITR 406, observed that the proviso to sub-section (1) of section 44BB can only mean that the flat rate of 10 per cent of the revenues cannot be deemed to be the profits of the non-resident where the services are of the type which do not fall under that section, but are more general in nature so as to fall under section 44DA. Similarly, the second proviso to sub-section (1) of section 44DA can only be interpreted to mean that where the services are general in nature and fall under the sub-section read with Explanation 2 to section 9(1)(vii), then an assessee rendering such services as provided in section 44BB cannot claim the benefit of being assessed on the basis that 10 per cent of the revenues will be deemed to be the profits as provided in section 44BB.

13. The Delhi Tribunal in the case of Siem Offshore Crewing AS v. ADIT [2016] 68 Taxmann.com 135, held that a proviso was also inserted to section 44BB which, inter alia, excluded the royalty or FTS contemplated under section 44D or section 115A. Section 44DA was inserted by Finance Act 2010 w.e.f. 1-4- 2011. From the combined reading of these sections it is evident that all the sections relating to royalty/FTS operate in different fields and that is the reason for insertion of proviso to sections 44BB/44DA/115A. Where the assessee was imparting services which entitled it to royalty or FTS simpliciter then the same continues to be assessed u/s 9(1)(vi)/(vii) read with section 115A of the Act. However, where the assessee is imparting services in relation to oil exploration, the Royalty/FTS would be taxable under section 44BB. Specific services are contemplated only under section 44BB and, therefore that being special provision, the same will prevail over all other provisions dealing with royalty/FTS.

14. A Similar ruling has been also rendered by the Delhi Tribunal in the case of RPS Energy Pty Ltd. [2018] 92 taxmann.com 77 wherein it was held that Sections 9, 44BB, 44DA and 115A relating to royalty/fees for technical services operate in different fields; where assessee is imparting services which could be a simple royalty or fees for technical services, then same would be taxed under section 9(1)(vi)/(vii) read with section 115A, but where assessee is imparting any services in relation to exploration of mineral oil then royalties/ fees for technical services would be taxable under section 44BB.

15. A similar ruling has been rendered by Delhi ITAT in the case of M/S PGS GEOPHYSICAL AS 2019(2) TMI 1422 that It is necessary for the claim of the assessee for applicability of Section 44BB of I.T. Act to succeed, that the vessels given on hire by the Assessee are shown to be fitted with necessary equipments, and having the technical capacity for use in the prospecting for, or extraction or production of, mineral oils. In addition, it is also necessary for assessee's claim U/s 44BB of I.T. Act to succeed, that the vessels used for the contract with parties must be the same vessels (fitted with necessary equipments, and has the technical capacity for use in the prospecting for, or extraction or production of, mineral oils) that were taken on hire from the assessee.

16. The Mumbai Tribunal in the case of Production Testing Services Inc. [2018] 89 taxmann.com 416 has held that prospecting for or extraction or production of mineral oil is not to be treated as technical services for purpose of Explanation 2 of section 9(1)(vii) and, therefore, payments received by assessee for rendering of Fracturing Flow Back Services for extraction or production of mineral oil as sub-contractor would not fall within realm of 'fees for technical services'

17. The Delhi Tribunal in the case of ONGC as Representative Assessee of University of Calgary, Alberta, Canada v. ADIT [2017] 81 Taxmann.com 419 held that Section 44BB applies in a case where consideration is for services relating to exploration activity which are not in nature of technical services; if consideration is in nature of fee for technical services, provisions of either section 44DA or section 115A will be applicable.

18. Provisions of section 44BB are applicable to taxpayer being a second leg contractor/sub-contractor. [Technip UK Ltd. v. DIT [2017] 81 Taxmann.com 311 (Delhi Tribunal)]

19. Section 44BB does not envisage only direct use of plant and machinery in prospecting for or extraction or production of mineral oils. Hence, amount received by a foreign company from hiring of barge used for offshore accommodation of employees was also liable to be taxed under section 44BB. [Valentine Maritime (Gulf) LLC v. ADIT [2017] 163 ITD 32 (Mumbai Tribunal)]

20. In case, the Service-tax and/or VAT have been separately charged in the bills and accordingly accounted for, then it would not form part of the receipts under Section 44BB of the Act and if it is found that these items are included in the consolidated amount of bills, then it should form part of the receipts under Section 44BB of the Act [B.J. Services Company Middle East Ltd. v. ADIT [2017] 77 Taxmann.com 218 (Delhi Tribunal)].

21. In the case of DIT v. Mitchell Drilling International (P.) Ltd. [2016] 380 ITR 130, the Delhi High Court held that service tax collected and passed on to Government does not have any element of income and therefore cannot form part of gross receipts for purposes of computing 'presumptive income' of under section 44BB of the Act.

22. In Swiwar Offshore Pte. Ltd. [2018] 89 taxmann.com 346, the Mumbai Tribunal held that where a non-resident assessee gave vessels on hire to Indian companies, in view of fact that said vessels were used by hirers for transporting men and machines to locations where it was doing exploration/production of mineral oil, said service being 'in connection with' prospecting for and exploration activities, income arising out of such activities had to be assessed under section 44BB and not under section 44B. Further, it also held that where assessee had charged service tax as a part of billing for charter hire charges, said amount being in nature of a statutory payment, which had to be deposited with Government, it could not be included in gross receipts for purpose of computing presumptive income of assessee under section 44BB.

23. In Ensco Maritime Ltd. v. ADIT [2017] 244 Taxman 261, the Uttarakhand High Court held that section 44BB is a complete code in itself and the amount received, be it by way of reimbursement, is not, in any way, excluded from the ambit of Section 44BB of the Act. The Special leave petition has been granted by the Supreme Court [2017] 244 Taxman 190.

24. In SeaBird Exploration FZ LLC., In re [2018] 92 taxmann.com 328, the AAR New Delhi held that where activities of applicant relating to offshore seismic data acquisition and other associated services to ONGC were in connection with exploration of mineral oils, special provisions of section 44BB would apply, and income of applicant in respect of contract with ONGC was to be computed as laid out therein

The Act has amended section 44BB with effect from assessment year 2004-05 to provide that an assessee may claim lower profits and gains than the profits and gains specified under sub section (1), if he keeps and maintains such books of account and other documents as required under section 44AA(2) and get his accounts audited and furnishes a report of such audit as required under section 44AB.The Assessing Officer shall then make an assessment of the total income or loss of the assessee under section 143(3).

Profits and gains of the business of operation of aircraft in the case of non-resident [Section 44BBA]

Section 44BBA is a non-obstante, so sections 28 to 43A are not applicable in the case of a non-resident engaged in the business of operation of aircraft.

Income from such business is calculated at a flat rate of 5% of the following:

(a) amount paid or payable whether, in or out of India, to the tax payer or to any person on his behalf on account or carriage of passenger, livestock, mail or goods from any place in India and

(b) amount received or deemed to be received in India by or on behalf of the taxpayer on account of carriage of passenger, livestock, mail or goods from any place outside India.

Profits and gains of foreign companies engaged in the business of civil construction [Section 44BBB]

Section 44BBB provides that notwithstanding anything to the contrary contained in sections 28 to 44AA, the income of foreign companies engaged in the business of civil construction or erection or testing or commissioning of plant or machinery in connection with a turnkey power project shall be deemed @ 10% of the amount paid or payable to such assessee or to any

person on his behalf whether in or out of India. For this purpose, the Central Government should approve turnkey power project.

The Central Board of Direct Taxes vide its circular no. 557 dated February 09,1990 clarified that an approval issued by the Department of Power in the Ministry of energy shall be deemed to be the approval of the Central Government for the purpose of section 44BBB of the Act.

In Van Oord ACZ. BV, In re [2001] 248 ITR 399 (AAR Delhi), held that section 44BBB literally applies to a foreign company engaged in the construction and other specified business in connection with a power project financed under an international aid programme. The assessee is taxed on ten per cent of the entire amount received by it under the contract without any deduction or allowance permissible under chapter IV-D of the Act.

Section 44BBB was amended with effect from assessment year 2004-05 to provide that an assessee may claim lower profits and gains than the profits and gains specified under sub section (1), if he keeps and maintains such books of account and other documents as required under section 44AA(2) and get his accounts audited and furnishes a report of such audit as required under section 44AB. The Assessing Officer shall then make an assessment of the total income or loss of the assessee under section 143(3).

In Shandong Tiejun Electric Power Engineering Co. [2018] 400 ITR 371, the Gujarat High Court held that where assessee engaged in execution of turnkey projects, maintained books of account under section 44AA(2), audited the said accounts and audit report had been furnished before Assessing Officer, its claim for being taxed as per provisions of section 44BBB(2) was to be allowed.

Non-applicability of section 115JB

Explanation 4A to Section 115JB as inserted by the Finance Act 2018 (retrospectively made applicable from 1 April 2001) provides that the MAT provisions will not apply to foreign companies covered by section 44B, 44BB, 44BBA or section 44BBBA and that is the only source of profits or gains from business.

Head office expenditure in the case of non-resident [Section 44C]

In case of a non-resident, head office expenditure is allowed in accordance with the provision of section 44C. This section is a non-obstante provision and anything contrary contained in sections 28 to 43A is not applicable.

Deduction in respect of head office expenditure is restricted to the least of the following:

(a) an amount equal to 5% of "adjusted total income" or in the case of loss, 5% of the "average" adjusted total income; or

(b) the amount of so much of the expenditure in the nature of head office expenditure incurred by the assessee as is attributable to the business or profession of the assessee in India.

"Adjusted total income" means the total income computed in accordance with the provisions of the Act without giving effect to the following.

(i) Unabsorbed depreciation allowance under section 32(2).

(ii) Investment allowance under section 32A.

(iii) Development rebate under section 33.

(iv) Development allowance under section 33A.

(v) Expenditure incurred by a company for the purpose of promoting family planning amongst its employees under first proviso to section 36(1)(ix).

(vi) Allowance under this section.

(vii) Business loss carried forward under section 72(1).

(viii) Speculation loss brought forward under section 73(2).

(ix) Loss under the head "capital gain" under section 74(1).

(x) Loss from certain specified source brought forward under Section 74A(3).

(xi) Deduction under section 80C to 80U.

"Average adjusted total income" means the total income of the assessee, assessable for each of the three assessment years immediately preceding the relevant assessment year, one third of the aggregate amount of the

adjusted total income in respect of previous years relevant to the aforesaid three assessment years is average adjusted total income.

When the total income of the assessee is assessable only for two of the aforesaid three assessment years, one half of the aggregate amount of the adjusted total income in respect of the previous years relevant to the aforesaid two assessment years is taken on average adjusted total income.

Where the total income of the assessee is assessable only for one of the aforesaid three assessment years, the amount of the adjusted total income in respect of the previous year relevant to that assessment year is average adjusted total income.

"Head office expenditure" means executive and general administration expenditure incurred by the assessee outside India, including expenditure incurred in respect of:

(a) rent, rates, taxes, repairs or insurance of any premises outside India used for the purpose of the business or profession.

(b) salary, wages, annuity, pension, fees, bonus, commission, gratuity, perquisites or profit in lieu of or in addition to salary, whether paid or allowed to any employee or other person employed in, or managing the affairs of, any office outside India;

(c) traveling by any employee or other person employed in, or managing the affairs, of any office outside India; and

(d) such other matters connected with executive and general administrative as may be prescribed.

Important Judicial Precedents & Board Circulars:

1. The purpose of this section has been explained by the Bombay High Court in CIT v. Emirates Commercial Bank Ltd. [2003] 262 ITR 55. The court explained that section 44C is applicable only in the cases of those non-residents, who carry on business in India through their branches The said section was introduced to get over difficulties in scrutinizing claims in respect of general administrative expenses incurred by the foreign head office in so far as such expenses stand related to their business or profession in India having regard to the fact that foreign companies operating through branches in India sometimes try to reduce the incidence of tax in India by inflating their claims in respect of the head office expenses. In other words, section 44C seeks to impose a ceiling/restriction on head office expenses.

2. In CIT v. Saudi Arabian Airlines [1985] 155 ITR 65 (Bombay HC), the Indian income of the assessee a non-resident was computed in accordance with the provisions contained in rule 10(ii) of the Income tax Rules, 1962. For this purpose, the world income of the business of the assessee was required to be computed. Hence, the Bombay High Court held that section 44C is not applicable, where the computation of non-resident is made in accordance with rule 10(ii).

3. Similarly, in DCIT v. Mitsubishi Heavy Industries Ltd. [1999] 102 Taxman 301, the Delhi Tribunal held that in view of the Article III (3) of the DTA with Japan, the provision of section 44C were not applicable, and the assessee was entitled to claim head office expenses at higher amount.

4. CBDT circular no 649 dated March 31, 1993 provides for the treatment of the technical expenses remitted to head office of a non-resident enterprise by a branch office in India. It provides that the technical fee paid to head office on account of reimbursement towards third party expense shall be allowed as deduction without any limit while computing the profits of branch. The provisions of TDS shall apply to the payment made towards such third party reimbursement of technical expenses.

5. The assessee did not carry any business outside India therefore entire head office expenses attributable to business in India are to be allowed. [DIT v. Ravva Oil (Singapore) (P.) Ltd. [2008] 300 ITR 53 (Delhi HC)]

6. The Mumbai Tribunal in the case of Lloyd's Register Asia (India Branch Office) v. ACIT [2015] 69 SOT 441, held that 'license fees' and 'management service fees' paid by an Indian branch to its UK Head office does not fall in nature of 'Head office expenses' under section 44C of the Act.

7. In Oman International Bank, S.A.O.G v. DDIT [2014] 62 SOT 98, the Mumbai Tribunal held that payment made to employee deputed to India exclusively for work performed by him for Indian branch of assessee bank, does not fall under section 44C of the Act but is fully allowable under section 37 of the Act.

8. In Shinhan Bank v. DDIT (Int. tax.) 54 SOT 140 (Mumbai Tribunal), it was held that head office expenditure under section 44C includes common expenditure that benefits both head office and branch.

Salary paid to expatriate employees deputed from head office to Indian branch is an expenditure to be allowed in full without restriction of section 44C.

Special provisions for computing income by way of royalties etc, in case of foreign companies [Section 44D]

Section 44D(a) provides that while computing the income from royalty or fees for technical services in pursuance of agreements entered into by foreign companies with Government of India or Indian company before April 1, 1976, shall not exceed 20% of the gross amount of such royalty or fees for technical services as reduced by gross amount of royalty or fees for technical services which consist of lump sum consideration for the transfer of data, documentation, drawing or specification relating to any patent, invention, model, design, secret formula or process or trademark of similar property.

No deduction in respect of any expense or allowance is allowed where the agreement is entered into after March 31, 1976 but before April 1, 2003 [Section 44D(b)]

Special provisions for computing income by way of royalties etc, in case of non-residents [Section 44DA]

Section 44DA provides the method of computation of income by way of royalty or fees for technical services arising from the agreement made by the non-resident with the Indian company or Government of India after March 31, 2003 where:

(a) such non-resident carries business/profession in India through permanent establishment or fixed place of profession; and

(b) the right, property or contract in respect of which the royalty or fees for technical services in respect of which the royalty or fees for technical services is paid is effectively connected with such permanent establishment or fixed place of profession.

While computing the income chargeable to tax under this section following expenses are allowed as deduction:

(i) actual expenses incurred wholly and exclusively for such permanent establishment or fixed place of profession in India

(ii) reimbursement of actual expenses to head office or to any of its other offices

The provisions of section 44BB do not apply in respect of income covered by this section.

Under this section the non-resident is mandatorily required to maintain the books of accounts and get them audited.

The assessee is required to furnish the audit report in Form 3CE before the specified date referred to in section 44AB and furnish by that date.

Chapter 5
Capital Gains

A non-resident or a foreign company is liable to capital gains tax in India, if he/it transfers a property (capital asset) in India. Section 45 of the Act provides for capital gains. In order that section 45 may be attracted there must be a transfer of a capital asset. The expression 'transfer' is defined under section 2(47) and 'capital asset' is defined in section 2(14) of the Act.

The transfer must be effected in the previous year and some profit or gain must arise from such transfer. If these conditions are fulfilled the section provides that such profit or gain is chargeable to income-tax under the head 'Capital gains' and the same shall be deemed income of the previous year in which the transfer has taken place. Thus, the section brings to charge capital gains and its ingredients are:

(i) the existence of a capital assets; owned by the assessee;

(ii) a transfer of such asset during the previous year;

(iii) profits and gains arising from transfer of such asset, and

(iv) such profits and gains must accrue or arise to the assessee.

If these conditions are satisfied, then such profits shall be deemed to be income of such previous year and attract charge of tax.

Section 48 lays down the mode of computation of capital gain and provides that the income chargeable under the head 'Capital gains' shall be computed by deducting the full value of consideration received or accruing as a result of the transfer of the capital asset from the following amounts viz:-

(i) expenditure incurred wholly and exclusively in connection with such transfer;

(ii) the cost of acquisition of the asset and the cost of any improvement thereto.

The first proviso to the said section provides that in case of a non-resident, capital gains arising from transfer of a capital asset being shares in or debentures of an Indian company shall be computed by converting the cost of acquisition, the expenditure incurred wholly and exclusively in connection with such transfer and the full value of consideration received or accruing as a result of the transfer of the capital asset into the same foreign currency as

was initially utilized in the purchase of the shares or debentures. Thereafter, the capital gains so computed in such foreign currency shall be re-converted into Indian currency.

Rule 115A of the Income tax Rules, 1962 provides for the purpose of computing capital gains arising from the transfer of a capital asset being shares in, or debentures of, an Indian company, in case of an assessee who is a non-resident Indian, the rate of exchange shall be:

(a) for converting the cost of acquisition of capital asset, the average of the telegraphic transfer buying rate and telegraphic transfer selling rate of the foreign currency initially utilized in the purchase of the said asset, as on the date of its acquisition;

(b) for converting expenditure incurred wholly and exclusively in connection with transfer of capital asset referred to in clause (a), the average of the telegraphic transfer buying rate and telegraphic transfer selling rate of the foreign currency initially utilized in the purchase of the said asset, as on the date of transfer of capital asset;

(c) for converting the full value of consideration received or accruing as a result of transfer of capital asset referred to in clause (a), the average of the telegraphic transfer buying rate and telegraphic transfer selling rate of the foreign currency initially utilized in the purchase of the said asset, as on the date of transfer of capital asset;

(d) for reconverting capital gains computed in the foreign currency initially utilized in the purchase of the capital asset into rupees, the telegraphic transfer buying rate or such currency, as on the date of transfer of the capital asset.

For the purposes of this rule, 'telegraphic transfer buying rate' in relation to a foreign currency, means the rate or rates of exchange adopted by the State Bank of India for buying such currency having regard to the guidelines specified from time to time by the RBI for buying such currency where such currency, made available to that bank through a telegraphic transfer.

Further, for this rule, 'telegraphic transfer selling rate', in relation to a foreign currency, means the rate of exchange adopted by the State Bank of India for selling such currency where such currency is made available by that bank through telegraphic transfer.

It is also provided that the aforesaid manner of computation of capital gains shall be applicable in respect of capital gains accruing or arising from every re-investment thereafter in and sale of shares in or debentures of an Indian

company. Proviso to section 48 provides that for computing the full value of consideration, any gains arising to a non-resident on account of appreciation of rupee against a foreign currency at the time of redemption of rupee denominated bonds of an Indian company subscribed by him, shall be ignored.

Additional proviso to section 48 inserted by the Finance Act 2018 (applicable from April 1, 2018) states that the provisions related to conversion of currency conversion as discussed above shall not apply to the long-term capital gains arising from the transfer of equity shares or unit of an equity oriented fund etc. covered by section 112A.

In Cairn UK Holdings Ltd v. DIT [2013] 359 ITR 268, the Delhi High Court has held that the long-term capital gain earned by the assessee non-resident on off-market sale of shares of listed Indian company is taxable at 10% under the proviso to section 112. Proviso to section 112(1) does not state that an assessee, who avails benefit of the first proviso to section 48, is not entitled to the benefit of lower rate of tax at 10%.

If the total income of an assessee includes any income chargeable under the head 'capital gains' arising from transfer of a capital asset being an equity share in a company or unit of an equity oriented fund and transaction of sale of such security has been entered on or after October 1, 2004 on which Securities Transaction Tax ('STT') is chargeable, then, short term capital gains shall be payable @ 15% and no long term capital gains shall be payable on such securities.

Proviso to section 10(38) as inserted by Finance Act 2017 and which is made applicable from April 1, 2018 states that long term capital gains from transfer of listed equity shares acquired on or after October 1, 2004, other than the acquisition notified by the Central Government in this behalf, would be exempt from tax under section 10(38) of the Act only if the STT was paid at the time of acquisition of such shares. However, to protect the exemption in genuine cases, it was proposed to notify transfers for which the pre-condition of chargeability to STT on acquisition would not be applicable.

The CBDT had issued guidelines vide notification dated June 5, 2017, which would come into force with effect from April 1, 2018 and shall accordingly apply to assessment year 2018-19 onwards. Provisions of final notification are as under:

The Government, for the purposes of the proviso to section 10(38) notifies all the transactions of acquisition of equity shares entered into on or after 1 October 2014 which are not chargeable to STT, other than the following-

I. Preferential allotment

a) Where acquisition is made through a preferential issue of existing listed equity shares in a company whose equity shares are not frequently traded on a recognized stock exchange of India. However, the exemption under section 10(38) of the Act would continue to be available in respect of acquisition of listed equity shares in a company-

- Which has been approved by the Supreme Court, High Court, National Company Law Tribunal, Securities and Exchange Board of India or Reserve Bank of India in this behalf;
- by any non-resident in accordance with foreign direct investment guidelines issued by the Government of India;
- by an investment fund referred to in clause (a) of Explanation 1 to section 115UB of the Income-tax Act or a venture capital fund referred to in clause (23FB) of section 10 of the Act or a Qualified Institutional Buyer;
- through preferential issue to which the provisions of chapter VII of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009 does not apply.

II. Off-market acquisitions

b) Where transactions for acquisition of existing listed equity shares in a company is not entered through a recognized stock exchange of India

- However, exemption would continue to be available in respect of the following transactions of acquisition of listed equity shares even if such acquisition is not routed through a recognized stock exchange in India, provided the same is made in accordance with the provisions of the Securities Contracts (Regulation) Act, 1956, if applicable;

- Acquisition through an issue of shares by a company other than the issue referred to in above;
- Acquisition by scheduled banks, reconstruction or securitization companies or public financial institutions during their ordinary course of business;
- Acquisition which has been approved by the Supreme Court, High Courts, National Company Law Tribunal, Securities and Exchange Board of India or Reserve Bank of India in this behalf;
- Acquisition under employee stock option scheme or employee stock purchase scheme framed under the Securities and Exchange Board of India (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999;
- Acquisition by any non-resident in accordance with foreign direct investment guidelines of the Government of India;
- Where acquisition of shares of a company is made under Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011
- Acquisition by any non-resident in accordance with foreign direct investment guidelines of the Government of India;
- Where acquisition of shares of company is made under Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulation, 2011;
- Acquisition from the Government;
- Acquisition by an investment fund referred to in clause (a) of Explanation 1 to section 115JB of the Act or venture capital fund referred to in clause (23FB) of section 10 of the Act or a Qualified Institutional Buyer;
- Acquisition by mode of transfer referred to in section 47 (transfers under a gift/will/irrevocable trust, transfers between holding/subsidiary, amalgamation, demerger etc.) or 50B (slump sale) of the Act, if the previous owner of such shares has not acquired them by any mode

referred to in point (a)/(b) or (c) (other than the carve outs) mentioned under (a) or (b) above].

III. Acquisition during de-listed period

c) Acquisition of equity shares of a company during the period beginning from the date on which the company is delisted from a recognized stock exchange and ending on the date immediately preceding the date on which the company is again listed on a recognized stock exchange in accordance with the Securities Contracts (Regulation) Act, 1956 read with Securities and Exchange Board of India Act, 1992 and the rules made thereunder.

Explanation, –for the purpose of this notification, –

(a). "Frequently traded shares*"* means shares of a company, in which the traded turnover on a recognized stock exchange during the twelve calendar months preceding the calendar month in which the transfer is made, is at least ten per cent of the total number of shares of such class of the company:

Provided that where the share capital of a particular class of shares of the company is not identical throughout such period, the weighted average number of total shares of such class of the company shall represent the total number of shares

(b). "Listed' means listed in a recognized stock exchange in India in accordance with the Securities Contracts (Regulation) Act, 1956 (42 of 1956) and any rule made there under

(c). "Recognised stock exchange" shall have the same meaning as in clause (f) of section 2 of the Securities Contracts (Regulation) Act, 1956 (42 of 1956).

Other terms defined under the notification are preferential issue, Qualified Institutional Buyer, public financial institution, scheduled bank, reconstruction company and securitization company. Subsequent proviso to section 10(38) of the Act (as inserted by the Finance Act 2018) provides that the exemption therein shall not apply to any long-term capital gains arising from the transfer of an equity shares or units of an equity oriented fund etc. effected on or after April 1, 2018 vis-à-vis section 112A.

New Section 112A as inserted by the Finance Act 2018 provides that the 10% tax will apply on all long-term capital gains arising from the transfer of

equity share in a company or a units of an equity oriented fund or a unit of a business trust on an amount exceeding Rs. 1 lakh.

For the purpose of section 112A, 'equity oriented fund' means a fund set up under a scheme of mutual fund specified under section 10(23D) and:

- The fund invests in the units of another fund which is traded on a recognized stock exchange:
    - At least 90% of the total proceeds is invested in the units of such other fund; and
    - Such other fund also invests at least 90% of its total proceeds in the equity shares of domestic companies listed on recognized stock exchange; and
- Other case – at least 65% of the total proceeds of such fund is invested in the equity shares of domestic companies listed on recognized stock exchange.

However, the aforementioned percentage of holding shall be computed with reference to the annual average of the monthly averages of the opening and closing figures.

Following conditions to be fulfilled for applying the concessional tax rate of 10% viz.

- STT has been paid on –
    - acquisition and transfer of equity shares being transferred;
    - Transfer of unit of equity oriented fund or a unit of a business trust

Condition of payment of STT not to apply to-

- Transfers undertaken on recognized stock exchange located in International Financial Services Centre and where sales consideration is received in foreign currency
- Acquisitions to be specified by the Central Government. In this connection, the CBDT has issued a draft notification on 24 April 2018 inviting suggestions of the stakeholders on the same by 30 April 2018. In furtherance of the same, the CBDT issued the final notification on 01 October 2018 ("**Final Notification**")

Benefit under chapter VIA and rebate under section 87A cannot be availed.

However, the application of section 112A provisions are relaxed to an extent by providing the cost step-up benefit based on fair value as on January 31 2018, subject to conditions. The cost for acquisitions prior to January 31, 2018 may be computed by comparing the higher of-

- Actual cost of acquisition And
- Lower of – fair Market value and full value of consideration received or accruing on transfer of capital asset

Fair market value for the above purpose shall be computed in the following manner-

- In case the specific capital asset listed on stock exchange traded on January 31, 2018 – Highest price of the capital asset quoted on stock exchange on that date
- In case the capital asset listed on stock exchange but not traded on 31 January 2018 - Highest price of the capital asset quoted on stock exchange on a date immediately preceding 31 January 2018 when such asset was traded on stock exchange
- In case the capital asset is a unit and is not listed on stock exchange - Net asset value of such asset on 31 January 2018
- In case the capital asset is an equity share in a company which is:
    - Not listed on stock exchange on 31 January 2018 but listed on the date of transfer; or
    - Listed on stock exchange on the date of transfer and which became the property in consideration of share which is not listed as on 31 January 2018 by way of transaction not regarded as transfer under section 47

  Cost of acquisition of the capital asset after comparing with the cost inflation index for the financial year 2017-18 and for the year of acquisition or the financial year 2001-2002, whichever is later.

Further, Section 47 provides that nothing contained in section 45 shall apply to the following transfers:-

(1) Any transfer of a capital asset under a gift or will or an irrevocable trust

(2) Any transfer, in a scheme of amalgamation, of capital asset being a share or shares held in an Indian company, by the amalgamating foreign company to the amalgamated foreign company, if –

(a) at least twenty-five per cent of the shareholders of the amalgamating foreign company continue to remain shareholders of the amalgamated foreign company, and

(b) such transfer does not attract tax on capital gains in the country, in which the amalgamating company is incorporated.

(3) Any transfer, in a scheme of amalgamation, of a capital asset, being a share of a foreign company referred to in the Explanation 5 to section 9(1)(i) of the Act, which derives its value directly or indirectly substantially from the sale of share or shares of an Indian company, held by the amalgamating foreign company to the amalgamated foreign company. Conditions prescribed are same as (1) above.

(4) Any transfer of a capital asset, being bonds or Global Depository Receipts referred to in sub-section (1) of section 115AC, made outside India by a non-resident to another non-resident.

(5) Any transfer made outside India of a capital asset being rupee denominated bond of an Indian company issued outside India, by a non-resident to another non-resident.

(6) Any transfer of a bond or Global Depository Receipts covered by section 115AC(1), rupee denominated bond or derivatives made by a non-resident on a recognized stock exchange located in any International Financial Service Centre and where the consideration for the transaction is paid or payable in foreign currency

(7) Any transfer made outside India of a capital asset being a Government Security carrying a periodic payment of interest through an intermediary dealing in settlement of securities, by a non-resident to another non-resident.

(8) Any transfer in a demerger of a capital asset, being a share or shares held in an Indian company by the demerged foreign company to the resulting company, if –

(a) the share holder holding not less than three-fourths in value of shares of the demerged foreign company continue to remain shareholders of the resulting foreign company; and

(b) such transfer does not attract tax on capital gains in the country, in which the demerged foreign company is incorporated.

The provision of section 391 to 394 of the Companies Act, 1956 shall not be applicable to such demerger.

(9) Any transfer in a demerger, of a capital asset, being a share of a foreign company, referred to in Explanation 5 to clause (i) of sub-section (1) of section 9, which derives, directly or indirectly, its value substantially from the share or shares of an Indian company, held by the demerged foreign company to the resulting foreign company. Conditions prescribed are same as (4) above. Thus, in the aforesaid cases a non-resident or a foreign company is not liable to capital gains.

Further, section 50C provides that the consideration received or accruing as a result of the transfer by an assessee of a capital asset, being land or building or both, is less than the value adopted or assessed by any authority of a State Government for the purpose of payment of stamp duty in respect of such transfer, the value so adopted or assessed shall, for the purpose of section 48, be deemed to be the full value of the consideration received or accruing as a result of such transfer. Proviso to section 50C provides that where the date of agreement fixing the amount of consideration and the date of registration for transfer of the capital asset are not the same, the value adopted by the stamp valuation authority on the date of agreement may be taken for computing the full value of consideration for such transfer. The second proviso provides that the first proviso shall apply only in a case where the amount of consideration, or a part thereof, has been received by way of an account payee cheque or account payee bank draft or by use of electronic clearing system through a bank account, on or before the date of the agreement for transfer. Third Proviso has been inserted by the Finance Act, 2018 w.e.f. 1-4-2019 to provide that where the value adopted or assessed or assessable by the stamp valuation authority does not exceed one hundred and five per cent (which is now increased to one hundred and ten percent by Finance Act, 2020 w.e.f. 01-04-2021) of the consideration received or accruing as a result of the transfer, the consideration so received or accruing as a result of the transfer shall, for the purposes of section 48, be deemed to be the full value of the consideration.

Section 50CA inserted by the Finance Act 2017 w.e.f 1.04.2018 provides that where the consideration received or accruing on transfer of a capital asset, being an unquoted shares of a company is less than the fair market value of

such share determined in such manner as may be prescribed, for the purpose of section 48 of the Act, the value so determined shall be deemed to be the full value of consideration received or accruing as a result of such transfer.

Proviso to section 50CA as inserted from Finance Act 2020 provides that the provisions of this section shall not apply to any consideration received or accruing as a result of transfer by such class of persons and subject to such conditions as may be prescribed.

Explanation to section 50CA provides the meaning of 'quoted share' as the share quoted on any recognized stock exchange with regularity from time to time, where the quotation of such share is based on current transaction made in the ordinary course of business.

Similarly, Section 50D provides that where the consideration received or accruing as a result of the transfer of a capital asset by an assessee is not ascertainable or cannot be determined, then for the purpose of computing income chargeable to tax as capital gains, the fair market value of the asset on the date of transfer shall be deemed to be the full value of consideration received or accruing as a result of such transfer.

Section 112(1)(c) provides that where the total income of an assessee includes any income, arising from the transfer of a long-term capital asset, which is chargeable under the head "Capital gains", the tax payable by the assessee, non-resident (not being a company) or a foreign company, on the total income shall be the aggregate of:

(i) the amount of income-tax payable on the total income as reduced by the amount of such long-term capital gains, had the total income as so reduced been its total income ; and

(ii) the amount of income-tax calculated on long-term capital gains [except where such gain arises from transfer of capital asset referred to in sub-clause (iii)] at the rate of twenty per cent; and

(iii) the amount of income-tax on long-term capital gains arising from the transfer of a capital asset, being unlisted securities or shares of a company not being a company in which the public are substantially interested, calculated at the rate of ten per cent on the capital gains in respect of such asset as computed without giving effect to the first and second proviso to section 48.

Further, section 112 provides that an assessee shall not be eligible for deduction under Chapter VIA and rebate under section 88 in respect of any income arising from the transfer of a long-term capital asset.

Chapter 6
Deductions

The Chapter VI of the Income tax Act 1961, provides for deduction from gross total income. The deductions available to non-resident are stated in this topic.

General Principles

Section 80A provides certain general principles, for the purpose of deductions to be allowed, while computing the total income.

Section 80A(2) limits the aggregate of deduction under section 80C to 80U to the amount of the gross total income of the assessee.

If the gross total income of the assessee is determined as 'nil ', then there is no question of any deduction being allowed under Chapter VI-A in computing the total income. The gross total income must be determined, by setting off against the income, the business losses of earlier years, before allowing deduction under Chapter VI-A and if the resultant income was 'nil', then the assessee could not claim deduction under Chapter VI-A. [Synco Industries Ltd. v. AO [2008] 299 ITR 444 (SC)]

Section 80A(3) provides that where, in computing the total income of an association of persons or body of individuals any deduction is admissible in either of sections, viz, 80G, 80GGA, 80GGC, 80HH, 80HHA, 80HHB, 80HHC, 80HHD, 80I, 80-IA, 80-IB, 80IC, 80ID, 80IE, 80-J or 80JJ, no deduction under the same section shall be made in computing the total income of a member of the association of persons or body of individuals in relation to the share of such member in the income of the association of persons or body of individuals.

Section 80A(4) puts rider on allowability of deduction under this section. It provides that notwithstanding anything to the contrary contained in section 10A or section 10AA or section 10B or section 10BA or in any provisions of this Chapter where, in the case of an assessee, any amount of profits and gains of an undertaking or unit or enterprise or eligible business is claimed and allowed as a deduction under any of those provisions for any assessment year, deduction in respect of, and to the extent of, such profits and gains shall not be allowed under any other provisions of this Act for such

assessment year and shall in no case exceed the profits and gains of such undertaking or unit or enterprise or eligible business, as the case may be.

Where the assessee fails to make a claim in his return of income for any deduction under section 10A or section 10AA or section 10B or section 10BA or under any provision of this Chapter under the heading "C.— Deductions in respect of certain incomes", no deduction shall be allowed to him thereunder.[Section 80A(5)]

Section 80A(6) provides that the price of transfer of goods or services from one undertaking or unit to another undertaking or unit of the assessee is to be taken at arm's length. That is, notwithstanding anything to the contrary contained in section 10A or section 10AA or section 10B or section 10BA or in any provisions of this Chapter under the heading "C—Deductions in respect of certain incomes",

— where any goods or services held for the purposes of the undertaking or unit or enterprise or eligible business are transferred to any other business carried on by the assessee, or

— where any goods or services held for the purposes of any other business carried on by the assessee are transferred to the undertaking or unit or enterprise or eligible business

and, the consideration, if any, for such transfer as recorded in the accounts of the undertaking or unit or enterprise or eligible business does not correspond to the market value of such goods or services as on the date of the transfer,

then, for the purposes of any deduction under this Chapter, the profits and gains of such undertaking or unit or enterprise or eligible business shall be computed as if the transfer, in either case, had been made at the market value of such goods or services as on that date.

The expression "market value" means,—

(i) in relation to any goods or services sold or supplied, the price that such goods or services would fetch if these were sold by the undertaking or unit or enterprise or eligible business in the open market, subject to statutory or regulatory restrictions, if any;

(ii) in relation to any goods or services acquired, means the price that such goods or services would cost if these were acquired by the undertaking or unit or enterprise or eligible business from the open market, subject to statutory or regulatory restrictions, if any.

(iii) in relation to any goods or services sold, supplied or acquired means the arm's length price as defined in clause (ii) of section 92F of such goods or services, if it is a specified domestic transaction referred to in section 92BA.

80A(7) debars the allowability of deduction under section 35AD if a deduction under any provision of this Chapter under the heading "C.—Deductions in respect of certain incomes" is claimed and allowed in respect of profits of any of the specified business referred to in section 35AD(8)(c)

The deductions are to be allowed only if the assessee claims and establishes the circumstances warranting such deduction. *[Stumpp Schuele & Somappa P. Ltd. [1977] 106 ITR 399 (Karnataka HC)].*

Section 80AB states that the deduction in respect of certain income in respect of any income of the nature specified in that section which is included in the 'gross total income' of the assessee, then notwithstanding anything contained in that section, for the purpose of computing the deduction under that section, the amount of income of the nature as computed in accordance with the provisions of the Act before making any deduction under this chapter, shall alone be deemed to be the amount of income of that nature which is derived or received by the assessee and which is included in his gross total income.

Deduction not to be allowed unless return furnished [Sec 80AC]

In respect of previous year beginning April 1, 2006 but upto March 31, 2018 and thereafter, where any deduction is admissible under section 80-IA or section 80-IAB or section 80-IB or section 80-IC or section 80-ID or section 80-IE, no such deduction shall be allowed to the assessee unless he furnishes a return of his income for such assessment year on or before the due date specified under sub-section (1) of section 139. [DCIT v. Siroya Developers [2017] 162 ITD 718 (Mumbai Tribunal)]Similarly, for Assessment years beginning on or after April 1, 2018, no deduction under part C of Chapter VIA viz. section 80HH, 80HHA, 80HHB, 80HHBA, 80HHC, 80HHD, 80HHE and 80HHF, etc. shall be allowed unless the return of income is furnished on or before the due date specified under section 139(1) of the Act.

Section 80B defines "Gross Total Income" to mean the total income computed in accordance with the provisions of this Act, before making any deductions under this chapter.

It was held by the Supreme Court in the case of Synco Industries Ltd. v. AO [2008] 299 ITR 444 that the effect of section 80B is that gross total income will be arrived at after making the computation as follows:—

(i) making deductions under the appropriate computation provisions;

(ii) including the incomes, if any, under sections 60 to 64 in the total income of the assessee;

(iii) adjusting intra-head and/or inter-head losses; and

(iv) setting off brought forward unabsorbed losses and unabsorbed depreciation, etc.

Deduction in respect of life insurance premia, deferred annuity, contributions to provident fund, subscription to certain equity shares or debentures etc [Section 80C]

Deduction under this section is available to residents as well as non- resident assesses being individual or HUF. The maximum permissible deduction is Rs.1,50,000/-

The payments towards life insurance, deferred annuity, provident fund, Superannuation fund, ULIPS, Pension fund, repayment of Housing loan installment, tuition fee of children, investment in equity linked schemes etc are eligible for deduction.

The assessee in order to claim exemption under section 80C must, at least, establish that sums in question have quality of entering the field of taxation, apart from exemptions and exclusions. Thus, if the foreign income of non-resident assessee does not enter his total income, sums paid for life insurance by him out of his foreign income which was not assessable to tax in India, could not be deducted in computing his income assessable to tax in India. [S. Inder Singh Gill v. CIT [1963] 47 ITR 284 (Bombay HC)]

Deduction in respect of pension fund [Section 80CCC]

Section 80CCC provides that, where an assessee being an individual has in the previous year paid or deposited any amount out of his income chargeable to tax, to effect or keep in force a contract for any annuity plan of LIC of India or any other insurer for receiving pension from fund set up by the said corporation as approved by the Controller of Insurance, be allowed a deduction in respect of whole of the amount paid or deposited but not exceeding Rs.1,50,000/-.

Where the assessee or his nominee surrenders the annuity before maturity date of such annuity, the surrender value shall be taxable in the hands of the assessee or his nominees, as the case may be, in the year of receipt.

The amount received by the assessee or his nominee as pension will be taxable, in the hands of the assessee or nominee, as the case may be, in the year of receipt.

No rebate under section 88 to person to whom deduction under this section has been allowed for any assessment year before April 1, 2006.

No deduction is allowed u/s 80C on the amount on which deduction u/s 80CCC has been allowed for any assessment year beginning on or after April 1, 2006.

Deduction in respect of contribution to pension scheme of Central Government [Section 80CCD]

(1) Deduction under this section is available to all individual assesses resident or non-resident. The deduction is available on fulfillment of following conditions:

(a) An assessee, being an individual is employed by the Central Government on or after January 1, 2004, or any other employer,

(b) Any other assessee, being an individual has in the previous year paid or deposited any amount in his account under a pension scheme notified or as may be notified by the Central Government;

he shall be allowed a deduction in the computation of his total income, of the whole of the amount so paid or deposited as does not exceed,—

(a) in the case of an employee, ten per cent of his salary in the previous year; and

(b) in other case, twenty per cent of his gross total income in the previous year.

(1B) An assessee referred to in sub-section (1), shall be allowed a deduction in computation of his total income, whether or not any deductions is allowed under sub-section (1), of the whole of the amount paid or deposited in the previous year in his account under a pension scheme notified or as may be notified by the Central Government, which shall not exceed fifty thousand rupees.

However, no deduction under this sub-section shall be allowed in respect of the amount on which a deduction has been claimed and allowed under sub-section (1).

(2) The amount contributed by the Central Government as an employer or any other employer, to assessee employee's pension scheme account, the assessee employee shall be allowed a deduction in the computation of his total income, of the whole of the amount contributed by the Central Government as does not exceed fourteen per cent of his salary in the previous year and does not exceed ten percent where such contribution is made by any other employer.

(3) Where any amount standing to the credit of the assessee in his account referred to in sub-section (1) or (1B), in respect of which a deduction has been allowed under those sub-sections or sub-section (2), together with the amount accrued thereon, if any, is received by the assessee or his nominee, in whole or in part, in any previous year,—

(a) on account of closure or his opting out of the pension scheme referred to in sub-section (1) or (1B); or

(b) as pension received from the annuity plan purchased or taken on such closure or opting out,

the whole of the amount referred in (a) or (b) shall become taxable in the previous year in which such amount is received.

However, the amount received by the nominee, on the death of the assesee, under the circumstances referred to in clause (a) above, shall not be deemed to be the income of the assessee.

Where deduction is allowed under sub-section (1) or (1B):

(a) no rebate for such amount shall be allowed under section 88 for any assessment year ending before April 1, 2006;

(b) no deduction with reference to such amount shall be allowed under section 80C for any assessment year beginning on or after April 1, 2006;

The amount is deemed not to have received for the purposes of this section, if such amount is used for purchasing an annuity plan in the same previous year.

Limit on deductions under section 80C, 80CCC and 80CCD [Section 80CCE]

The aggregate amount of deductions under section 80C, section 80CCC and section 80CCD(1) shall not, in any case, exceed Rs. 1,50,000.

Deduction in respect of medical insurance premia [Section 80D]

Section 80D provides that, if an individual or a HUF has paid by cheque in the previous year out of his/its income chargeable to tax, any sum to effect or to keep in force an insurance on the health of or any contribution made to the Central Government Health Scheme or such other scheme as may be notified by the Central Government in this behalf or any payment made on account of preventive health check-up of the assessee or spouse or dependent parents or dependent children or any member of the family, then a deduction to the extent of amount deposited or Rs.25,000/- whichever is lower is allowed.

Where the assessee or his/her spouse or dependant parents or any member of the family is a senior citizen or a very senior citizen i.e. who is resident in India and has attained 60 or 80 years of age respectively at any time during the year and insurance premium is paid to effect or keep in force an insurance on the health or any contribution made to the Central Government Health Scheme or such other scheme as may be notified by the Central Government in this behalf or any payment made on account of preventive health check-up, then, the aforesaid limit of Rs. 25,000/- would be increased to Rs. 50,000/-.

Where the amounts are paid on account of preventive health check-up, the deduction for such amounts shall be allowed to the extent, it does not exceed in the aggregate Rs. 5,000/-.

Further, Sub-section (4A) has been inserted w.e.f. April 1, 2019 to provide a fractional deduction for amounts paid in lump sum for more than one previous year.

Deduction in respect of interest on loan taken for higher education [Section 80E]

The deduction is available to all individual assessees

Quantum of deduction is amount paid in the previous year out of income chargeable to tax, by way of interest on loan taken by individual assessee

from any financial institution or any approved charitable institution for the purpose of pursuing higher education for self or relative.

The deduction is available in 8 assessment years beginning the year in which assessee starts paying interest or until the interest is paid in full whichever is earlier.

“Higher education" means any course of study pursued after passing the Senior Secondary Examination or its equivalent from any school, board or university recognised by the Central Government or State Government or local authority or by any other authority authorised by the Central Government or State Government or local authority to do so;

"relative", in relation to an individual, means the spouse and children of that individual or the student for whom the individual is the legal guardian.

For claiming deduction under section 80E, there is no condition that higher education should be in India only. [Nitin Shantilal Muthiyan v. DCIT [2015] 154 ITD 543 (Pune Tribunal)]

Deduction in respect of interest on loan taken for residential house property [Section 80EE]

The deduction is available to all individual assesses in respect of interest payable on loan taken by him from any financial institution for the purpose of acquisition of a residential property.

The deduction shall not exceed Rs. 50,000 and shall be allowed in computing the total income of the individual for the assessment year 2017-18 and onwards.

The deduction shall be subject to the following conditions:

- the loan has been sanctioned by the financial institution during the period beginning on between April 1, 2016 and March 31, 2017;
- the amount of loan sanctioned for acquisition of the residential house property does not exceed Rs. 35,00,000;
- the value of residential house property does not exceed Rs. 50,00,000;
- the assessee does not own any residential house property on the date of loan sanction.

Where a deduction under this section is allowed for any interest referred to in sub-section (1), deduction shall not be allowed in respect of such interest

under any other provision of this Act for the same or any other assessment year.

Deduction in respect of interest on loan taken for certain house property [Section 80EEA]

(A) As per section 80EEA of the Act, In computing the total income of an assessee, being an individual not eligible to claim deduction under section 80EE, interest payable, not exceeding Rs. 1,50,000, on loan taken by him from any financial institution for the purpose of acquisition of a residential house property shall be allowed as deduction.

(B) The deduction shall be subject to the following conditions:

(i) the loan has been sanctioned by the financial institution during the period beginning on the 1st day of April, 2019 and ending on the 31st day of March, 2021;

(ii) the stamp duty value of residential house property does not exceed forty-five lakh rupees;

(iii) the assessee does not own any residential house property on the date of sanction of loan.

Deduction in respect of purchase of electric vehicle [Section 80EEB]

Under section 80EEB of the Act, in computing the total income of an assessee, deduction is available to all individual assesses in respect of interest payable on loan taken by him from any financial institution for the purpose of purchase of an electric vehicle.

The deduction shall not exceed Rs.1,50,000 and shall be allowed in computing the total income of the individual

The deduction shall be subject to that the loan has been sanctioned by the financial institution during the period beginning on the 1st day of April, 2019 and ending on the 31st day of March, 2023.

Deduction in respect of donations to certain funds charitable institutions etc. [Section 80G]

(A) Under section 80G of the Act, in computing the total income of an assessee an amount equal to the 100% of the sum is entitled for

deduction as donation irrespective of limit of 10% of the gross total income. The items covered are:

(i) the National Defence Fund set up by the Central Government, or

(ii) the Prime Minister's National Relief Fund the Prime Minister's Citizen Assistance and Relief in Emergency Situations Fund (PM CARES FUND); or

(iii) the Prime Minister's Armenia Earthquake Relief Fund; or

(iv) the Africa (Public contributions India) Fund; or

(v) the National Children's Fund; or

(vi) the National Foundation for Communal Harmony; or

(vii) a University or any educational institution of national eminence as may be approved by the prescribed authority in this behalf; or

(viii) the Maharashtra Chief Minister's Relief Fund during the period beginning on October 1, 1993 and ending on October 6, 1993 or to the Chief Minister's Earthquake Relief Fund, Maharashtra; or

(ix) any fund set up by the State Government of Gujarat exclusively for providing relief to the victims of earthquake in Gujarat, or

(x) any Zila Saksharta Samiti constituted in any district under the chairmanship of the collector of that district for the purposes of improvement of primary education in villages and towns in such district and for literacy and post literacy activities. For this clause 'town' means a town which has a population not exceeding one lakh according to the last preceding census of which the relevant figure have been published before the first day of the previous year; or

(xi) the National Blood Transfusion Council or to any State Blood Transfusion Council which has its sole object the control, supervision, regulation or encouragement in India of the services related to operation and requirements of blood banks. For this purposes, "National Blood Transfusion Council" means a society registered under the Societies

Registration Act, 1860 and has an officer not below the rank of an Additional Secretary to the Government of India dealing with the AID Control Project as its chairman by whatever named called; and "State Blood Transfusion Council" means a society registered in consultation with the National Blood Transfusion Council, under the Societies Registration Act, 1860 or under any law corresponding to that Act in force in any part of India and has secretary to the Government of that state dealing with the Department of Health, as its chairman, by whatever named called; or

(xii) any fund set up a State Government to provide medical relief to the poor; or

(xiii) the Army Central Welfare Fund or the Indian Naval Benevolent Fund or the Air Force Central Welfare Fund established by the armed forces of the union for the welfare of the past and present members of such forces, as their dependents; or

(xiv) the Andhra Pradesh Chief Minister's Cyclone Relief Fund 1996; or

(xv) the National illness Assistance Fund, or

(xvi) the Chief Minister's Relief Fund or the Lieutenant Governor's Relief Fund in respect of any state or union territory, as the case may be; provided that such fund is –

(a) the only fund of its kind established in the state or the union territory as the case may be;

(b) under the overall control of the Chief Secretary or the Department of Finance of the State of the Union territory, as the case may be;

(c) administered in such manner as may be specified by the State Government or the lieutenant Governor as the case may be ; or

(xvii) the National Sports Fund to be set up by the Central Government; or

(xviii) the National Cultural Fund set up by the Central Government; or

(xix) the fund for Technology Development and Application set up by the Central Government; or

(xx) the National Trust for welfare of Persons with Autism, Cerebral Palsy, Mental Retardation and Multiple Disabilities constituted under section 3(1) of the National Trust for welfare of Persons with Autism Cerebral Palsy, Mental Retardation and Multiple Disabilities Act, 1999; or

(xxi) the Swachh Bharat Kosh, set up by the Central Government, other than the sum spent by the assessee in pursuance of Corporate Social Responsibility under sub-section (5) of section 135 of the Companies Act, 2013; or

(xxii) the Clean Ganga Fund, set up by the Central Government, where such assessee is a resident and such sum is other than the sum spent by the assessee in pursuance of Corporate Social Responsibility under sub-section (5) of section 135 of the Companies Act, 2013; or

(xxiii) the National Fund for Control of Drug Abuse constituted under section 7A of the Narcotic Drugs and Psychotropic Substances Act, 1985 (61 of 1985); or

(xxiv) any sums paid by the assessee, during the period beginning on January 26, 2001 and ending on September 30, 2001, to any trust, institution or fund to which this section applies for providing relief to the victims of earthquake in Gujarat.

(B) Further, under section 80G, in computing the total income deduction to the extent of 50% of donation made of the following amounts irrespective of limit of 10% of gross total income is allowed:

(i) The Jawaharlal Nehru Memorial Fund referred to in the Deed of Declaration of Trust adopted by the National committee at its meeting held on August 17, 1964; or

(ii) the Prime Minister's Drought Relief Fund; or

(iii) the Indira Gandhi Memorial Trust, the deed of declaration in respect whereof was registered at New Delhi on February 21, 1985; or

(iv) the Rajiv Gandhi Foundation, the deed of declaration in respect of whereof was registered at New Delhi on June 21, 1991; or

(C) Under section 80G, in computing the total income of an assessee an amount equal to 100% of the sum is entitled for deduction as donation subject to limit 10% of gross total income as reduced by deductions permissible under other provisions of chapter VIA:

(i) the Government or to any such local authority, institution or association as may be approved in this behalf by the Central Government to be utilized for the purpose of promoting family planning;

or

(ii) any sums paid by the assessee being a company, in the previous year as donation to the Indian Olympic Association or to any other association or institution established in India, as the Central Government may having regard to the prescribed guidelines, by notification in Official Gazette specify, specify in this behalf for:-

(a) the development of infrastructure for sports and games in India, or;

(b) the sponsorship of sports and games in India.

(D) Under section 80G in computing the total income of an assessee an amount equal to 50% of the sums in entitled for deduction as donation, subject to limit of 10% of gross total income as reduced by deduction permissible under the provisions of chapter VIA.

(i) Any other final or any institution to which this section applies; or

(ii) the Government or any local authority, to be utilized for any charitable purpose other than the purpose of promoting family planning; or

(iii) an authority constituted in India by or under any law enacted either for the purpose of dealing with and satisfying the need for housing accommodation or for the purpose of planning, development or improvement of cities, towns and villages, or for both.

(iv) any sums paid by the assessee in the previous year as donations for the renovation or repair of any such temple, mosque, gurdware, church or other place as notified by the Central Government in the Official Gazette to be of historic,

archeological or artistic importance or to be place of public worship of renown though out any state or states.

(v) any corporation referred to in clause (26BB) of section 10

As per Explanation 5 to section 80G, only donation in form of money and not in kind will qualify for deduction.

As per section 80G(5A) where deduction in respect of donations is claimed and allowed under this section for any assessment year, deduction in relation to such sum shall not be allowed under any other provision of the Act for the same or any other assessment year.

Any other fund or institution referred to in D(i) above should comply the following conditions:

(i) where the institution or fund derives any income such income would not be liable to inclusion of its total income under the provisions of section 11 and 12 or section 10(23AA) or section 10(23C).

Provided that where an institution or fund derives any income being profits and gains of business, the conditions that such income would not be liable to inclusion in its total income under the provisions of section 11 shall not apply in relation to such income, if -

(a) the institution or fund maintains separate books of account in respect of such business;

(b) the donations made to the institution or fund are not used by it, directly or indirectly, for the purpose of such business; and

(c) the institution or fund issues to a person making the donation a certificate to the effect that it maintains separate books of account in respect of such business and that the donations received by it will not be used, directly or indirectly, for the purposes of such business;

(ii) the instrument under which the institution or fund is constituted does not, or the rules governing the institution or fund do not, contains any provision for the transfer or application at any time of the whole or any part of the income or assets of the institution or fund for any purpose other than a charitable purpose;

(iii) the institution or fund is not expressed to be for the benefit of any particular religious community or caste;

(iv) the institution or fund maintains regular accounts of its receipts and expenditure;

(v) the institution or fund is either constituted as a public charitable trust or is registered under the Societies Registration Act, 1860 or under any law corresponding to that Act in force in any part of India or under section 25 of the Companies Act, 1956 or is a University established by law, or is any other educational institution recognized by the Government or by a university established by law, or affiliated to any university established by law, or is an institution financed wholly or in part by the Government or a local authority and

(vi) in relation to donations made after March 31,1992 the institution or fund is for the time being approved by the Commissioner in accordance with the rules made in this behalf.

No deduction shall be allowed under this section in respect of any donation in excess of Rs. 2,000 unless the payment is made by any mode other than cash.

Deductions in respect of rents paid [Section 80GG]

The assessee, being an employee who is entitled to house rent allowance from the employer is eligible for exemption under section 10(13A) of the Act, but however, no such deduction is available in all other cases.

Therefore, under section 80GG, self-employed person and/or a salaried employee who is not in receipt of any house rent allowance from his employer at any time during the previous year; is entitled to claim deduction out of his total income, in respect of an expenditure towards payment of rent for any furnished or unfurnished accommodation occupied by him for the purpose of his own residence.

However, he or his spouse or minor child or a Hindu undivided family of which he is a member, should not own any residential accommodation at the place where the tax payer ordinarily resides or performs the duties of his office or employment or carries on his business or profession.

If taxpayer owns any residential accommodation at any other place and the deduction in respect of self occupied house property is claimed by him in respect of such accommodation under section 23(2)(a) or 23(4)(a), no deduction would be allowed under this section.

The amount of deduction would be least of the following amounts:

(a) Rs. 5,000/- per month

(b) 25% of total income before allowing deduction for any expenditure under this section

or

(c) the excess of actual rent paid over 10% of total income before allowing deduction for any expenditure under this section.

The deduction under section 80GG cannot be allowed where there were no facts on record to show that assessee had satisfied all conditions for allowance of deduction. [Surinder Singh v. AO [2003] 1 SOT 96 (Delhi Tribunal)]

Deduction in respect of certain donations for scientific research or rural development [Section 80GGA]

Under section 80GGA of the Act, in computing the total income of an assessee, there shall be deducted, the following amounts:

(a) any sum paid to a research association having object of scientific research or a university college or other institution to be used for scientific research which has been approved by the prescribed authority for the purpose of section 35(i)(ii);

The deduction shall not be denied merely on the ground that subsequent to the payment of such sum by the assesee the approval to such association, university, college or other institution has been withdrawn;

(b) any sum paid by the assessee in the previous year to a research association which has as its object the undertaking of research in social science or statistical research or to a university, college or other institution to be used for research in social science or statistical research provided that such association, university, college or institution is approved for the purposes of section 35(1)(iii);

The deduction shall not be denied merely on the ground that subsequent to the payment of such sum by the assesee the approval to such association, university, college or other institution has been withdrawn;

(d) any sum paid to an association or institution which has its object the undertaking of any programme of rural development to be used for carrying out any programme of rural development approved for the purposes of section 35CCA or to an association or institution which

has its object the training of persons for implementing programmes of rural development, provided the assessee furnishes the certificate referred to in section 35CCA(2) or section 35CCA(2A), as per case may be;

The deduction shall not be denied merely on the ground that subsequent to the payment of such sum by the assesee the approval to such association, university, college or other institution has been withdrawn;

(d) any sum paid to a public sector company or a local authority or to an association or institution approved by the National Committee, for carrying out any eligible project or scheme, provided the assessee furnishes a certificate referred to in section 35AC(2)(a);

The deduction shall not be denied merely on the ground that subsequent to the payment of such sum by the assesee the approval to such association or institution has been withdrawn;

(e) any sum paid to a rural development fund set up and notified by the Central Government for the purpose of section 35CCA(1)(c);

(f) any sum paid to the National Urban Poverty Eradication Fund set up and notified by the Central Government for the purposes section 35CCA(1)(d);

No deduction shall be allowed under this section in respect of any sum exceeding Rs. 10,000 unless such sum is paid by any mode other than cash; No deduction under this section to an assessee whose gross total income includes income which is chargeable under the head “Profit and gains of business or profession”;

Where assessee has incurred business loss which is included in its gross total income, deduction under section 80GGA will not be allowable [K. Anji Reddy v. DCIT [2013] 59 SOT 92 (Hyderabad Tribunal)(URO)].

If a deduction under this section is claimed and allowed for any assessment year in respect of payments referred above, no deduction shall be allowed in respect of such payments under any other provision of this act, for the same or any other assessment year.

Contributions to political parties [Section 80GGC]

In computing the total income of any person, other than local authority or every artificial juridical person wholly or partly funded by the Government,

there shall be deducted any contribution made by him to political party or to an electoral trust under section 80GGC of the Act.

No deduction shall be allowed under this section in respect of any sum contributed by way of cash.

For this section, 'political party' means a political party registered under section 29A of the Representation of the People Act, 1951.

Deduction in respect of certain incomes

(1) Deductions in respect of profits and gains from industrial undertakings or enterprises engaged in infrastructure development etc. [Section 80-IA]

Section 80-IA provides for deduction in respect of profits and gains of the following undertakings:

(A) Infrastructure facility;

(B) Telecommunication services;

(C) Industrial Park;

(D) Power generation, transmission and distribution; and

(E) Reconstruction or revival of power generating plant (available only to Indian Company).

(A) Infrastructure facility

An enterprise must carry on the business of (a) developing or (b) maintaining and operating or (c) developing maintaining and operating any infrastructure facility.

The term "infrastructure facility" means –

(a) a road including toll road, a bridge or a rail system;

(b) a highway project including housing or other activities being an integral part of the highway project;

(c) a water supply project, water treatment system, irrigation project, sanitation and sewerage system or solid waste management system;

(d) a port, airport, inland waterway or inland port or navigational channel in sea.

An undertaking is owned by a company registered in India or by consortium of such companies or by an authority or a board or a corporation or any other body established or constituted under any Central or State Act;

It has entered into an agreement with the Central Government or a state government, a local authority or any other statutory body for (i) developing or (ii) operating and maintaining or (iii) developing, operating and maintaining a new infrastructure facility.

It has started or starts operating and maintaining the infrastructure facility on or after April 1, 1995. However, where an infrastructure facility is transferred on or after April 1, 1999 by an enterprise which developed such infrastructure facility to another enterprises for the purpose of operating and maintaining the infrastructure facility on its behalf in accordance with the agreement with the Central Government, State Government, Local authority or statutory body, the provisions of this section shall apply to the transferee enterprise as if it were the enterprise to which this clause applies and the deduction from profits and gains would be available to such transferee enterprise for the unexpired period.

Nothing contained in this section shall apply to any enterprise which starts the development or operation and maintenance of the infrastructure facility on or after April 1, 2017.

100% profit is deductible for 10 consecutive assessment years, falling within a period of twenty assessment years beginning with the assessment year in which an assessee begins development, operating and maintaining infrastructure facility (applicable w.r.t clause a), b), and c) above).

100% profit is deductible for 10 consecutive assessment years, falling within a period of twenty assessment years beginning with the assessment year in which an assessee begins development, operating and maintaining infrastructure facility (applicable w.r.t clause d)).

By virtue of section 80IA(6), the profit of housing or other activities, which are integral part of a highway project, shall be computed on the basis and manner specified in rule 18BBE, then, such profit shall not be liable to tax if the profit is transferred to special reserve account and utilized for the highway project (excluding housing and other activities) before the expiry of the three years, following the year in which such amount was transferred to the reserve account. The amount not so utilized shall be chargeable to tax as income of the year in which such transfer to reserve account was made.

(B) Telecommunication Services

Any undertaking which has started or starts providing telecommunication services whether basic or cellular, including radio paging, domestic satellite service, network of trunking, broad band net work and internet services on or after April 1,1995 but on or before March 31,2005 shall be entitled for deduction to the extent of 100% of profits and gains of such business for the first five assessment years and thereafter 30% of such profits and gains for further five assessment years, commencing from the initial assessment year. Initial assessment year means the assessment year specified by the assessee at his option to be the initial year not falling beyond the fifteenth assessment year starting from the previous year in which the undertaking begins providing telecommunication services.

"Domestic Satellite" for this purpose, means a satellite owned and operated by an Indian company for providing telecommunication services.

(C) Industrial Park

Any undertaking which develops, develops and operates or maintains and operates an industrial park or special economic zone notified for this purpose in accordance with any scheme framed and notified by the Central Government starts operating from April 1, 1997 but before March 31,2006, shall be entitled for deduction @ 100% of profit for ten years commencing from initial assessment year.

However, if an undertaking develops an industrial park on or after April 1, 1999 or a SEZ on or after April 1,2001 and transfers the operation and maintenance of such industrial park or such special park or such special economic zone, as the case may be to another undertaking (i.e. transferee undertaking), the deduction shall be allowed to such transferee undertaking for the remaining period in the ten consecutive assessment years as if the operation and maintenance were not so transferred to the transferee undertaking.

In case of any undertaking which develops, develops and operates or maintains and operates an industrial park, the provisions of this clause shall apply to schemes framed and notified by central government and which starts operating from April 1, 1997 but before March 31, 2011

(D) Power generation transmission and distribution

An undertaking is set up in any part of India for the generation or generation and distribution of power, if it begins to generate power at any time during

April 1, 1993 and March 31, 2017 or it starts transmission or distribution by laying a network of new transmission or distribution line at any time between April 1, 1999 and March 31, 2017 shall be entitled for deduction @ 100% of profit for ten consecutive years, commencing from initial assessment year.

An undertaking which undertakes substantial renovation and modernization of the existing network of transmission or distribution lines at any time during the period beginning on April 1, 2004 and ending on March 31, 2017.

Substantial renovation and modernization means an increase in the plant and machinery in the network of transmission or distribution of lines by at least 50% of the book value of such plant and machinery as on April 1, 2004

In case transmission or distribution by laying a network of new transmission or distribution lines, the deduction shall be allowed only in relation to the profits derived from such activities.

However the undertaking set up for the generation or generation and distribution or transmission or distribution or substantial renovation and modernization of the existing network of transmission or distribution lines of power has to comply with following conditions:

(i) It is not formed by splitting up or the reconstruction of a business already in existence. This condition shall not apply in respect of an undertaking which is formed as a result of the re-establishment, reconstruction or revival by the assessee of the business of any such undertaking as a result of (a) flood, typhoon, hurricane, cyclone, earth quake or other convulsion of the nature, or (b) riot or civil disturbance, or (c) accidental fire or explosion, or (d) action by any enemy or action taken in combating an enemy.

In T. Satish U. Pai v. CIT [1979] 119 ITR 877, the Karnataka High Court held that in order to hold that an industrial undertaking was formed by splitting up of a business already in existence, there must be some material to hold that either some asset of the existing business is divided and another business is set up from such splitting up of assets. Where there is no tangible evidence of transfer of any asset from an earlier business to the new business, a conclusion cannot be reached that the new business is formed by the splitting up of the business already in existence.

The aforesaid view has been accrued by the Supreme Court in Textile Machinery Corporation Ltd. [1977] 107 ITR 195. The Court observed that a new industrially recognizable unit of an assessee

cannot be said to be re-construction of old business where there is no transfer of any assets of old business to the new undertaking, which takes place when there is re-construction of old business. If, the new industrial undertaking is separate and independent production unit in the sense that the commodities produced or the result achieved are commercial tangible products and the undertaking carried on separately without complete absorption and loosing its identity in the old business, it is not to be treated as being formed by reconstruction of the old business.

(ii) It is not formed by the transfer of a new business to machinery or plant previously used for any purpose.

For this purposes, any machinery or plant which was used outside India by any person other than the assessee shall not be regarded as machinery or plant previously used for any purpose, if the following conditions are fulfilled, viz.,:

(a) such machinery or plant was not, at any time previous to the date of the installation by the assessee, used in India;

(b) such machinery out plant is imported into India from any country outside India; and

(c) no deduction on account of depreciation in respect of such machinery or plant has been allowed or is allowable under the provisions of the Act in computing the total income of any person for any period prior to the date of the installation of machinery or plant by the assessee.

Further, any machinery or plant or any part thereof previously used for any purpose is transferred to a new business and the total value of the machinery or plant or part so transferred does not exceed 20% of the total value of the machinery or plant used in the business, then, the condition specified hereinabove shall be deemed to have been complied with.

This condition of not formed by transfer to a new business of machinery or plant previously used for any purpose shall not apply also in case where machinery or plant has been previously used by State Electricity Board referred to in section 2(7) of Electricity Act 2003 whether or not such transfer is in pursuance of splitting up or reconstruction or reorganization of the board under Part XIII of that Act

Section 80-IA(5) provides that, notwithstanding anything contained in any other provisions of this Act, for the purpose of determining the quantum of deduction under section 80IA for the assessment year immediately

succeeding the initial assessment year or any subsequent assessment year, the profits and gains from the eligible business shall be computed as if such eligible business were the only source of income of the assessee during the previous year relevant to the initial assessment year and to every subsequent assessment year upto and including the assessment year for which the determination is to be made.

The CBDT vide Circular No. 1/2016 dated February 15, 2016 has clarified that the term 'initial assessment year' referred to in section 80-IA(5) would mean the first year opted by the assessee for claiming deduction under section 80-IA.

The deduction under section 80-IA is admissible only if the accounts of the undertaking have been audited by a Chartered Accountant and the audit report duly signed and verified by such accountant is furnished along with the return of income (before the specified date referred to in section 44AB and the assessee furnishes by that date) [Section. 80-IA(7)].

Section 80-IA(8) provides that, if any goods or services held for the purposes of the eligible business are transferred to any other business carried on by the assessee, or where any goods or services held for the purposes of any other business carried on by the assessee are transferred to the eligible business and in either case, the consideration, if any, for such transfer as recorded in the accounts of the eligible business does not correspond to the market value of such goods or services as on the date of transfer, profit and gains of the eligible business shall be computed as if the transfer in either case, had been made at the market value of such goods or services as on that date. If, in the opinion of the Assessing Officer, the computation of the profits and gains of eligible business in the manner herein before specified exceptional difficulties, the Assessing Officer may compute such profits and gains on such reasonable basis as he may deem fit. For this purpose 'market value' in relation to any goods or services means the price that such goods or services would ordinarily fetch in the open market or the arm's length price as defined in clause (ii) of section 92F, where the transfer of such goods or services is a specified domestic transaction referred to in section 92BA.

Section 80-IA(9) provides that where an amount of profits and gains of an industrial undertaking is claimed and allowed as deduction under section 80-IA, the profits to that extent shall not qualify for deduction for any assessment year under any other provisions of chapter VIA and in no case shall exceed the eligible profit of the industrial undertaking as the case may be.

Section 80-IA(10) provides that, if it appears to the Assessing Officer that owing to the close connection between the assessee carrying on the eligible business and any other person or for any other reason, the course of business is so arranged that the business transacted between them produces to the assessee more than the ordinary profits which might be expected to arise in such eligible business, then the Assessing Officer shall take the amount of profit as may be reasonable deemed to have been derived therefrom. However, in case the aforesaid arrangement involves a specified domestic transaction referred to in section 92BA, the amount of profits from such transaction shall be determined having regard to arm's length price as defined in clause (ii) of section 92F.

As per section 80-IA(12), where any undertaking of an Indian company which is entitled to the deduction is transferred before the expiry of the period specified in this section, to another Indian company in a scheme of amalgamation or demerger.

(a) no deduction shall be admissible to the amalgamating or demerged company for the previous year in which the amalgamation or the demerger takes place, and

(b) the amalgamated or the resulting company would be entitled to deduction for unexpired period, if the amalgamation or demerger had not taken place.

The benefit of deduction shall not be available to an enterprise under sub-section (12) which is transferred in the scheme of amalgamation or demerger on or after April 1, 2007

This section does not apply to SEZ notified on or after April 1, 2005

The Finance Act 2009 has inserted an explanation to section 80IA applicable w.r.e.f April 1, 2000 to clarify that nothing contained in this section shall apply to business which is in the nature of works contract awarded by any person (including the central or state government) and executed by the undertaking or enterprise.

(2) Deduction in respect of profits and gains by an undertaking or enterprise engaged in development of special economic zone [section 80-IAB]

Section 80-IAB provides that where the gross total income of an assessee, being a Developer, includes any profits and gains derived by an undertaking or an enterprise from any business of developing a Special Economic Zone,

notified on or after April 1,, 2005 under the Special Economic Zones Act, 2005, there shall be allowed, in computing the total income of the assessee, a deduction of an amount equal to 100% of the profits and gains derived from such business for ten consecutive assessment years.

The provisions of this section shall not apply to an assessee, being a developer, where the development of Special Economic Zone begins on or after April 1, 2017

The deduction may at the option of the assessee, be claimed by him for any ten consecutive assessment years out of fifteen years beginning from the year in which a Special Economic Zone has been notified by the Central Government.

Where in computing the total income of any undertaking, being a Developer for any assessment year, its profits and gains had not been included by application of the provisions of sub-section (13) of 80-IA i.e. SEZ notified on or after April 1, 2005 in accordance with 80-IA(4)(iii), the undertaking being the Developer shall be entitled to deduction referred to in this section only for the unexpired period of ten consecutive assessment years and thereafter it shall be eligible for deduction from income as provided this section.

Where an undertaking, being a Developer who develops a Special Economic Zone on or after April 1, 2005 and transfers the operation and maintenance of such Special Economic Zone to another Developer (hereafter in this section referred to as the transferee Developer), the deduction under sub-section (1) shall be allowed to such transferee Developer for the remaining period in the ten consecutive assessment years as if the operation and maintenance were not so transferred to the transferee Developer.

For the purposes of this section, the provisions of sub-section (5) and sub-sections (7) to (12) of section 80-IA shall apply to the Special Economic Zones for the purpose of allowing deductions under sub-section (1) of section 80-IAB.

“Developer” and “Special Economic Zone” shall have the same meanings respectively as assigned to them in clauses (g) and (za) of section 2 of the Special Economic Zones Act, 2005

In Marni Prasuna Versus Income Tax Officer 2020 (5) [ITA 186/Viz/2018] – ITAT Visakhapatnam it was held that share income received from society claiming deduction u/s 80IAB can not be taxed in the hands of members of the society since the claim of deduction u/s 80IAB has reached finality in the hands of the society and Taxing the income again in the hands of the

assessee would amount double taxation of the same income which is not permissible

(3) Deduction in respect of profits and gains from certain industrial undertaking other than infrastructure development undertakings [Section 80-IB]

As per section 80-IB, the following business are eligible business for the assessment year 2004/05 and thereafter for deduction in computing the total income of the assessee from such profits and gains of an amount equal to such percentage and such number of years as specified:

(A) Industrial undertaking manufacturing any article or thing not specified in Eleventh Schedule.

(B) Industrial Undertaking in backward state.

(C) Industrial Undertaking in backward districts.

(D) Business of a ship.

(E) Hotel.

(F) Multiplex theatre.

(G) Convention center.

(H) Scientific research & development.

(I) Commercial production or refining mineral oil

(J) Developing & building housing projects.

(K) A cold chain facility for agriculture produce.

(L) Business of processing, preservation, and packaging of fruits, vegetables or meat and meat products or poultry or marine, dairy products handling, storage and transportation of food grains.

(M) Business of operating & maintaining a hospital in rural area.

(N) Business of operating & maintaining a hospital located anywhere in India other than excluded area.

(A) Industrial undertaking

In case of an industrial undertaking, the amount of deduction shall be @ 25% (30% where the assessee is a company) of the profits and gains derived from such industrial undertaking for a period of ten consecutive assessment years

(twelve consecutive assessment years where the assessee is a co-operative society) beginning with the initial assessment year, if:

(i) it begins to manufacture or produce, articles or things or to operate such plant or plants before March 31,1995 or such further period as may be notified by the Central Government with reference to any particular undertaking.

(ii) it is an industrial undertaking being a small scale industrial undertaking begins to manufacture or produce articles or things or to operate its cold storage plant before March 31,2002.

For this purpose, 'small scale industrial undertaking' means an industrial undertaking which is, as on the last day of the previous year, regarded as small-scale industrial undertaking under section 11B of the Industries (Development and Regulation) Act, 1951.

Further 'initial assessment year' in the case of an industrial undertaking or cold storage plant or ship or hotel, means the assessment year relevant to the previous year in which the industrial undertaking begins to manufacture or produce articles or things or to operate its cold storage plant or plants or the cold chain facility or the ship is first brought into use or the business of the hotel starts functioning.

If conditions stipulated under section 80-IB are fulfilled, benefit of deduction cannot be denied to an assessee merely for reason that he did not claim that benefit in initial assessment year. [Praveen Soni v. CIT [2011] 333 ITR 324 (Delhi HC)]

(B) Industrially backward State

Section 80-IB provides that the amount of deduction in case of an industrial undertaking in an industrially backward state in the Eight Schedule shall be hundred per cent of the profits and gains derived from such industrial undertaking for five assessment years beginning with the initial assessment year and thereafter twenty five per cent (or thirty per cent in case assessee is a company) of the profits and gains derived from such industrial undertaking.

The total period of deduction should not exceed ten consecutive assessment years or twelve consecutive assessment years in case of a co-operative society, subject to condition that it begins to manufacture or produce article or thing or to operate its cold storage plant or plants before March 31, 2004.

However, in case of such industries in the North-Eastern Region as may be notified by the Central Government, the amount of deduction shall be 100%

for a period of ten assessment years. No deduction under this sub-section shall be allowed from assessment year 2004-05 to an undertaking or enterprise referred in section 80-IC(2). In case of industrial undertaking in the state of Jammu & Kashmir, no deduction shall be allowed from assessment year 2012-13

In CIT v. Cement Distributors Ltd. Ltd. [1994] 208 ITR 355, the Delhi High Court observed that the word 'derived' has to be assigned a restricted meaning as compared to the words 'attributable to' or 'referred to' and, therefore, the assessee must establish that he has derived profits and gains from the industrial undertaking. In other words, the industrial undertaking must itself be the source of that profit and gain and it is not sufficient if a commercial connection is established between the profits and gains earned and the industrial undertaking. This view has been reiterated by the Supreme Court in Pandian Chemicals Ltd. v. CIT [2003] 262 ITR 278.

(C) Industrially backward districts

(i) An industrial undertaking, located in industrial backward districts notified by the Central Government as industrial backward district of category 'A" shall be entitled for deduction of 100% profits and gains derived from an industrial undertaking located in such backward districts for five assessment years beginning with the initial assessment year and thereafter @ 25% (30% where the assessee is a company) of the profits and gains of an industrial undertaking. The total period of deduction shall not exceed ten consecutive assessment years or where the assessee is a co-operative society twelve consecutive assessment years. The industrial undertaking must begin to manufacture or produce article or things or to operate its cold storage plant or plants before March 31, 2004.

(ii) An industrial undertaking located in notified backward district of category 'B' shall be entitled for deduction @ 100% of the profits and gains derived from an industrial undertaking located in such backward district for three assessment years beginning with the initial assessment year and thereafter @ 25% (30% where the assessee is a company) of the profits and gains of the industrial undertaking. The total period of deduction shall not exceed eight consecutive assessment years (or where the assessee is a co-operative society, twelve consecutive assessment years). The industrial undertaking must begin to manufacture or produce articles or things or to operate its cold storage plant or plants before March 31, 2004.

(D) Business of ship

In case of business of ships, the amount of deduction shall be 30% of the profits and gains derived from such ship for a period of 10 consecutive assessment years including the initial assessment year provided that the ship:

(i) is owned by an Indian company and is wholly used for the purpose of the business carried on by it;

(ii) was not, previous to the date of its acquisition by the Indian company, owned or used in Indian territorial waters by a person resident in India, and

(iii) is brought into use by the Indian company at any time between April 1,1991 and March 31,1995.

(E) Hotel

In case of any hotel, the amount of deduction shall be:

(a) 50% of the profits and gains derived from the business of such hotel for a period of ten consecutive years beginning from the initial assessment year as is located in a hilly area or a rural area or a place of pilgrimage or such other place as the Central Government may notify having regard to the need for development of infrastructure for tourism in any place and other relevant consideration and such hotel should start functioning before March 31, 2001.

Nothing contained in this clause shall apply to a hotel located at a place within the municipal jurisdiction (whether known as a municipality, municipal corporation, notified area committee or a cantonment board or by any other name) of Calcutta, Chennai, Delhi or Mumbai which has started functioning before March 31, 2001.

Further, for the purpose of this clause, where the said hotel has been approved by the prescribed authority before March 31, 1992 shall be deemed to have been approved for the purpose of this section.

(b) 30% of the profits and gains derived from the business of such hotel as is located in any place other than those mentioned in para (a) above, for a period of ten consecutive years beginning from the initial assessment year if such hotel has started functioning before March 31,2001

Nothing contained in this clause shall apply to a hotel located at a place within municipal jurisdiction (whether known as a municipality, municipal corporation, notified area committee, town area committee or a cantonment board or by any other name) of Calcutta, Chennai, Delhi or Mumbai which has started functioning before March 31, 2001

(c) The deduction under this sub-section shall be available if:

(i) the business of hotel is not formed by the splitting up, or the reconstruction of a business already in existence or by the transfer to a new business of a building previously used as a hotel or of any machinery or plant previously used for any purpose.

(ii) the business of hotel is owned and carried on by a company registered in India with a paid up capital of not less than Rs. 5,00,000/-.

(iii) the hotel is for the time being approved by the prescribed authority.

Any hotel approved by the prescribed authority before April 1, 1999 shall be deemed to have been approved under this sub section.

(F) Multiplex theatre

In case of any multiplex theatre, the amount of deduction shall be:

(a) 50% of the profits and gains derived from the business of building owning and operating multiplex theatre, for a period of five consecutive years beginning from the initial assessment year in any place; provided that a multiplex theatre should not be located at a place within the municipal jurisdiction (whether known as municipality, municipal corporation, notified area committee or a cantonment board or any name) of Chennai, Delhi, Kolkata or Mumbai.

(b) The deduction shall be allowed only if:

(i) such multiplex theater is constructed between April 1, 2002 and March 31, 2005;

(ii) the business of the multiplex theatre is not formed by the splitting up or the reconstruction of a business already in existence or by the transfer to a new business of any building or of any machinery or plant previously used for any purpose;

(iii) the assessee furnishes along with the return of income the report of an audit in Form no. 10CCB duly signed and verified by a chartered accountant, , before the specified date referred to in section 44AB, certifying that the deduction has been correctly claimed.

"Multiplex theater" means a building of a prescribed area comprising of two or more cinema theatres and commercial shops of such size and number and having such facilities and amenities as prescribed in rule 18DB.

Rule 18DB of the Income tax Rules 1962 prescribes, for the purpose of sub section 7(A) and clause (da) of sub section (14) of section 80IB that the multiplex theatre shall have the following facilities and amenities

(a) The total build-up area occupied by all the cinema theatres comprised in the multiplex shall not be less than 22,500 square feet, and shall consist at least 50% of the total build-up area of the multiplex excluding the area specified for parking.

(b) The multiplex theatres shall be comprised of at least three cinema theatres and at least three commercial shops.

(c) Total seating capacity of all the cinema theatre comprised in the multiplex shall be at least 900 seats, and no cinema theatre should consist of less than 100 seats.

(d) The total building area occupied by all commercial shops comprised in the multiplex theatre shall not be less than 300 sq. ft. and the minimum built up area of each shop shall not be less than 250 sq. ft.

(e) There shall be at least one lobby or foyer in the cinema theatre, whose area shall be at least 3 sq. ft. per seat.

(f) The multiplex theatre shall have adequate parking, toilet blocks and other public conveniences, as per local building or cinema regulations and shall also fulfil all local building or cinema regulations in respect of fire and safety.

(g) The cinema theatre comprised in the multiplex theatre shall use modern stereo projection systems with at least two screen speakers per screen and one surround speaker per 25 seats

in a theatre. The expression 'modern stereo projection system' shall consists of Xerox lamp, plattex and digital sound systems.

(h) The cinema theatres shall use seats with seat pitch not less than 20" (centre to centre).

(i) Ticketing system employed by the cinema theatre shall be fully computerized.

(j) The multiplex theatre cinema shall be centrally air-conditioned.

(G) Convention Centre

In case of any convention centre, the amount of deduction shall be:

(a) 50% of the profits and gains derived, by the assessee from the business of building, owning and operating a convention centre for a period of five consecutive years beginning from the initial assessment year.

(b) The deduction shall be allowable only if –

(i) such convention centre is constructed between April 1,2003 and March 31, 2005

(ii) the business of the convention centre is not formed by the splitting up; or reconstruction, of a business already in existence or by the transfer to a new business of any building or of any machinery or plant previously used for any purpose.

(iii) The assessee furnishes along with the return of income the report of an audit in Form no. 10CCBA duly signed and verified by a chartered accountant, , before the specified date referred to in section 44AB, certifying that the deduction has been correctly claimed.

'Convention centre' means a building of prescribed area comprising of convention halls to be used for the purpose of holding conferences and seminars, being of such size and number and having such other facilities and amenities as may be prescribed. Rule 18DC of the Income tax Rules 1962 prescribes the conditions for the convention centre.

(H) Scientific research and development

In case of any company carrying on scientific research and development, the amount of deduction, shall be 100% of the profits and gains of such business for a period of five assessment years beginning from the initial assessment year if such company –

(a) is registered in India;

(b) has the main object of scientific and industrial research and development;

(c) is for the time being approved by the Secretary Department of Scientific and Industrial Research, Ministry of Science and Technology, Government of India at any time after March 31, 2000 but before April 1, 2007; and

(d) fulfills the following conditions; viz:

- has adequate infrastructure such as laboratory facilities, qualified manpower, scale-up facilities and prototype development facilities for undertaking, scientific research and development of its own;
- has a well formulated research and development programme comprising of time bound research and development projects with proper mechanism for selection and review of the projects or programme.
- is engaged exclusively in scientific research and development activities leading to technology development, improvement of technology and transfer of technology developed by themselves;
- submits the annual return alongwith statement of accounts and annual report within eight months after the close of each accounting year to the prescribed authority.

In the case of a company carrying on scientific and industrial research and development, initial assessment year means the assessment year relevant to the previous year in which the company is approved by the prescribed authority.

(I) Mineral Oil

In the case of production or refining of mineral oil, the amount of deduction to an undertaking shall be 100% of the profits for a period of seven consecutive

assessment years including the initial assessment year from the commencement of commercial production. The deduction is available if the undertaking fulfills any of the following conditions:

(i) is located in North-Eastern Region and has begun or begins commercial production of mineral oil before April 1, 1997;

(ii) is located in any part of India and has begun or begins commercial production of mineral oil on or after April 1, 1997 but not later than March 31, 2017;

(iii) is engaged in refining of mineral oil and begins such refining on or after October 1, 1998 but not later than March 31, 2012.

(iv) is engaged in commercial production of natural gas in blocks licensed under the VIII Round of bidding for award of exploration contracts (hereafter referred to as "NELP-VIII") under the New Exploration Licencing Policy announced by the Government of India vide Resolution No. O-19018/22/95-ONG.DO.VL, dated February 10, 1999 and begins commercial production of natural gas on or after April 1, 2009 but not later than March 31, 2017;

(v) is engaged in commercial production of natural gas in blocks licensed under the IV Round of bidding for award of exploration contracts for Coal Bed Methane blocks and begins commercial production of natural gas on or after April 1, 2009 but not later than March 31, 2017.

For the purposes of claiming deduction under this sub-section, all blocks licensed under a single contract, which has been awarded under the New Exploration Licencing Policy announced by the Government of India vide Resolution No. O-19018/22/95-ONG.DO.VL, dated February 10, 1999 or has been awarded in pursuance of any law for the time being in force or has been awarded by Central or a State Government in any other manner, shall be treated as a single "undertaking".

(J) Housing project

In case of an undertaking developing and building housing projects approved before March 31, 2008 by a local authority, the amount of deduction shall be 100% of the profits derived from such housing projects if-

(a) such undertaking has commenced development and construction of housing project on or after October 1,1998 and completes such construction on or before the dates provided below:

(*i*) in a case where a housing project has been approved by the local authority before April 1, 2004, on or before March 31, 2008;

(*ii*) in a case where a housing project has been, or, is approved by the local authority on or after April 1, 2004 but not later than March 31, 2007 , within four years from the end of the financial year in which the housing project is approved by the local authority;

(*iii*) in a case where a housing project has been approved by the local authority on or after April 1, 2005, within five years from the end of the financial year in which the housing project is approved by the local authority.

For the purposes of this clause,—

(*i*) in a case where the approval in respect of the housing project is obtained more than once, such housing project shall be deemed to have been approved on the date on which the building plan of such housing project is first approved by the local authority;

(*ii*) the date of completion of construction of the housing project shall be taken to be the date on which the completion certificate in respect of such housing project is issued by the local authority;

(b) the project is on the size of a plot of land which has a minimum area of one acre, and the conditions mentioned in clause (*a*) or clause (*b*) shall not apply to a housing project carried out in accordance with a scheme framed by the Central Government or a State Government for reconstruction or redevelopment of existing buildings in areas declared to be slum areas under any law for the time being in force and such scheme is notified by the CBDT.

(c) the residential unit has a maximum built-up area of one thousand square feet where such residential unit is situated within the cities of Delhi or Mumbai or within twenty five kilometers from the municipal limit of these cities and one thousand and five hundred square feet at any other place.

(d) the built-up area of the shops and other commercial establishments included in the housing project does not exceed three per cent of the

aggregate built-up area of the housing project or five thousand square feet, whichever is higher;

(e) not more than one residential unit in the housing project is allotted to any person not being an individual; and

(f) in a case where a residential unit in the housing project is allotted to a person being an individual, no other residential unit in such housing project is allotted to any of the following persons, namely:—

(i) the individual or the spouse or the minor children of such individual,

(ii) the Hindu undivided family in which such individual is the karta,

(iii) any person representing such individual, the spouse or the minor children of such individual or the Hindu undivided family in which such individual is the karta.]

Nothing contained in this sub-section shall apply to any undertaking which executes the housing project as a works contract awarded by any person (including the Central or State Government).

(K) Cold chain facility for agriculture produce

In case of industrial undertaking carrying on business of setting up and operating a cold chain facility for agricultural produce, the amount of deduction, shall be 100% of the profits and gains derived from such industrial undertaking for five assessment years beginning with the initial assessment year and thereafter, 25% (30% where the assessee is a company) of the profits and gains derived from the operation of such facility in a manner that the total period of deduction does not exceed ten consecutive assessment years (twelve consecutive assessment years where the assessee is a co-operative society) and subject to condition that it has began to operate such facility on or after April 1, 1999 but before April 1, 2004.

(L) Business of processing, preservation and packaging of fruits or vegetables or meat products or poultry or marine or dairy products or integrated business of handling, storage and transportation of food grains

In case of an undertaking deriving profit from the business of processing,

preservation and packaging of fruits or vegetables or meat products or poultry or marine or dairy products or integrated business of handling, storage and transportation of food grains, the amount of deduction shall be 100% of the profits and gains derived from such undertaking for five assessment years beginning with the initial assessment year and thereafter 25% (30% where the assessee is a company) of the profits and gains derived from the operation of such business for consecutive ten assessment years, subject to fulfillment of the condition that it begins to operate such business on or after April 1, 2001.

The provisions of this section shall not apply to an undertaking engaged in the business of processing, preservation and packaging of meat or meat products or poultry or marine or dairy products if it begins to operate such business before the April 1, 2009.

(M) Business of operating & maintaining a hospital in rural area

The amount of deduction in the case of an undertaking deriving profits from the business of operating and maintaining a hospital in a rural area shall be hundred per cent of the profits and gains of such business for a period of five consecutive assessment years, beginning with the initial assessment year, if—

(*i*) such hospital is constructed at any time during the period beginning on October 1, 2004 and ending on March 31, 2008;

(*ii*) the hospital has at least one hundred beds for patients;

(*iii*) the construction of the hospital is in accordance with the regulations, for the time being in force, of the local authority; and

(*iv*) the assessee furnishes along with the return of income, the report of audit in such form and containing such particulars as prescribed in Rule 18DD, Form no. 10CCBC, and duly signed and verified by a chartered accountant, before the specified date referred to in section 44AB, certifying that the deduction has been correctly claimed.

A hospital shall be deemed to have been constructed on the date on which a completion certificate in respect of such construction is issued by the concerned local authority.

(N) Business of operating & maintaining a hospital located anywhere in India other than excluded area.

The amount of deduction in the case of an undertaking deriving profits from the business of operating and maintaining a hospital located anywhere in India, other than the excluded area, shall be hundred per cent of the profits and gains derived from such business for a period of five consecutive assessment years, beginning with the initial assessment year, if—

(*i*) the hospital is constructed and has started or starts functioning at any time during the period beginning on April 1, 2008 and ending on March 31, 2013;

(*ii*) the hospital has at least one hundred beds for patients;

(*iii*) the construction of the hospital is in accordance with the regulations or bye-laws of the local authority; and

(*iv*) the assessee furnishes along with the return of income, a report of audit in such form and containing such particulars, as prescribed in rule 18DDA, Form no. 10CCBD and duly signed and verified by a chartered accountant before the specified date referred to in section 44AB, certifying that the deduction has been correctly claimed.

All other provisions such as computation of income, audit report, amalgamation, re-computation of profits by the Assessing Officer, consequences of merger/amalgamation etc. are applicable similar to section 80-IA.

(4) Deductions in respect of profits and gains from housing projects [Section 80-IBA]

Section 80-IBA provides that where the gross total income of an assessee includes any profits and gains derived from the business of developing and building housing projects, there shall, subject to the provisions of this section, be allowed, a deduction of an amount equal to hundred per cent of the profits and gains derived from such business.

A housing project shall be a project which fulfils the following conditions, namely:

(a) the project is approved by the competent authority after June 1, 2016, but on or before March 31, 2021;

(b) the project is completed within a period of 5 years from the date of approval by the competent authority:

Provided that:

(i) where the approval in respect of a housing project is obtained more than once, the project shall be deemed to have been approved on the date on which the building plan of such housing project was first approved by the competent authority; and

(ii) the project shall be deemed to have been completed when a certificate of completion of project as a whole is obtained in writing from the competent authority;

(c) the carpet area of the shops and other commercial establishments included in the housing project does not exceed three per cent of the aggregate carpet area;

(d) the project is on a plot of land measuring not less than—

(i) 1000 square metres, where the project is located within the cities of Chennai, Delhi, Kolkata or Mumbai; or

(ii) 2000 square metres, where the project is located in any other place;

(e) the project is the only housing project on the plot of land as specified in clause (d);

(f) the carpet area of the residential unit comprised in the housing project does not exceed—

(i) 30 square metres, where the project is located within the cities of Chennai, Delhi, Kolkata or Mumbai; or

(ii) 60 square metres, where the project is located in any other place;

(g) where a residential unit in the housing project is allotted to an individual, no other residential unit in the housing project shall be allotted to the individual or the spouse or the minor children of such individual;

(h) the project utilises—

(i) not less than 90% of the floor area ratio permissible in respect of the plot of land under the rules to be made by the Central Government or the State Government or the local authority,

as the case may be, where the project is located within the cities of Chennai, Delhi, Kolkata or Mumbai or

(ii) not less than eighty per cent of such floor area ratio where such project is located in any place other than the place referred to in sub-clause (i); and

(i) the assessee maintains separate books of account in respect of the housing project.

Nothing contained in this section shall apply to any assessee who executes the housing project as a works-contract awarded by any person (including the Central Government or the State Government).

Where the housing project is not completed within the period specified and in respect of which a deduction has been claimed and allowed under this section, the total amount of deduction so claimed and allowed in one or more previous years, shall be deemed to be the income of the assessee chargeable under the head "Profits and gains of business or profession" of the previous year in which the period for completion so expires.

Where any amount is claimed and allowed under this section for any assessment year, deduction to the extent of such profit and gains shall not be allowed under any other provisions of this Act.

(5) Special provisions in respect of certain undertakings or enterprises in certain special category states [Section 80-IC]

Where the gross total income of an assessee includes any profits and gains derived by an undertaking or an enterprise from any business mentioned below shall be entitled for deduction, from such profits and gains for ten consecutive assessment years from the initial assessment year i.e. the undertaking or enterprise begins to manufacture or produce articles or things or commences operation or complete substantial expansion:

(A) Which has began or begins to manufacture or produce any article or things not being any article or things specified in Thirteenth Schedule or which manufactures or produces any article or thing not being any article or thing specified in the Thirteenth Schedule an undertakes substantial expansion during the period beginning

		Percentage of profit of such under-taking	Number of years commencing with the initial assessment year
(i)	Between December 23, 2002 and April 1, 2007, in any Export Processing Zone or Integrated Infrastructure Development centre or Industrial Growth Centre or Industrial Estate or Industrial Park or Software Technology Park or Industrial Area or Theme Park, as notified by CBDT in accordance with the scheme framed and notified by the Central Government in this regards, in the state of Sikkim; or	100%	10
(ii)	Between January 7, 2003 and April 1, 2012 in any Export Processing Zone or Integrated Infrastructure Development Centre or Industrial Growth centre or Industrial Estate or Industrial Park or Software Technology park or Industrial Area or Theme Park as notified by CBDT in accordance with the scheme framed and notified by the Central Government in this regard in the State of Himachal Pradesh or the state of Uttarachal	100% 25% (30%) in case of Company	5 5
(iii)	Between December 24, 1997 and April 1, 2007, in any Export Processing Zone or Integrated Infrastructure Development Centre or Industrial Estate or Industrial Park or Software Technology Park or	100%	10

		Percentage of profit of such under-taking	Number of years commencing with the initial assessment year
	Industrial Area or Theme Park as notified by the CBDT in accordance with the scheme framed and notified by the Central Government in this regard, in any of the North-Eastern States		

(B) Which has began or begins to manufacture or produce any article or thing specified in the Fourteenth Schedule or commences any operation specified in that schedule, or which manufactures or produces any article or thing specified in the Fourteenth Schedule or commences any operation specified in that schedule and undertakes substantial expansion during the period beginning –

		Percentage of profit of such undertaking	Number of years commencing with the initial assessment year
(i)	Between December 23, 2002 and April 2007 in the State of Sikkim	100%	10
(ii)	Between January 7, 2003 and April 2012 in State of Himachal Pradesh or State of Uttaranchal	100% 25% (30%) in case of Company	5 5
(iii)	Between December 24, 1997 and April 1, 2007 in any of the North Eastern State	100%	10%

For the purpose of this section, 'substantial expansion', means increase in the investment in the plant and machinery by at least 50% of the book value

of plant and machinery i.e. before taking depreciation of any year, as on the first day of the previous year in which the substantial expansion is undertaken.

All other provisions such as splitting and reconstruction of business computation of income, audit report, amalgamation, re-computation of profits by the Assessing Officer, consequences of merger/amalgamation etc. are applicable similar to section 80-IA.

Losses of section 80-IC eligible industrial undertaking can be set off against other taxable business income. [Wipro Ltd. v. ACIT [2013] 55 SOT 3 (Bangalore Tribunal)(URO)]

(6) Deduction in respect of profits and gains from business of collecting and processing of bio-degradable waste [Section 80JJA]

Section 80JJA provides that if the gross total income of an assessee includes any profits and gains derived from the business of collecting and processing or treating of bio-degradable waste for generating power or producing bio fertilizers, bio-pesticides or other biological agents or for producing bio-gas or making pallets or briquettes fuel or organic manure, shall be entitled for a deduction of an amount equal to the whole of such profits and gains of five consecutive assessment years beginning with the assessment year relevant to the previous year in which such business commences.

(7) Deduction in respect of employment of new employees [Section 80JJAA]

Section 80JJAA provides for 30% of the additional employee cost for three assessment years (including the assessment year in which the new employment is provided) to all assessees covered under tax audit provisions as per section 44AB of the Act.

Additionally, section 80JJAA(2) also lays down the following specific scenarios in which the above deduction will not be available:

- If the business is formed by splitting up, or the reconstruction, of an existing business; or
- If the business is acquired by the assessee by way of transfer from any other person or as a result of any business reorganisation; or

- unless the assessee furnishes the report of the accountant, as defined in the Explanation below sub-section (2) of section 288, before the specified date referred to in section 44AB giving such particulars in the report as may be prescribed.

Meaning of additional employee under the section is provided as-

- "additional employee" means an employee who has been employed during the previous year and whose employment has the effect of increasing the total number of employees employed by the employer as on the last day of the preceding year, but does not include,—

  (a) an employee whose total emoluments are more than Rs. 25,000 per month (payable through account payee cheque or account payee bank draft or bank account or through such other electronic mode as may be prescribed); or

  (b) an employee for whom the entire contribution is paid by the Government under the Employees' Pension Scheme notified in accordance with the provisions of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952 (19 of 1952); or

  (c) an employee employed for a period of less than 240 days during the previous year (150 days in respect of specific industries viz. the manufacturer of apparels or footwear or leather products); or

  (d) an employee who does not participate in the recognised provident fund;

Finance Act 2018 made an amendment to the above provision to include that if the condition of 240/150 days as the case may be is not completed in the first year of employment, but is complied with in the immediately succeeding year, the deduction under this section shall be available from such succeeding year considering that the employee deemed to have been employed in the said succeeding year.

Similarly, one may also need to borne in mind the meaning of ‘additional employee cost’ and ‘emoluments’ while computing the deduction under section 80JJAA of the Act.

(7) Deduction in respect of certain incomes of Offshore Banking Units and International Financial Services Centre [Section 80LA]

Section 80LA(1) provides that where the gross total income of an assessee, being a scheduled bank, or, any bank incorporated by or under the laws of a country outside India; and having an Offshore Banking Unit in a Special Economic Zone; includes any income referred to in sub-section (2), there shall be allowed, in accordance with and subject to the provisions of this section, a deduction from such income, of an amount equal to—

(a) 100% of such income for five consecutive assessment years beginning with the assessment year relevant to the previous year in which the permission, under clause (a) of sub-section (1) of section 23 of the Banking Regulation Act, 1949 (10 of 1949) or permission or registration under the Securities and Exchange Board of India Act, 1992 (15 of 1992) or any other relevant law was obtained, and thereafter;

(b) 50% of such income for five consecutive assessment years.

80 LA(1A) provides where the gross total income of an assessee, being a Unit of an International Financial Services Centre, includes any income referred to in sub-section (2), there shall be allowed, in accordance with and subject to the provisions of this section, a deduction from such income, of an amount equal to one hundred per cent. of such income for any ten consecutive assessment years, at the option of the assessee, out of fifteen years, beginning with the assessment year relevant to the previous year in which the permission, under clause (a) of sub-section (1) of section 23 of the Banking Regulation Act, 1949 (10 of 1949.) or permission or registration under the Securities and Exchange Board of India Act,1992 (15 of 1992.) or any other relevant law was obtained.

The income referred to in sub-section (1) and sub-section (1A) shall be the income—

(a) from an Offshore Banking Unit in a Special Economic Zone; or

(b) from the business referred to in sub-section (1) of section 6 of the Banking Regulation Act, 1949 (10 of 1949) with an undertaking located in a Special Economic Zone or any other undertaking which develops, develops and operates or develops, operates and maintains a Special Economic Zone; or

(c) from any Unit of the International Financial Services Centre from its business for which it has been approved for setting up in such a Centre in a Special Economic Zone. [Section 80LA(2)]

As per section 80LA(3), no deduction under this section shall be allowed unless the assessee furnishes along with the return of income,—

(*i*) the report, in Form no. 10CCF of an accountant certifying that the deduction has been correctly claimed in accordance with the provisions of this section; and

(*ii*) a copy of the permission obtained under clause (*a*) of sub-section (1) of section 23 of the Banking Regulation Act, 1949 (10 of 1949).

(8) Deduction for interest on deposits in saving account (not being time deposits) [Section 80TTA]

This deduction is available to Individual/HUF. The amount subject to maximum deduction is Rs. 10,000/-. The conditions for deduction are as below:

The saving account is with the banking co., co-op society or post office

Where the interest is from saving a/c held by, or on behalf of a firm, AOP or BOI, no deduction to be allowed in respect of interest in computing the total income of any partner of the firm, or any member of AOP or BOI

(9) Other deductions available in respect of all assesses (including non-residents):

a. Deduction in respect of profits and gains from business of hotels and convention centers in specified area [Section 80-ID]

b. Special provisions in respect of certain undertakings in north eastern states [Section 80-IE]

Chapter 7

Double Taxation Avoidance Agreements and Double Taxation Relief

This chapter analyses the impact of double or multiple taxation of the same income in the hands of the same assessee simultaneously under the Indian income-tax law as well as under the taxation laws of different countries.

International Juridical double taxation mainly arises because of levying taxes on income/capital sourced in its jurisdiction by the source state (source rule), as well as by the residence state on the same income/capital due to the recipient being resident in that state (residence rule). Eg.: If an US entity lends money to an Indian Company, then interest income earned by the US entity will be chargeable to tax in India since income is sourced in India. At the same time, the US entity, would be subject to tax on its world-wide income in the US, it being resident of USA. This gives rise to double taxation. Thus:

- When a person is considered as Resident in two or more states simultaneously, double taxation of same income may arise. E.g. In cases where one person is deemed to be resident by virtue of POEM situated in Country X, while naturally he is also resident in Country Y.
- When source rules overlap, double taxation may arise. i.e. where two or more countries as per their domestic laws conclude that in respect of the same transaction, income arises or is deemed to arise in both their respective jurisdictions.
- 'Economic double taxation' happens when the same, item of income or capital is taxed in two or more states but in hands of different taxpayers (because of lack of subject identity). Eg. When one state attributes an income/capital to its legal owner whereas the tax law of other state attributes it in the hands of the person in possession or having economic control over the income. Yet another classic example is tax on distributed surplus by a company which is taxed in the hands of the company distributing such surplus, while the other jurisdiction taxes the said income from distribution in the hands of the shareholder. This type of double taxation happens due to transfer pricing adjustments.

The Concept of Tax Neutrality

Generally, the tax system should strive to be neutral so that decisions are made on their economic merits and not for tax reasons. In some cases, neutrality is impossible, and policymakers have to accept a certain level of distortion to behavior as inevitable. In other cases, neutrality may be undesirable if policymakers intend to promote the specific goals

In the international context, the concept of tax neutrality has several standards.

These are:

- Capital export Neutrality
- Capital-Import neutrality or Foreign Competitive Neutrality
- National Neutrality

The taxability of an assessee in India on any item of income depends upon his residential status taken in conjunction with the situs of accrual, arise or receipt of the particular item.

The position in many other countries being also broadly similar, it frequently happens that a person may be found to be a resident in more than one country or that the same item of his income may be treated as accruing, arising or received in more than one country with the result that the same item becomes liable to tax in more than one country. It is to prevent this hardship that the provisions of sections 90 & 91 are incorporated under the Income-tax Act, 1961.

It is possible to provide for relief against this hardship in two ways. One of them, enacted in section 90, is to have the relief against double taxation in any two countries worked out on the basis of a mutual agreement between the two concerned sovereign States. This may be called a scheme of 'bilateral relief as both concerned States agree as to the basis of the relief to be granted by either of them.

Agreements for 'bilateral relief' may be of two kinds. One kind of agreement is where two countries agree that income from various specified sources which are likely to be taxed in both the countries should either be taxed only in one of them or that each of the two countries should tax only a particular specified portion of the income so that there is no overlapping. Such an agreement will result in a complete avoidance of double taxation of the same

income in the two countries. The other kind of agreement is one that does not envisage any such scheme of single taxability but merely provides that, if any item of income is taxed in both the countries, the assessee should get relief in a particular manner. Under this type of agreement, the assessee is liable to have his income taxed in both the countries but is given a deduction, from the tax payable by him in India, of a part of taxes paid by him thereon, usually the lower of the two taxes paid.

Section 90(1) provides four clauses for distinct circumstances. Clause (a) provides for relief in certain cases where income-tax has already been charged and paid, both in India and in another foreign country, on the same income or to promote mutual economic relations, trade and investment. Clause (b) on the other hand, does not provide relief against double taxation which has already taken place, but provides for the avoidance of double taxation, without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in the said agreement for the indirect benefit to residents of any other country or territory). Clause (c) provides for exchange of information for the prevention of evasion or avoidance of income-tax chargeable under this Act, or under the corresponding law in force in that country, or investigation of cases of such evasion or avoidance. While Clause (d) provides for recovery of income-tax under this Act and under corresponding law in force in that country.

From the above, it is clear that under clause (a) relief is granted after an income has suffered taxes under the laws of both the countries, while in clause (b) relief is allowed at the time of assessment itself i.e. provision has been made for avoiding double taxation.

Section 90(2) provides that where the Central Government has entered into an agreement with the Government of any country outside India under sub-section (1) for granting relief of tax, or as the case may be, avoidance of double taxation, then, in relation to the assessee to whom such agreement applies, the provisions of this Act shall apply to the extent they are more beneficial to that assessee.

Further, section 90(2A) provides that the provisions of newly inserted Chapter X-A on General Anti Avoidance Regulations shall apply even if such provisions are not beneficial to the assessee.

Section 90(3) read with explanation 3 provides that any term used but not defined in treaty as well as in the Act should be considered to have a meaning as assigned to it in the notification issued by the Central Government and shall be deemed to have effect from the date of the tax treaties entered into between the countries...

In this connection, notification no. 91/2008 dated 28 August 2008 provides that the term 'may be taxed' could be considered as providing that the said income shall also be included in the total income chargeable to tax in India in accordance with the provisions of the Income-tax Act, 1961 (43 of 1961), and that the relief shall be granted in accordance with the method for elimination or avoidance of double taxation provided in tax treaties between the countries.

The above notification was considered by the Delhi High Court in the case of Daler Singh Mehndi v. DCIT [2018] 91 taxmann.com 178 while deciding that income earned by the assessee in respect of stage shows performed in Canada, USA and Netherlands prior to the date of notification viz. upto assessment year 2004-05 is not chargeable to tax in India. However, the income earned outside India post assessment year 2004-05 shall be included in the total income chargeable to tax in India under the Act and that the tax credit shall be granted considering the relevant provisions of the treaty.

Above principles were also earlier reiterated by Mumbai Tribunal in the case of Essar Oil Ltd. v. ACIT [2014] 28 ITR (T) 609.

Similarly, explanation 4 to section 90, as inserted by the Finance Act 2017 provides that where any term used in the treaty is defined in the treaty, such term shall have the meaning as assigned to it in the treaty; however, where the term is not defined in the said treaty, but it is defined in the Act, it shall have the same meaning as assigned to it in the Act and explanation to it as given by the Central Government.

Section 90(4) provides that non-resident shall not be entitled to claim any relief under such agreement unless a certificate, containing prescribed particulars namely the tax residency certificate ('TRC'), of his being a resident in any country outside India or specified territory outside India, as the case may be, is obtained by him from the Government of that country or specified territory.

Similarly, section 90(5) of the Act read with rule 21AB prescribes that Form 10F shall be furnished providing the details viz. status, nationality, tax

identification number, period for which the residential status is applicable and address; if these information are not contained in the TRC as discussed earlier.

Important Judicial Precedents & Board Circulars:

1. In CIT v. Visakhapatnam Port Trust [1983] 144 ITR 146 (Andhra Pradesh HC), it has been held that though under section 9(1)(i), all income arising, whether directly or indirectly, through or from any 'business connection' in India shall be deemed to accrue or arise in India, the charging section 4 as well as the definition of 'total income' in S.5 are expressly made subject to the provisions of the Act, which means that they are subject to the provisions of section 90. By necessary implication this subject to the terms of Double Taxation Avoidance Agreement, if any, entered into by the Government of India with foreign countries. Even assuming that all the profits of a foreign company are to be deemed to accrue or arise in India under section 9 of the Act, the provisions of the articles of the agreement will prevail over section 9. In effect, such profits of a foreign company will not be liable to tax under section 9 except to the extent allowed by the Agreement with the foreign country.

2. In Advance Ruling Petition No. P-11 of 1995, In re [1997] 228 ITR 55 (AAR) has held that it is well settled that the specific provisions of an agreement for avoidance of double taxation is override the general provisions of the Act.

3. Furthermore, the Supreme Court in UOI v. Azadi Bachao Andolan & Another [2003] 263 ITR 706 has held that no provision of the Double Taxation Avoidance Agreement can possibly fasten a tax liability where the liability is not imposed by the Act. If a tax liability is imposed by the Act, the Agreement may be resorted to for negativing or reducing it; and, in case of difference between the provisions of the Act and the Agreement, the provisions of the agreement would prevail over the provisions of the Act and can be enforced by the appellate authorities in the court.

4. In CIT v. PVAL Kulandagan Chettiar [2004] 267 ITR 654, Supreme Court has held that in case of conflict between Income-tax act and provisions of DTAA, provisions of DTAA would prevail over provisions of Income-tax Act. Section 90(2) of the Act makes it clear that the Act

gets modified in regard to the assessee insofar as the agreement is concerned if it falls within the category stated therein.

5. In Sanofi Pasteur Holding SA v. Department of Revenue [2013] 354 ITR 316 (Andhra Pradesh HC), wherein revenue authorities sought to tax capital gains arising from transaction in issue on the basis of retrospective amendments made in Explanation 2 to section 2(47) and Explanation 4 and 5 to section 9 by the Finance Act, 2012. According to revenue authorities, retrospective amendments to Act would override provisions of DTAA. It was held that since retrospective amendment sought to be relied upon by revenue were fortified by a non-obstante clause expressed to override tax treaties, contention raised by revenue was to be set aside.

Thus, from the above, it is clear that whichever provision either in the Act or DTAA beneficial to the assessee, the assessee could take the advantage of the same.

The agreements entered into with the foreign countries for avoidance of double taxation may be broadly divided into two categories (i) comprehensive agreements; and (ii) other agreements covering receipts from air or shipping trade, or both. As on date, the Government of India has entered into comprehensive agreements for avoidance of double taxation with more than sixty five countries and limited agreements with more than seventeen countries.

India has signed a protocol with Mauritius, Singapore and Cyprus to amend various articles in tax treaties related to permanent establishment, capital gains, limitation of benefit clause, interest etc.

In March 2018, India has also entered into tax treaties with Kazakhstan and Hong Kong. Some of the important highlights of India – Hong Kong DTAA are as under:

- 'Trust' and 'partnership' are also brought under the purview of 'person'
- Specific anti-avoidance rules are incorporated under the articles dealing with dividend, interest, royalty, fees for technical services, capital gains viz. main purpose or one of the main purposes of any person is to take advantage of these Articles
- Under the 'Other Income' article, Source Country has also been given the taxation rights in line with UN Model Convention
- Dependent Agent PE also contains clause related to 'securing orders'

Section 90A of the Act is very much similar to section 90 except the fact that it deals with tax reliefs between specified associations. Section 91 deals with issues related to non-treaty countries. The said section provides that if the Government of India has not entered into agreement with any country for avoidance of double taxation or for relief on double taxation, an assessee who is resident in India during the previous year is entitled to relief calculated on the following basis. The average rates of tax for the year applicable to the assessee both in the Indian assessment and in the foreign assessment are compared and whichever of these rates is lower is applied to the doubly taxed income and the tax is calculated thereon. This amount of tax is deducted from the total tax assessed on the assessee and the balance alone recovered from him. If the assessee had already paid the tax, a corresponding refund will be made.

Before any relief for double taxation can be granted under this section the amount of income as statutorily computed for purposes of imposition of the tax has to be examined and the identity of the amount which has borne tax under the law of the foreign country and the law of India has to be established. The expression 'such doubly taxed income' indicates that it is only that portion of the income on which tax has in fact been imposed and been paid by the assessee that is eligible for the double tax relief.

Unilateral relief from double taxation is admissible under section 91 of the Income Tax Act, 1961 inter alia, if the following conditions are satisfied:-

(a) the assessee is resident in India in the previous year;

(b) the income accrued or arose during the previous year outside India, (and is not deemed to accrue or arise in India);

(c) the income has been taxed both in India and the foreign country with which there is no agreement under section 90 for the relief or avoidance of double taxation; and

(d) the assessee has paid income tax in the foreign country.

Payment of income-tax by a person in the foreign country of his income which accrued or arose during the previous year outside India is, therefore, a pre-requisite for the grant of unilateral relief from double taxation under section 91 of the Income tax Act.

In CIT v. Bombay Burmah Trading Corporation Ltd. [2003] 259 ITR 423, the Bombay High Court held that basically under section 91(1) the expression 'such doubly taxed income' indicates that the phrase has reference to the tax which the foreign income bears when it is against subjected to tax by its

inclusion in the computation of income under the Income-tax Act, 1961. Further, section 91(1) shows that in case of double taxation relief to the resident, the relief is allowed at the Indian rate of tax or at the rate of tax of the other country, whichever is less. Therefore, the relief under section 91(1) is by way of reduction of tax by deducting the tax paid abroad on such doubly taxed income from tax payable in India. Under the circumstances, the scheme is clear. The relief can be worked out only if it is implemented country- wise. Therefore, the argument based on aggregation of income would result in defecting the scheme of section 91(1). Thus, where the assessee has its business in India, Tanzania and Thailand, the assessee would be entitled to double income- tax relief under section 91(1) in respect of income from Tanzania without adjusting losses from Thailand branch.

Section 91(2) provides that if any person, resident in India proves that in respect of his income which accrue or arise to him, during the previous year in Pakistan and has paid the tax in that country on agricultural income, he shall be entitled to a deduction from the Indian income-tax payable by him of the amount of the tax paid in Pakistan on such income which is liable to tax under this Act or of a sum calculated on that income at the Indian rate of tax, whichever is less.

Interpretation of tax treaties

DTAAs as we have seen earlier, aim at eliminating or reducing the tax burden of a resident of a Contracting State engaged in transactions with a resident of another Contracting State. The intention of the Contracting States for entering into a DTAA is to aid in enhancing trade. As the tax element is an important consideration for a businessman, he would always weigh his return on investments post tax. In order to attract more trade, which generates more employment, which in turn raises the disposable income and increases the purchasing power, giving a general boost to the economy; countries are willing to forsake a certain percentage of collection in revenues.

As the problems faced by most countries in adopting the DTAA were largely similar, a need was felt to standardize the DTAA. As early as in the 1920s, the International Chamber of Commerce sought the help of the League of Nations to overcome the problem of double taxation. The need to standardize DTAAs was felt to reconcile the laws and needs of different countries while preserving their individuality. A standardized DTAA would also help the persons for dealing in trade with different countries at the same time.

Model Tax Convention was first prepared by the Fiscal Committee of the League of Nations in 1927. Later, the Committees conducted meetings in Mexico during 1943 and in London in 1946 to discuss the drafts and proposed minor variations. The Model Conventions were published in 1946 by the Fiscal Committee of the United Nations (UN) Social and Economic Council. These drafts were the starting point for Organisation for Economic Co-operation and Development (OECD) for its draft Model DTAA.

There are three generally used Models of the DTAA:

A. OECD Model Tax Convention: The draft Model DTAA was first published by the OECD in 1963 and is updated periodically. The OECD model is generally regarded as favouring the developed countries, or the capital exporting countries, as it gives priority of taxation to the residence state over that of the state of source. OECD Model is the base on which other Models are built. It has also been used as a Model for negotiating Treaties between OECD Members and non-member countries. India is not a member to the OECD. It has made certain observations/reservations with respect to the OECD commentary on some of the Articles. While the judiciary in India has made reference to the OECD commentary for the purpose of interpretation [see Asia Satellite Telecommunications Co Ltd. (2011)(332 ITR 340)(Del)], some judicial precedents have also recognised the reservations made by India while interpreting the DTAA [see Linklaters LLP v. ITO (2010) (132 TTJ 20)(Mum) Trib.), Gracemac Corporation v. ADIT (2010)(42 SOT 550)(Del Trib.).

B. UN Model Double Taxation Convention: Since the OECD Model was regarded as furthering the interests of the developed countries, the developing countries prepared their own model in 1979, which is known as the 1979 UN Model Tax Convention. This was developed / modified further in 1980, 2001,2011, 2014 and 2017, incorporating the changes gained out of the experience Indian DTAAs are a mix of both the models.

C. US Model Income Tax Convention: US Model serves as a model to negotiate Treaty by USA. Like UN Model Convention, the US Model Convention is also based on the OECD Model. It adapts to the conditions peculiar to the US. The US Model convention was first published in 1976 and revised in 1977, 1981, 1996, 2006 and recently in 2016. USA has also published a Technical Explanation to explain / clarify the provisions in the Articles of the US Model Convention.

These DTAA Models have led to the development of international tax law besides harmonization of DTAAs at the time of negotiation and also at the

time of interpretation of the DTAAs in the event of disputes. Normally, the thumb rule to be followed in the interpretation of a DTAA is that the provisions of the DTAA override the provisions of the Act, unless the provisions of the Act are more beneficial.

DTAAs not being different from other international agreements, are to be interpreted using the same principles accepted in the International law. Therefore, the principles set out in the Vienna Convention on the Law of Treaties will be useful in interpreting the DTAAs in the case of conflict. The Vienna Convention on the Law of Treaties provides guidelines to the countries in legal interpretation of the treaties which are parties to this Convention. Even though India is not a party to the Vienna Convention, nonetheless, one may rely on this convention for the purpose of interpretation in case of ambiguity. The Delhi bench of Tribunal in the case of British Airways Plc. (2002)(80 ITD 90)(Del. Trib.) has taken recourse to the Vienna Convention for the purpose of interpretation of double taxation treaties.

The General Rule of interpretation as provided in Article 31 of the Vienna Convention are as follows:

- A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.
- The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes:
  - (a) Any agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty;
  - (b) Any instrument which was made by one or more parties in connection with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty.
- There shall be taken into account, together with the context:
  - (a) Any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions;
  - (b) Any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation;

(c) Any relevant rules of international law applicable in the relations between the parties.

- A special meaning shall be given to a term if it is established that the parties so intended.

The U.S. Court in the case of Scotland West Life Insurance Co. Canada v. CIR (1996) (107 TC US 363) has cited the following principles of precedence for the guidelines in interpretation of the DTAAs:

(i) The meaning should be consistent with genuine shared expectation of the contracting parties;

(ii) It should give effect to the purpose of the treaty. Where interpretations, both restricted and liberal are possible, the liberal interpretation should be preferred;

(iii) Words should be understood in its ordinary meaning unless it is specifically given a special or restricted meaning. As far as possible, the language in the law and the DTAA should be both effective;

(iv) Ambiguities could be resolved by making reference to the materials used during the process of negotiations, which can be given due weightage, though, it may not be conclusive.

In the context of reference to material used in the process of negotiation, different countries have taken different approaches to the weightage to be given to the working papers on the negotiations between them. The purposive interpretation so as to meet the spirit and substance of the DTAA has been recognized by the Supreme Court in the case of Azadi Bachao Andolan [2003] 263 ITR 706 (SC).

Thus, the International law on the subject would also throw light on the interpretation when recourse to domestic case law does not throw much light.

The provisions of the DTAA override the provisions of the Act. The landmark decision of the Andhra Pradesh High Court in the case of Visakhapatnam Port Trust (1983)(144 ITR 146)(AP) has considered the international law on this subject and concluded that DTAAs override the provisions of the Act.

In the case of Hindustan Paper Corporation Ltd. (1994) (77 Taxman 450)(Cal), the question before the Court was whether the definition of royalty in the Act was to be ignored in favour of the definition in the DTAA. The Court has ruled that section 90 of the Act clearly provided that the provisions of the DTAA would override the provisions of the Act to the extent they are more beneficial. The court also held that where there is no specific provision

in the DTAA, the Act should be followed. Similar views have been expressed in the case of; Arabian Express Line (1995)(212 ITR 31)(Guj); R.M.Muthiah (1993)(202 ITR 508)(Kar); Davy Ashmore India Ltd. (1991)(190 ITR 626)(Cal) and in the Circular issued by the CBDT No.333 (137 ITR (St.)1), dated 2 April 1982.

However, the Delhi Bench of the Tribunal in the case of Gracemac Corporation (2010)(42 SOT 550), held that the domestic law provisions can override the provisions of the DTAA, if they are enacted at a later point in time. Nevertheless, while arriving at such a conclusion, the Tribunal has not taken into consideration the above referred numerous rulings and the circular issued by the CBDT. Thus, adopting the view taken by the Tribunal in these decisions is not free from litigation.

If giving purposive interpretation results in uncertainty between the provisions of the DTAA and the domestic law, e.g. in a case where one country recognizes the 'person' as a 'resident' and another country does not recognize it as a 'person' perse, both the contracting states may opt to re-negotiate the DTAA.

The procedure for Mutual Agreement Procedure (MAP) provided in the DTAAs may also be resorted to when there is a conflict on the interpretations of the DTAA which are examined in detail in the Chapter dealing with MAP.

In addition to the Model Tax Conventions, one may also refer to the following for interpreting DTAAs:

- Overseas Laws and regulations pertaining to the other Contracting State;
- International decisions;
- Protocol to a DTAA;
- Technical Explanations to the DTAA (like Technical Explanation to India-USA DTAA);
- International Commentaries; etc.

In fact, now in a world of shrinking borders it is very important to understand the evolving law on the problems of interpretation of the DTAAs. This is also evident with the introduction of BEPS Action Plan by the OECD, whereby the countries across the world are evaluating on amending the existing terms of the DTAA to factor the Action Plans. The countries are also proposing amendments in their domestic tax laws in line of the Action Plans.

Scope of tax treaties

A general overview of DTAA is as under (The Article numbers indicated herein may vary from DTAA to DTAA). For the purpose of forthcoming paragraphs, the UN Model convention is taken as base. Deviations if any from the OECD / US Model conventions are covered separately.

1. *Chapter I - Scope of the Convention* - This Chapter generally specifies whom the convention applies to and the taxes it covers (Article 1 - Persons covered; Article 2 - Taxes covered).

2. *Chapter II* - It defines the concepts of the DTAA and the terms used (Article 3 – General Definitions; Article 4 - Resident; Article 5 – Permanent Establishment).

3. *Chapter III - Taxation of Income* - This is the body of the DTAA. This Chapterdeals with categorization of the income under various heads and the method of taxation of such income. (Article 6 - Income from Immovable Property; Article 7 - Business Profits; Article 8 – Shipping, Inland waterways transport and Air transport; Article 9 - Associated enterprises; Article 10 - Dividends; Article 11 - Interest; Article 12 - Royalties and Fees for Technical Services (FTS) (While FTS is not covered under any of the Model conventions, but it is covered under DTAAs signed by India with most of the countries); Article 13 - Capital Gains; Article 14 - Independent Personal Services (absent in OECD); Article 15 - Dependent Personal Services; Article 16 - Directors' Fees and remuneration of top-level managerial officials; Article 17 - Artistes and Sportspersons; Article 18 – Pensions and social security payments; Article 19 - Government Service; Article 20 - Students; Article 21 - Other Income).

4. *Chapter IV* - Normally deals with Norms for Taxation of Capital [Article 22 – Capital (absent in U.S. Model)].

5. *Chapter V* - Contains special provisions to ensure elimination of double taxation (Article 23 - Elimination of Double Taxation). The U.S. Model convention also contains an additional article (Article 22 - Limitation of Benefits) which provides for conditions for claiming the benefits under the DTAA.

6. *Chapter VI* – Contains special provisions dealing with procedural recourse for grievances against unfair application / interpretation of the DTAA [Article 24 - Non Discrimination; Article 25 – Mutual Agreement Procedure; Article 26 - Exchange of Information; Article

27 – Assistance in the collection of taxes; Article 28 – Members of diplomatic missions and consular posts; Article 29 – Territorial Extension (present in OECD)].The U.S. Model convention covers an additional article (Article 28 – Subsequent changes in law).

7. *Chapter VII* – This provides for the date when the DTAA would come into force and when it would be terminated (Article 29 - Entry into Force; Article 30- Termination).

8. *Protocol* – Every DTAA would also have a protocol which is an integral part of the DTAA and explains in detail the provision of the Articles of the DTAA. The Protocol puts in the clarification arrived at by the Contracting States after exchange of letters on issues which need to be ironed out. The India-USA DTAA also has a long list of illustrations explaining the provisions of the DTAA. Exchange of notes and Protocol which are acted upon by the parties are also recognized in international law as a valid and binding agreement and do not need to be formalized. The Supreme Court also took due cognizance of the protocol appended to the India-Japan DTAA in its landmark ruling of Ishikawajma-Harima Heavy Industries Ltd [2007] 158 Taxman 259 (SC).

A few of these Articles are analysed in detail in the ensuing paragraphs.

Some DTAAs like the India's DTAA with the USA also contain a Technical Explanation which throw light on the intent of the DTAA and become a guide to understand the scope and extent of the DTAA.

The scope of a DTAA is wide enough to encompass the various categories of income that may arise to ensure that the income is not doubly taxed in both the countries, and/or to allow credit for tax paid/deducted in the country of source.

The Calcutta High Court in the case of *Hindustan Paper Corporation Ltd. (supra)* touched upon an issue with respect to cases where there is no specific provision in the DTAA. It held that such income would be taxable under the Act. However, lately, there are diverging views from the courts on this issue viz. if there is no specific Article under the DTAA;

(i) It should be taxable under 'Other Income' Article [see Lanka Hydraulic Institute Ltd. (2011) (AAR)];

(ii) It should be taxable as business income only if it has a Permanent Establishment [*see Andaman Sea Food Pvt. Ltd.(2012) 18 ITR(T) 509 (Kol), Essar Oil Ltd. (2005)(TII 24 ITAT Mum INTL), Mckinsey*

Business Consultants Sole Partner LLC (2015) (54 taxmann.com 300)(Mum ITAT), IBM India Pvt. Ltd. (2014) Bang ITAT (TS-78-ITAT-2014), Viceroy Hotels Ltd. (2011)(TII 97 ITAT Hyd INTL), Tekniskil (Sendirian) Berhard (1996)(222 ITR 0551)AAR))

(iii) It should be taxable under the Act (see *Gearbulk AG (AAR) (2009).*

India deposited its instrument of ratification for the MLI on June 25, 2019 with the OECD conveying its final position on MLI provisions to implement tax treaty related measures for preventing BEPS. The MLI provisions have come into force for India on 1 October 2019, and are already into effect from 01 April 2020, to certain extent. Therefore, the articles of the DTAAs must be read correspondingly with the MLI articles. The government has also released the synthesized text of the DTAAs for countries that have deposited their instrument of ratification with the OECD and have listed India as one of the Covered Tax Agreements.

Methods of Avoidance of Double Taxation Accepted in Indian Treaties

Double Taxation: Double Taxation is of two types, Juridical Double Taxation and Economic Double Taxation. Juridical Double Taxation is where the same income or capital is taxable in the hands of the same person by more than one state. Economic Double Taxation is where two different persons are taxable in respect of the same income or capital.

Double Taxation Avoidance Agreement: Government of India has entered into bilateral agreements with Government of other Countries to avoid double taxation of Income earned by persons in India and other country under section 90 of Income Tax Act, 1961.

Methods of elimination of double taxation:

1) Exemption Method/Principle of Exemption
2) Credit Method/Principle of Credit
3) Tax Sparing Method
4) Underlying Tax Credit Method

1) Exemption Method/ Principle of Exemption:

Under this method, the Country of Residence does not tax the income which according to the Convention may be taxed in Country of Source i.e. income which shall be taxable only in Country of Source. It has main two methods:

(a) The income taxable in Country of Source is not taken into account at all by the Country of Residence. Country of Residence is not entitled to take the income so exempted into consideration when determining the tax to be imposed on the rest of the income; this method is called "full exemption".

(b) The income which may be taxed in Country of Source is not taxed by Country of Residence, but Country of Residence retains the right to take that income into consideration when determining the tax to be imposed on the rest of the income; this method is called "exemption with progression".

Following treaties has used Exemption method for following Income:

(i) India-Australia: 'Exemption with progression' in respect of income which is taxable only in other contracting state.

(ii) India-Belarus: 'Exemption with progression' in respect of income which is taxable under the treaty in the other Contracting State only.

(iii) India-Canada: 'Exemption with progression' in respect of income or capital which is exempt from tax in Canada and in respect of income which is exempt in India.

(iv) India-Egypt: In respect of taxes paid on other income.

(v) India – Austria : Article 23(c) provides for exemption with progression

2) Credit method/Principle of Credit:

Under this method, the Country of Residence calculates its tax on the basis of the taxpayer's total income including the income from the other Country of Source which, according to the Convention, may be taxed in that other Country (but not including income which shall be taxable only in Country of Residence). It then allows a deduction from its own tax for the tax paid in the other State.

The principle of credit may be applied by two main methods:

(a) Country of Residence allows the deduction of the total amount of tax paid in the other State on income which may be taxed in that State, this method is called "full credit";

Article 23 of India – Namibia tax treaty provides for full credit.

(b) The deduction given by Country of Residence for the tax paid in the other State is restricted to that part of its own tax which is appropriate

to the income which may be taxed in the other State; this method is called "ordinary credit".

Article 25 of India – USA tax treaty contains provisions related to ordinary credit.

In Elitecore Technologies (P.) Ltd. v. DCIT [2017] 184 TTJ 166, Ahmedabad Tribunal has held that where assessee-company receives certain amount from AEs after deduction of tax at source, tax credit has to be allowed to assessee only to the extent corresponding income suffers tax in India and it is not correct approach to take into account gross receipts for the purpose of computing admissible tax credit.

Karnataka High Court in Wipro Limited [2016] 382 ITR 179 has allowed credit allowed on income under section 10A. However, we also need to note that the special leave petition filed by revenue against the order has been accepted by the Supreme Court [2016] 240 Taxman 299.

India has followed Credit method in most of the treaties.

3) Tax Sparing

Where tax incentives are granted by Country of Source to foreign taxpayers by reducing a tax that, absent such measure, would be higher, the taxpayer is denied the effect of the intended benefit if Country of Residence, in a tax credit situation, allows the deduction only for the tax actually paid. In such a case, the treasury of Country of Residence would obtain the benefit and the goal of the incentive provision would not be attained. To avoid this effect, countries running such incentive programs often insist on the inclusion of a so-called “tax sparing” provision in tax treaties. By means of such a provision, the taxpayer is given a tax credit for taxes which have not been paid, hence ‘spared’, in the Country of Source. This means that, Country of Resident gives credit of tax which may have been paid in Country of Source, if tax was not spared by Country of Source.

Following treaties has used Tax Sparing Method for following Income:

(i) India-Brazil: In respect of Interest (Article 11/2) and Royalties (Article 12/2b) in Article 23/2.

(ii) India-Bulgaria: In respect of tax which would have been payable in the other Contacting State but for any relief allowed under the laws of that State in Article 25/3.

(iii) India-Canada: In respect of taxes not paid in India under certain provisions of Indian Income Tax Act, as listed in Article 23/4 of the

treaty, provided that such relief shall not be given if the income relates to a period starting more than 10 years after the exemption from, or reduction of, Indian tax is first granted to the resident of Canada, in respect of the source.

(iv) India-China, India-Cyprus, India-Korea, India-Sweden, India-Trinidad & Tobago, India-Turkmenistan, India-Ukraine, India-UAE, India-Uzbekistan, India-Vietnam, : In respect of income which is not taxed for economic development.

(v) India-Syria, India-Tanzania, India-Thailand, India-UK, India-Zambia.

Important Judicial Precedents & Board Circulars:

(a) In Krishak Bharati Co-operative Ltd. [2017] 80 taxmann.com 326, Delhi High Court while analyzing the tax treaty between India and Oman, which contains tax sparing clause had held that foreign tax credit is available in respect of dividend income received from Oman company even though no taxes thereon have been paid in Oman under its domestic law.

(b) In Indian Farmers Fertilizers Co-operative Ltd. v. Principal CIT [2016] 51 ITR(T) 162 while dealing with tax sparing credit provisions viz. Article 25 of India and Oman tax treaty, the Delhi Tribunal had held that from the combined reading of Articles 25(2), 25(4) and section 90(1)(a)(ii), it is clear that actual payment of taxes is not a sina qua non for the claim of the tax credit. However, the two conditions which still need to be satisfied for the claim of the Tax Credit are that the tax should have been "payable" and that the tax is not actually paid on account of the tax incentive provisions aimed at promoting economic development. Where both these conditions are fulfilled, assessee is entitled to claim the credit of deemed dividend which would have been payable in Oman.

4) Underlying Tax Credit/Indirect Credit

As regards dividends/distributions received from the subsidiary, the Country in which the parent company is a resident gives credit as of taxes paid in the Country of Source, by deduction, payment, withholding taxes, etc, as appropriate, not only for the tax on dividends as such, but also for the tax paid by the subsidiary on the profits distributed in the Country of Subsidiary's Resident. "Tax Paid" by the subsidiary on Corporate Profit also includes the tax which has not been paid, actually, due to exemption or deduction available under domestic laws. Example: If Indian Subsidiary availing the

Exemption or deduction under section 10A, 10AA, 80IA, or 80IB then Holding Company can claim the underlying tax credit of the tax payable on Corporate Profit by Subsidiary even if such tax has not been paid.

Following treaties has used Underlying Tax Credit Method for following Income:

(i) India-Mauritius: In respect of tax on dividends received from other contracting Country's subsidiaries if holding is not less than 10% of the shares.

(ii) India-Singapore: In respect of tax on dividends received from a subsidiary which is a resident of other contracting country if the holding is not less than 25%.

(iii) India-Spain: In respect of dividends received from a subsidiary which is a resident of India if holding is not less than 25%.

(iv) India – UK : In respect of tax on dividends received from an Indian entity which controls directly or indirectly atleast 10% of the voting power

Under the Income-tax Rules, CBDT vide Rule 128 prescribed rules regarding 'procedure for granting relief or deduction of any foreign tax paid against the Indian tax payable', which were made applicable from April 1, 2017. The Rules provide clarity on the mechanism of obtaining foreign tax credit in India for resident tax payers in respect of taxes paid overseas. Salient features of this Rule are as under:

- Any resident assessee shall be allowed a credit of FTC in the year in which the income corresponding to such tax has been offered to tax or assessed to tax in India and in case income is taxed in multiple years in India, FTC is allowed in all years in the same proportion as the income has been taxed in India in that particular year
- FTC shall be available against the amount of tax, surcharge and cess payable under the Act but not in respect of any sum payable by way of interest, fee or penalty.
- FTC Rules provide that in case of foreign taxes which are disputed, FTC shall not be available on such taxes until such dispute is resolved and the taxpayer furnishes evidence of payment of such disputed tax along with undertaking of no refund within 6 months from the settlement of dispute.

- FTC shall be allowed in the relevant year in which such income is offered or assessed to tax in India.
- The FTC shall be the aggregate of the credit computed separately for each source of income and the credit shall be the lower of the tax payable under the Act on such income and foreign tax paid on such income but restricting the credit to the extent of tax liability under the act and excess shall be ignored;
- FTC is also available against tax liability under section 115JB or 115JC of the Act, but credit is restricted to the extent of tax liability. Any excess FTC to be ignored.

In order to avail FTC, a taxpayer is required to furnish certain details in a specified form no.67 along with evidence of taxes deducted or paid in overseas jurisdiction on or before the due date of filing of the tax return.

Current development in the treaty front is India's signing of multi-lateral instruments. India being part of G20 countries is committed to the Base Erosion and Profit Shifting [BEPS] project. India has gradually amended its domestic law to implement the actions under the BEPS project.

Chapter 8
Tax Treaties

Introduction

The Government of India has entered into double taxation avoidance agreements or tax treaties with several countries like the UK, Japan, Germany, France, Australia, Austria, etc. to avoid double taxation or to apply beneficial tax rates in the hands of foreign entities on income sourced in India.

A tax treaty applies to the residents of either of the contracting states. A non-resident has an option to be governed by the domestic tax laws of India or by the applicable tax treaty, whichever is more beneficial. Generally, the tax treaty is beneficial as compared to the domestic tax laws. By virtue of the tax treaty, India essentially seeks to tax the operating income sourced in India. For instance, income of a foreign enterprise from sale of immovable property situated outside India is generally not taxed in India. In order to claim any relief under the treaty, non-resident needs to produce a certificate of his/her/its being a resident in any country outside India obtained from the government of that country.

In the section below, we describe some of the key provisions that exist in most of India's tax treaties with other countries.

Withholding Taxes:

An Indian resident is obligated to withhold taxes while making payment to a Non Resident. The withholding tax rates vary depending upon the nature of payments (e.g. royalties, fees for technical services, interest, etc.) Generally, withholding tax rates in the tax treaties are lower than the tax rates under the domestic tax laws of India.

Under the domestic tax laws of India, a mechanism has been provided whereby if the entire income of a non-resident is believed to be not taxable in India, the payer or the payee of the income can obtain an order from the tax authorities prescribing a lower rate of withholding tax.

Further, the payee needs to consider consequences for non-furnishing of PAN by the non-resident payer and thus, deduct tax at a higher withholding tax rate

Type of payment	Non Residents	
	Company	Individual
Dividends	10%/20% (plus surcharge and cess)	10%/20% (plus surcharge and cess)
Interest	5%/20%/40% (plus surcharge and cess)	5%/20%/30% (plus surcharge and cess)
Royalties	10%/20% (plus surcharge and cess)	10%/20% (plus surcharge and cess)
Fees for technical services	10%/20% (plus surcharge and cess)	10%/20% (plus surcharge and cess)

• Dividend

As from 1 April 2020, dividends paid to a non-resident generally are subject to withholding tax at 20%. The rate is 10% for dividends paid on foreign currency bonds or global depository receipts. Both rates are subject to applicable surcharge and cess and may be reduced under a tax treaty.

• Interest

Interest paid to a non-resident on a foreign currency borrowing or debt generally is subject to a 20% withholding tax (plus any applicable surcharge and cess). A 5% withholding tax (plus any applicable surcharge and cess) applies to certain types of interest, as discussed in chapter of concessional tax rates, paid to a non-resident, including interest paid on specific borrowings made before 1 July 2023 in foreign currency, and interest on investments made before 1 July 2023 by a foreign institutional investor or a qualified foreign investor in a rupee-denominated bond of an Indian company, a government security, or a municipal debt security. The rates may be reduced under a tax treaty. Where a treaty applies, but the non-resident does not have a permanent account number (PAN) (i.e., a tax registration number), tax must be withheld at the higher of the applicable tax treaty rate or 20%; however, this does not apply if the payments are in the nature of interest and the foreign taxpayer provides the required documents such as Tax Residency Certificate (TRC), No Permanent Establishment (PE) certificate, declaration in Form 10F etc., to the payer. Where the interest income derived by a non-resident does not fulfill certain prescribed conditions for concessional withholding tax rates, a withholding tax rate of 30% (for individuals and entities other than a foreign company) or 40% (for a

foreign company) applies (plus any applicable surcharge and cess). The rates may be reduced under a tax treaty.

• Royalties

Royalties may be payable for:

1. hire of equipment;
2. use of or right to use copyright of literary, artistic, scientific work or cinematographic film;
3. use of or right to use a patent, trademark, design or model plan or secret formula; and
4. information concerning industrial, commercial or scientific experience.

Royalties paid to a non-resident are subject to a 10% withholding tax (plus any applicable surcharge and cess). The rate may be reduced under a tax treaty. Where a treaty applies, but the non-resident does not have a PAN, tax must be withheld at the higher of the applicable tax treaty rate or 20%; however, this does not apply if the payments are in the nature of royalties and the foreign taxpayer provides the required documents such as Tax Residency Certificate (TRC), No Permanent Establishment (PE) certificate, declaration in Form 10F etc., to the payer.

• Fees for technical services

Technical service fees paid to a non-resident generally are subject to withholding tax at 10% (plus any applicable surcharge and cess). The rate may be reduced under a tax treaty. Where a treaty applies, but the non-resident does not have a PAN, tax must be withheld at the higher of the applicable tax treaty rate or 20%; however, this does not apply if the payments are in the nature of technical service fees and the foreign taxpayer provides the required documents such as Tax Residency Certificate (TRC), No Permanent Establishment (PE) certificate, declaration in Form 10F etc., to the payer.

• Capital gains

Gains arising from transfer of a capital asset is liable to capital gains tax in India. Most of the tax treaties signed by India provide for taxation of capital gains as per domestic tax laws of the respective countries. Accordingly, capital gains from sale of capital assets or immovable properties situated in India are generally taxable in India.

Relaxation from deduction of tax at higher rates:

The deductee shall in respect of making payments as discussed earlier, if furnish the following details and documents to the payer, the provision of withholding taxes at higher rates in case of non-availability of PAN shall not apply :-

(i) name, e-mail id, contact number;

(ii) address in the country or specified territory outside India of which the deductee is a resident;

(iii) a certificate of his being resident in any country or specified territory outside India from the Government of that country or specified territory if the law of that country or specified territory provides for issuance of such certificate;

(iv) Tax Identification Number of the deductee in the country or specified territory of his residence and in case no such number is available, then a unique number on the basis of which the deductee is identified by the Government of that country or the specified territory of which he claims to be a resident.]

Most favoured nation clause

Tax treaties signed by India with countries like France, Spain, Sweden, the Netherlands, etc. contain a "Most Favoured Nation Clause" which provides that if, after signing of a tax treaty with such country, India enters into a tax treaty with another country, which is a member of OECD, and such new treaty provides for lower rates of taxation or for restricted scope of taxation, then such lower rates or restricted scope of taxation will also apply to the tax treaty with the first-mentioned country.

Chapter 9
Transfer Pricing

Backdrop

The Finance Act 2001 substituted section 92 of the Income-tax Act, with new sections 92 and 92A to 92F; referred to as transfer pricing provisions. These provisions lay down that income arising from an international transaction and/or specified domestic transaction between associated enterprises shall be computed having regard to the arm's length price. It further provides that the allowance of expense or interest arising from an international transaction shall also be determined having regard to the arm's length prices.

Over the years, there have been significant developments in the Indian Transfer Pricing regulations. Some of the key developments are as follows:

The Finance Act 2012 has introduced significant amendments including inter alia clarifying the coverage of the term 'international transactions', expanding the scope of transfer pricing provisions to specified domestic transactions (Section 92BA) and providing an Advance Pricing Agreement framework (Section 92CC and Section 92CD).

Further, section 92B extends application of transfer pricing provisions to transaction entered by an Indian entity with a resident independent third party.

The Finance Act 2015 increased the threshold limit for the applicability of specified domestic transaction from INR 5 crores to INR 20 crores with effect from Financial Year 2015-16. Finance Act 2017 further rationalized regulations relating to specified domestic transactions by excluding (from the ambit of transfer pricing) the transactions relating to expenditure in respect of which payment has been made by the taxpayer to a person referred to in under section 40A(2)(b).

The Finance Act 2016, in line with Organisation for Economic Co-operation and Development ("OECD") recommendations of the Base Erosion and Profit Shifting ("BEPS") Action Plan 13, inserted section 286 for furnishing of country-by-country report ('CbCR' or 'CbC report') and inserted proviso to section 92D(1) for maintenance of Master File, with effect from Financial Year 2016-17.

The CBDT thereafter released the final rules on CbC reporting and Master File requirements in India (vide notification no. 92/2017 dated 31 October 2017).

The existing penalty provisions were rationalized along-with insertion of additional penalties for non-furnishing/ maintenance of country-by-country report and master file.

Finance Act 2017 inserted section 92CE with effect from 1 April 2018 where, as a result of primary adjustment to the transfer price, there is an increase in the total income or reduction in the loss, as the case may be, of the taxpayer, the excess money which is available with its AE, if not repatriated to India within the time as may be prescribed, shall be deemed to be an advance made by the taxpayer to such AE and the interest on such advance, shall be computed in such manner as may be prescribed. Finance Act, 2017 also inserted section 94B on limitation on interest deductions in some cases.

Further, Finance Act, 2017 also introduced section 271J for levying penalty on accountants or a merchant banker or a registered valuer for furnishing incorrect information in reports or certificates furnished under the provision of the Act or the rules made there under.

Finance Act, 2018 extended the time limit for furnishing of CbCR to twelve month from the end of the reporting accounting year (previously, the time limit was on or before the due date of furnishing the return of income for the relevant accounting year). Further, Finance Act, 2018 amended section 286(4) to extend the obligation of furnishing the CbCR, in Form 3CEAD, by constituent entities resident in India, having non-resident parent, in case the parent entity outside India has no obligation to file CbCR in its country or territory. However, in cases where the non-resident parent has appointed an alternate reporting entity, the Indian constituent entity shall not be obliged to file the CbCR in India subject to conditions specified in section 286(5).

Finance Act, 2019 made amendments to various sections of the Act as listed below:

- Sub section (3) of section 92CD on effect to advance pricing agreement has been amended to clarify that in cases where assessment or reassessment has already been completed and modified return of income has been filed by the taxpayer, the assessing officer shall pass an order modifying the total income of the relevant assessment year determined in such assessment or of

reassessment, having regard to and in accordance with the APA. This amendment was made applicable from 1st September 2019.

- Section 92CE on secondary adjustments, in certain cases, has been amended to include the provision of a one-time payment by the assessee.
- Clarification has been provided regarding definition of the term 'accounting year' in section 286 of the Act. It has been provided that accounting year in case of alternate reporting entity of an international group, the parent entity of which is not resident in India, shall be the one applicable to the parent entity of the alternate reporting entity. This said amendment shall apply from assessment year 2017-18 onwards.
- Section 92D read with Rule 10DA has been amended to provide that the information and documents to be kept and maintained by a constituent entity of an international group shall be applicable even where there is no international transaction undertaken by such constituent entity. This amendment will be applicable from assessment year 2020-21 onwards.

Finance Act, 2020 has made the following amendments to the Income Tax Act, 1961 with respect to transfer pricing provisions:

- The due date for filing accountants report in Form 3CEB under the provision of section 92E of the Income Tax Act, 1961 has been preponed to October 31 of the relevant assessment year.
- The determination of profits attributable to a permanent establishment has been brought within the scope of Safe Harbor Rules under the provisions of section 92CB from assessment year 2020-21 onwards. Further, the same issue on determination of profits to permanent establishment shall also apply to Advance Pricing Agreements ('APA') entered into on or after 1 April 2020. Further, rollback benefit can also be availed, in this regard.
- Interest paid to an Indian permanent establishment of a non-resident bank has been excluded from the ambit of thin capitalization rules under provisions of section 94B of the Income Tax Act, 1961.
- Scope of Dispute Resolution Panel ('DRP') under section 144C has been expanded to include cases where the assessing officer proposed any variation which is prejudicial to the interests of the taxpayer, even though the same may not result in any variation to the

income or loss of the taxpayer. Further, definition of 'eligible assessee' has been expanded to include non-corporate non-residents, in addition to foreign corporate.

Conditions

The transfer pricing provisions under the Act are applicable only if all the following conditions are fulfilled:

- There are two or more enterprises.
- They are associated enterprises
- The associated enterprises enter into a transaction.
- The transaction is an international transaction (as per Section 92B) or specified domestic transaction (as per Section 92BA).

If all these conditions are fulfilled; then the following may be followed:

(i) The income arising from an international transaction or specified domestic transaction (if applicable) shall be computed having regard to the arm's length price.

(ii) The Assessing Officer ("AO") / Transfer Pricing Officer ("TPO") may determine the arm's length price.

(iii) The AO may compute the total income of the assessee having regard to the arm's length price.

(iv) Every person entering into an international transaction shall maintain documents and information as per Rule 10D of the Income tax Rules, 1962.

(v) Every person entering into an international transaction or specified domestic transaction shall obtain and furnish a report from an accountant in Form No. 3CEB on or before 31st October of the relevant assessment year.

• Enterprise

Section 92F(iii) of the Act defines an 'enterprise'. The definition is very wide, and it attempts to cover almost every type of business or activity that an entity would normally be engaged in. An entity is an enterprise if it is or has been or is proposed to be engaged in, specified categories of activities or business, mentioned below:

(a) any activity relating to the production, storage, supply, distribution, acquisition or control of articles or goods or know-how, patents, copyrights, trademarks, licenses, franchises or any other business or commercial rights of similar nature or any data, documentation, drawing or specification relating to any patent, invention, model, design, secret formula or process, of which the other enterprise has exclusive rights;

(b) any activity relating to the provision of services of any kind in carrying out any work in pursuance to contract;

(c) investment activity;

(d) activity relating to providing of loans;

(e) business of acquiring, holding, underwriting or dealing with shares, debenture or other securities of a body corporate.

Thus, the definition covers tangible and intangible assets, services, investments, loans and shares/securities etc.

The term “enterprise” is defined as:

"enterprise" means a person (including a permanent establishment of such person) who is, or has been, or is proposed to be, engaged in any activity, relating to the production, storage, supply, distribution, acquisition or control of articles or goods, or know-how, patents, copyrights, trade-marks, licences, franchises or any other business or commercial rights of similar nature, or any data, documentation, drawing or specification relating to any patent, invention, model, design, secret formula or process, of which the other enterprise is the owner or in respect of which the other enterprise has exclusive rights, or the provision of services of any kind, or in carrying out any work in pursuance of a contract, or in investment, or providing loan or in the business of acquiring, holding, underwriting or dealing with shares, debentures or other securities of any other body corporate, whether such activity or business is carried on, directly or through one or more of its units or divisions or subsidiaries, or whether such unit or division or subsidiary is located at the same place where the enterprise is located or at a different place or places;”

• Associated Enterprises

Under section 92A(1) an enterprises would be regarded as ‘associated enterprise’ of another enterprise, if:

(a) it participates, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise;

or

(b) the persons participating, directly or indirectly or through one or more intermediaries in its management or control or capital also participate in the management or control or capital of other enterprise.

Section 92A(2) clarifies that where any of the criteria specified below is fulfilled, two enterprises shall be deemed to be an associated enterprises:

(a) One enterprise holds, directly or indirectly, shares carrying at least 26% voting power in other enterprises.

(b) Any person or enterprise holds, directly or indirectly, shares carrying at least 26% voting power in both these enterprises.

(c) A loan advanced by one enterprise to the other enterprise constitutes at least 51% of the book value of the total assets of the other enterprises.

(d) One enterprises guarantees at least 10% of the total borrowing of the other enterprise.

(e) More than half of the board of directors or members of the governing board or one or more of the executive directors or members of the governing board of one enterprise is appointed by the other enterprise.

(f) More than half of the directors or members of the governing boards or one or more of the executive directors or members of governing board of each of the two enterprises are appointed by the same person or persons.

(g) The manufacture or processing of goods or articles of business carried out by one enterprise is wholly dependent upon the use of know-how, patents, copyrights, trademarks, licenses, franchises or any other business or commercial rights of similar nature or any other business data, documentation, drawings or specification relating to any patent, invention, model, design, secret formula or process of which the other enterprises is the owner or has exclusive rights.

(h) Ninety percent or more of the raw materials and consumables required for the manufacture or processing of goods or articles

carried out by one enterprise, are supplied by the other enterprise or by the persons specified by the other enterprise and the prices and other conditions relating to the supply are influenced by such other enterprise;

(i) The goods or articles manufactured or processed by one enterprise, are sold to the other enterprise or to persons specified by the other enterprise, and the prices and other conditions relating thereto are influenced by such other enterprise.

(j) Where one enterprise is controlled by an individual, the other enterprise is also controlled by such individual or his relative or jointly by such individual and relative of such individual.

(k) Where one enterprise is controlled by a HUF, the other enterprise is controlled by a member of such HUF or by a relative of a member of such HUF, or jointly by such member and his relative.

(l) Where one enterprise is a firm, AOP or BOI, the other enterprise holds at least 10% interest in such firm, AOP or BOI.

(m) There exists between two enterprises, any relationship of mutual interests, as may be prescribed.

As per section 94A(1), the Central Government may specify a country or territory as a notified jurisdictional area. This clause seeks to cover transactions with persons located in notified jurisdictional areas where there is a lack of effective exchange of information. The relationship with the "person" is not specified in the section. Accordingly, a person could be a related or an unrelated person and therefore a person could also include an AE [i.e. an enterprise covered under section 92A(1)/(2)]

The Central Government on 1st November 2013 vide notification No. 86/2013 notified Cyprus as a notified jurisdictional area under section 94A of the Act. This step was taken as Cyprus was not providing the information requested by the Indian tax authorities under the exchange of information provisions. However, subsequently, Cypriot and Indian officials agreed to renegotiate the double taxation agreement and to improve efforts to facilitate effective exchange of information.

The Union Cabinet vide press release dated 24 August 2016 approved the new DTAA between India and Cyprus following which Cyprus has been de-notified as notified jurisdictional area under section 94A with retrospective effect from 1 November 2013.

Currently, no country or territory has been specified as a notified jurisdictional area.

• Transaction

Section 92F(v) defines 'transaction' to include an arrangement, understanding or action in concert:

(a) Whether or not such arrangement, understanding or action is formal or in writing;

or

(b) Whether or not such arrangement, understanding or action is intended to be enforceable by legal proceedings.

This definition is an inclusive definition and therefore wider in its scope. As per this definition, a transaction includes any arrangement, understanding or action, whether formal or informal, whether oral or in writing, whether legally enforceable or not.

• International Transaction

The term "international transaction", has been defined in section 92B of the Act as a "transaction" between two or more AEs, either or both of whom could be non-residents. The "transactions" covered, inter alia, include purchase, sale or lease of tangible or intangible property, provision of services, lending or borrowing of money or any other transaction, which has a bearing on the profits, income, losses or assets of an enterprise and includes a mutual agreement or arrangement between two or more AEs for the allocation or apportionment of, or any contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service or facility provided or to be provided to any one or more of such enterprises.

The Finance Act 2012 has inserted explanation to section 92B to clarify the meaning of term international transactions and intangible property. This amendment is applicable retrospectively from 1st April, 2002.

Explanation.—For the removal of doubts, it is hereby clarified that—

(i) the expression "international transaction" shall include—

(a) the purchase, sale, transfer, lease or use of tangible property including building, transportation vehicle, machinery, equipment, tools, plant, furniture, commodity or any other article, product or thing;

(b) the purchase, sale, transfer, lease or use of intangible property, including the transfer of ownership or the provision of use of rights regarding land use, copyrights, patents, trademarks, licences, franchises, customer list, marketing channel, brand, commercial secret, know-how, industrial property right, exterior design or practical and new design or any other business or commercial rights of similar nature;

(c) capital financing, including any type of long-term or short-term borrowing, lending or guarantee, purchase or sale of marketable securities or any type of advance, payments or deferred payment or receivable or any other debt arising during the course of business;

(d) provision of services, including provision of market research, market development, marketing management, administration, technical service, repairs, design, consultation, agency, scientific research, legal or accounting service;

(e) a transaction of business restructuring or reorganisation, entered into by an enterprise with an associated enterprise, irrespective of the fact that it has bearing on the profit, income, losses or assets of such enterprises at the time of the transaction or at any future date;

(ii) the expression "intangible property" shall include—

(a) marketing related intangible assets, such as, trademarks, trade names, brand names, logos;

(b) technology related intangible assets, such as, process patents, patent applications, technical documentation such as laboratory notebooks, technical know-how;

(c) artistic related intangible assets, such as, literary works and copyrights, musical compositions, copyrights, maps, engravings;

(d) data processing related intangible assets, such as, proprietary computer software, software copyrights, automated databases, and integrated circuit masks and masters;

(e) engineering related intangible assets, such as, industrial design, product patents, trade secrets, engineering drawing and schema-tics, blueprints, proprietary documentation;

(f) customer related intangible assets, such as, customer lists, customer contracts, customer relationship, open purchase orders;

(g) contract related intangible assets, such as, favourable supplier, contracts, licence agreements, franchise agreements, non-compete agreements;

(h) human capital related intangible assets, such as, trained and organised work force, employment agreements, union contracts;

(i) location related intangible assets, such as, leasehold interest, mineral exploitation rights, easements, air rights, water rights;

(j) goodwill related intangible assets, such as, institutional goodwill, professional practice goodwill, personal goodwill of professional, celebrity goodwill, general business going concern value;

(k) methods, programmes, systems, procedures, campaigns, surveys, studies, forecasts, estimates, customer lists, or technical data;

(l) any other similar item that derives its value from its intellectual content rather than its physical attributes.

Besides the above, under section 92B(2), a transaction between an enterprise and a third party is deemed to be a transaction between associated enterprises if there is a prior agreement between the enterprise's associated enterprise and the third party (referred to as "such other person" in the Income-tax Act); or the terms of relevant transactions are determined, in substance, between this associated enterprise and the third party (i.e. such other person).

Finance (No. 2) Act, 2014 has amended sub-section (2) of section 92B of the Act to clarify that the said third party (i.e., such other person) may or may not be a non-resident.

Thus, pursuant to this amendment, any transaction between two Indian entities (one of them being the enterprise under consideration and the other being an Indian third party) would be deemed to be an "international transaction", if the same has been undertaken in pursuance of a prior agreement between the enterprise's associated enterprise and the Indian third party, or the key terms and conditions of the transaction are being

influenced by the enterprise's associated enterprise and the Indian third party.

Specified Domestic Transactions

Transfer pricing regulations were extended vide Finance Act 2012 to include transactions entered into with domestic related parties or by an undertaking with other undertakings of the same entity for the purposes of section 40A (now omitted), Chapter VI-A and section 10AA. Domestic transfer pricing provisions are applicable from Assessment Year 2013-14 onwards.

All of the transfer pricing compliance requirements apply to specified domestic transactions, as well.

Section 92BA defines Specified Domestic Transaction (SDT) as under:

"For the purposes of this section and sections 92, 92C, 92D and 92E, "specified domestic transaction" in case of an assessee means any of the following transactions, not being an international transaction, namely:—

- any expenditure in respect of which payment has been made or is to be made to a person referred to in clause (b) of sub-section (2) of section 40A;
- any transaction referred to in section 80A;
- any transfer of goods or services referred to in sub-section (8) of section 80-IA;
- any business transacted between the assessee and other person as referred to in sub-section (10) of section 80-IA;
- any transaction, referred to in any other section under Chapter VI-A or section 10AA, to which provisions of sub-section (8) or sub-section (10) of section 80-IA are applicable;
- any business transacted between the persons referred to in sub-section (6) of section 115BAB;
- any other transaction as may be prescribed,

and where the aggregate of such transactions entered into by the assessee in the previous year exceeds a sum of rupees five crore. This threshold has been increased to Rupees Twenty Crores from 1 April 2015 onwards.

Finance Act 2017 restricted the scope of the transfer pricing provisions to the specified domestic transactions by excluding the expenditure in respect of which payment has been made by the taxpayer to a person referred to in

under section 40A(2)(b) from the scope of 'specified domestic transactions'. This amendment was made effective from FY 2016-17.

With effect from 1st April 2020, clause (va) has been inserted in section 92BA covering transactions between persons referred to in section 115BAB (6) within the ambit of domestic transfer pricing provisions.

It may be noted that transfer pricing provisions as discussed in the following subsections are applicable in case of Specified Domestic Transactions, as well.

Arm's length Price

Section 92 provides that income arising from an international transaction shall be computed having regards to the arm's length price. Any expense or outgoing in an international transaction is also to be computed having regard to arm's length price. Thus, in the case of a manufacture, for example, the provision will apply to exports made to the associated enterprise as also to imports from the same or any other associated enterprise. The provision is also applicable in a case where the international transaction comprises only an outgoing from the Indian assessee.

The section further provides that cost or expenses allocated or apportion between two or more associated enterprises under a mutual agreement or arrangement shall be at arm's length price. Examples of such transactions could be where one associated enterprise carries out centralized functions which also benefit one or more other associated enterprises, or two or more associated enterprises agreed to carry out joint activity, such as research and development, for their mutual benefit.

The section is intended to ensure that profits taxable in India are not understated (or losses are not overstated) by declaring lower receipts or higher outgoings than those which would have been declared by persons entering into similar transactions with unrelated parties in the same or similar circumstances.

The basic intention underlining the transfer pricing regulations is to prevent shifting of profits by manipulating prices charged or paid in international transactions, thereby eroding the country's tax base. The section is not to be applied in cases where the adoption of arm's length price determined under the regulations would result in decrease in the overall tax incidence in India in respect of the parties involved in the international transaction.

In commercial parlance, an arm's length price is the price at which independent enterprises deal with each other, where the conditions of their commercial and financial relations ordinarily are determined by market forces. Section 92F(ii) of the Act, however, defines the arm's length price as a price which is applied or proposed to be applied in a transaction between persons other than associated enterprises, in uncontrolled conditions.

The steps involved in the determination of the arm's length price can be summarized as follows:

(i) identification of the "international transaction/(s)" and/or "specified domestic transaction(s)";

(ii) deciding if the international transactions and/or specified domestic transactions are closely linked – Rule 10A(d);

(iii) identification of the functions performed, assets employed and risks assumed by the taxpayer and the associated enterprise being parties to the transaction/(s);

(iv) decide the characterisation of the entities who are party to the transaction based on the analysis of functions performed, assets employed and risks assumed;

(v) identification/ selection of the tested party (for application of resale price method, cost plus method and transactional net margin method);

(vi) identification of the most appropriate method which will inter-alia include

  (a) identification of an "uncontrolled transaction" - Rule 10A (a);

    — Review of existing internal uncontrolled transaction, if any;

    — Determination of available sources of information on external comparables where such external comparables are needed taking into account their relative reliability.

    — Identification and comparison of specific characteristics embodied in international transactions or specified domestic transactions and uncontrolled transactions - Rule 10B (2);

b) finding out whether uncontrolled transactions and international transactions/ specified domestic transaction can be compared by reconciling/resolving differences, if any - Rule 10B (3);

(vii) ascertaining the most appropriate method by applying the tests laid down - Rule 10C;

(viii) determination of the arm's length price by applying the method chosen - Rule 10B (1).

Arm's Length Principle and Most Appropriate Method

Sections 92 to 92F read together with relevant Rules 10A and 10E of the Rules stipulate the maintenance of necessary documents to demonstrate the conduct of the transaction at arm's length.

Rules 10A to 10E provide for the factors which are to be considered in selecting the most appropriate method. The major considerations in this regard have been specified to be the availability, coverage and reliability of data necessary for application of the method, the extent and reliability of assumptions required to be made, and the degree of comparability existing between the international transaction/ specified domestic transaction and the uncontrolled transaction. The rules also lay down in detail the manner in which the methods are to be applied in determining the arm's length price.

Section 92C(1) of the Act stipulates that the arm's length price is to be determined by adopting any one of the following methods, which is the most appropriate method, in connection with the transfer of services or products:

- Comparable Uncontrolled Price Method;
- Resale Price Method;
- Cost Plus Method;
- Profit Split Method;
- Transactional Net Margin Method;
- Such other method as may be prescribed by the CBDT.

Rule 10C(1) lays down the general guidelines in the selection of the most appropriate method. The Rule states that the method to be selected shall be the one best suited to the facts and circumstances of each international transaction/ specified domestic transaction and that provides the most reliable measure of the arm's length price.

Rule 10C(2) lists the specific factors that should be taken into account in the process of selecting the most appropriate method. These factors are as under:

(i) nature and class of international transactions or specified domestic transaction;

(ii) class or classes of associated enterprises entering into the transaction and the functions performed by them taking into account the assets employed or to be employed and risks assumed by such enterprises;

(iii) availability, coverage and reliability of data necessary for application of the method. For instance, data relating to transactions entered into by the enterprise itself would be more reliable than the data relating to transactions entered into by third parties;

(iv) the degree of comparability existing between the international transaction or specified domestic transaction and uncontrolled transaction and between enterprises entering into such transactions;

(v) the extent to which reliable and accurate adjustments can be made to account for the difference between the transactions;

(vi) the nature, the extent and reliability of assumptions required to be made in application of a method.

The factors referred above are to be applied cumulatively in selecting the most appropriate method. The reference therein to the terms 'best suited' and 'most reliable measure' indicates that the most appropriate method will have to be selected after a meticulous appraisal of the facts and circumstances of the international transaction or specified domestic transaction. Further, the selection of the most appropriate method shall be for each particular international transaction or specified domestic transaction. The term 'transaction' itself is defined in rule 10A(d) to include a number of closely linked transactions. Therefore, though the reference is to apply the most appropriate method to each particular transaction, keeping in view, the definition of the term 'transaction', the most appropriate method may be chosen for a group of closely linked transactions. Two or more transactions can be said to be linked when these transactions emanate from a common source being an order or a contract or an agreement or an arrangement and the nature, characteristics and terms of these transactions are substantially flowing from the said common source.

Section 92C(2) provides that the most appropriate method referred to in section 92C(1) shall be applied for determination of arm's length price, in the manner as prescribed in Rule 10B. The first proviso to section 92C(2) provides that where more than one price is determined by the most appropriate method, the arm's length price shall be taken to be the arithmetical mean of such prices.

The second proviso to section 92C(2) provides that if the variation between the arm's length price, so determined and price at which the transaction has actually been undertaken does not exceed such percentage as may be notified by the Central Government, the price at which the international transaction or specified domestic transaction has been undertaken will be deemed to be the arm's length price. The variation is to be computed with reference to the actual price at which the international transaction has been undertaken. Central Government has laid down the notification on the tolerance band specifying the variation between the arm's length price determined under section 92C of the Act and the price at which the international transaction has actually been undertaken shall not exceed one percent of the latter in respect of wholesale trading and three percent of the latter in all other cases. This proviso shall be applicable for assessment or reassessment proceedings pending before an Assessing Officer as on 1 October 2009.

A third proviso to this section has been inserted vide Finance (No. 2) Act 2014 stating that "where more than one price is determined by the most appropriate method, the arm's length price in relation to an international transaction or specified domestic transaction undertaken on or after the 1st day of April, 2014, shall be computed in such manner as may be prescribed and accordingly the first and second proviso shall not apply". With introduction of the new mechanism, the provisions of first and second proviso (i.e. arithmetic mean and tolerable range) shall not apply. CBDT vide Notification No. 83/2015 has introduced the use of the range concept as well as the use of multiple year data.

Uncontrolled transaction

Rule 10A(ab) defines an "Uncontrolled transaction" to mean "a transaction between enterprises other than Associated Enterprises, whether resident or non-resident". In other words, these are "transactions between enterprises that are independent enterprises with respect to each other". An uncontrolled transaction can, therefore, be between:

- a resident and a non resident; or
- a resident and a resident; or
- a non-resident and a non-resident.

When an uncontrolled transaction has been entered into, it could be said that it has been contracted in an "uncontrolled condition".

Rule 10B(2), lays down the criteria for comparability between international transactions or specified domestic transaction and uncontrolled transactions. This process is not quantitative but qualitative and judgmental in nature.

Comparability has to be judged with reference to the following:

- Distinctive nature of the property transferred or services provided;
- Functions performed taking into account the assets employed or to be employed;
- Risks assumed by the respective parties;
- Contractual terms of the transaction;
- Market conditions, etc.;

Market Conditions

The market conditions in which uncontrolled transactions and international transaction or specified domestic transaction are conducted must be evaluated to judge their comparability. Some of the parameters that effect market conditions are:

- geographical location and size
- regulatory laws and government orders
- level of competition
- nature of market whether wholesale/retail
- overall economic development

The above analyses are carried out to determine whether the uncontrolled transactions and international transactions or specified domestic transaction are comparable at all. If there are no differences, the transactions are comparable straightaway. If there is a difference, the difference can be adjusted with reasonable accuracy. Then, the transactions are comparable, subject to adjustments. If however, the differences cannot be adjusted with reasonable accuracy, the transactions are to be ignored and the search for comparable transactions would need to commence all over again.

The analysis of the uncontrolled transactions is made to assess their comparability with the international transaction or specified domestic transaction. The rules do not specify the number of transactions to be selected. It would be fair to conclude that a reasonable number of transactions, as would be justified by the facts and circumstances of the case, are to be selected and analysed.

After identifying uncontrolled transactions and then determining that the characteristics of the uncontrolled transactions and international transaction or specified domestic transaction are comparable, the next step would be to assess whether the differences, if any, are so material as to vitiate comparability or otherwise.

Rule 10B(3) states that an uncontrolled transaction shall be comparable to an international transaction or specified domestic transaction if:

(i) none of the differences between transactions or enterprises are likely to materially affect the price or cost charged or paid in or profit arising from, such transactions in the open market; or

(ii) reasonably accurate adjustments can be made to eliminate material effects of such differences.

Clause (ii) stipulates that where differences in the characteristics of uncontrolled transactions and international transactions or specified domestic transaction exist and if reasonably accurate adjustments can be made to eliminate the material effects of such differences, then the transactions can be used a comparables.

If the adjustments as specified in Rule 10B(3) cannot be made, the transactions cannot be taken as a comparable transactions and will have to be ignored.

It is important to note that the transactions entered into by associated enterprises with unrelated party (called 'internal comparables") would provide more reliable and accurate data as compared to transactions by and between third parties (called "external comparables"). OECD's Guidelines on Transfer Pricing recognizes the fact that external comparables are difficult to obtain and, also, it may be incomplete and difficult to interpret. Hence, for these reasons, internal comparable are preferred to external comparables

Rule 10B(4) provides that the data to be used in analyzing the comparability of an uncontrolled transaction with an international transaction or specified domestic transaction shall be the data relating to the financial year in which the international transaction or specified domestic transaction has been

entered into. The proviso to Rule 10B(4), further states that data relating to a period of not more than two years preceding such financial year may also be considered, if such data reveals facts which could have an influence on the determination of the price in an international transaction.

Multiple year data

As per the notification issued by CBDT, use of multiple year data (of the comparable companies for the purpose of comparability analysis) is applicable only in cases where Resale Price Method (RPM), Cost Plus Method (CPM) or Transactional Net Margin Method (TNMM) has been selected as the Most Appropriate Method.

Thus, in cases where CUP, PSM or Other Method are selected as the Most Appropriate Method, multiple year data of comparable companies cannot be used.

For each comparable selected (under RPM, CPM or TNMM), the data of the current year is required to be considered. In cases where such data is not available at the time of furnishing the return of income, data pertaining to up to two preceding financial years may be used.

When using multiple year data, data for each comparable shall be the weighted average of the selected years.

Further, the notification provides that in the event where current year data becomes available during the course of the assessment proceedings, then the same shall be used by the TPO for the purpose of the analysis.

The OECD in its Transfer Pricing Guidelines (2017) in Para 3.76 to 3.79 also supports the use of multiple year data. It states that in order to obtain a complete understanding of the facts and circumstances surrounding the controlled transaction, it generally might be useful to examine data from both the year under examination and prior years. The analysis of such information might disclose facts that may have influenced (or should have influenced) the determination of the transfer price.

Multiple year data can also improve the understanding of long term arrangements. Multiple year data will also be useful in providing information about the relevant business and product life cycles of the comparables. Differences in business or product life cycles may have a material effect on transfer pricing conditions that needs to be assessed in determining comparability. The data from earlier years may show whether the independent enterprise engaged in a comparable transaction was affected by

comparable economic conditions in a comparable manner, or whether different conditions in an earlier year materially affected its price or profit so that it should not be used as a comparable. Multiple year data can also improve the process of selecting third party comparables e.g. by identifying results that may indicate a significant variance from the underlying comparability characteristics of the controlled transaction being reviewed, in some cases leading to the rejection of the comparable, or to detect anomalies in third party information.

Application of range

As per the notification, the 'range concept' shall be applicable when:

(a) the Most Appropriate Method is either Comparable Uncontrolled Price (CUP) Method, RPM, CPM, or TNMM; and

(b) there are at least 6 entries in the dataset. Where these conditions are not fulfilled, 'arithmetic mean' shall continue to apply, as before, along with the tolerance range benefit (1% for wholesale trading and 3% for others).

For determination of the quartiles, the margins in the data set (i.e., set of comparable companies) are required to be arranged in ascending order and the arm's length range would be data points lying between the 35th and 65th percentile of the data set.

The section below discusses in brief each of the methods prescribed by the CBDT.

Different methods as prescribed in the Rules:

• Comparable Uncontrolled Price Method (CUP)

The OECD in its Transfer Pricing Guidelines has observed that:

"This method is particularly good where an independent enterprise sells the same product or service as is sold between two associated enterprises".

The uncontrolled transactions should reflect goods of similar type, quality and quantity as those between the associated enterprises, and relate to transactions taking place at a similar time and stage in the production/distribution chain, with similar conditions applying.

Generally CUP method is adopted in the following circumstances:

(a) Transfer of goods/ tangibles;

(b) Provisions of services;

(c) Loans, provision of finance etc.

The steps involved in the application of this method are:

(i) Identify the price charged or paid for property transferred or services provided in comparable uncontrolled transaction or a number of such transactions;

(ii) Adjust such price to account for the differences if any, between the international transaction or specified domestic transaction and the comparable uncontrolled transaction or between enterprises entering into such transaction which could materially affect the price in the open market;

(iii) The adjusted price is taken to be the Arm's Length Price;

(iv) The arm's length price is compared with the price charged in the international transaction or specified domestic transaction;

(v) If the price charged in the international transaction or specified domestic transaction is lower than the arm's length price or the price paid in the international transaction or specified domestic transaction is higher than the arm's length price then an adjustment is to be made to the price charged or paid in the international transaction or specified domestic transaction by the amount of such variance. The adjustment is required to be made only in cases where variance exceeds the permissible tolerance limit prescribed in second proviso to section 92C

• Resale Price Method (RPM)

The OECD in its Transfer Pricing Guidelines has observed that:

"It is generally accepted amongst most tax authorities that the Resale Price method is applicable and preferable where the entity performs basic sales, marketing and distribution functions (i.e. where there is little or no value addition by the reseller prior to the reselling of the goods acquired from related parties). The method is applicable even with differences in products, as long as the functions performed are similar. It is less useful where goods are further processed or incorporated into other products".

RPM is applicable in case of:

(a) Distribution of finished products or other goods involving no or little value addition.

(b) Sale to unrelated party.

The steps involved in the application of this method are:

(i) Identify the international transaction or specified domestic transaction of purchase of property or services;

(ii) Identify the price at which such property or services are resold or provided to an unrelated party;

(iii) Deduct the normal gross profit margin derived by the enterprise from the resale price of such property or services. The normal gross profit margin is that margin which the enterprise would earn from purchase of the similar product from an unrelated party and the resale of the same to another related party;

(iv) Deduct also expenses incurred in connection with the purchase of goods from the price so arrived;

(v) Adjust the price so computed for the differences between the uncontrolled transaction and the international transaction or specified domestic transaction. These differences could be functional and other differences including differences in accounting practices. Further these differences should be such as would materially affect the amount of gross profit margin in the open market;

(vi) The adjusted price arrived at is the arm's length price for the property purchased or services obtained;

(vii) Substitute the arm's length price for the price charged in the international transaction or specified domestic transaction and make adjustments to the income returned accordingly. The adjustment is required to be made only in cases where variance exceeds the permissible tolerance limit prescribed in second proviso to section 92C.

• Cost Plus Method (CPM)

The OECD in its Transfer Pricing Guidelines has observed as under:

"This method is particularly useful where semi finished goods are sold between associated enterprises, where there are long term buy and supply arrangements, or in the case of the provision of services or contract manufacturing, particularly where these are of a subsidiary or peripheral nature".

Typical transactions, where the cost plus method may be adopted are:

(a) provision of services;

(b) joint facility arrangements;

(c) transfer of semi finished goods;

(d) long term buying and selling arrangements.

The steps involved in the application of this method are:

(i) Determine the direct and indirect cost of production in respect of property transferred or service provided to an associated enterprise;

(ii) Identify a comparable uncontrolled transaction or a series of transactions with an unrelated party for same or similar property or service;

(iii) Determine gross profit mark up in the comparable uncontrolled transaction;

(iv) Adjust the gross profit mark-up to account for functional and other differences between the international transaction or specified domestic transaction and the comparable uncontrolled transaction;

(v) The direct and indirect cost of production in the international transaction or specified domestic transaction is to be increased by such adjusted gross profit mark-up.

(vi) The resultant figure is the Arm's length price;

(vii) The actual price charged in the international transaction or specified domestic transaction is to be compared with the arm's length price and adjustment to the income accordingly.

• Profit Split Method (PSM)

The observations of the OECD in its Transfer Pricing Guidelines on this method are:

"This method aims to determine what division of total profit independent enterprise would expect in relation to the relevant transactions. The profit should be split on an economically valid basis that reflects the functions and risks of each of the parties. In order to apply this method, it is necessary to identify the total profit arising from the related party transactions and split that profit between the parties according to their respective contributions".

Typical transactions where the profit split method may be used are transactions involving:

(a) integrated services provided by more than one enterprise;

(b) transfer of unique intangibles;

(c) multiple inter-related transactions, which cannot be separately evaluated.

The steps involved in the application of this method are:

(i) determine the combined net profit of all associated enterprise engaged in the international transactions or specified domestic transaction;

(ii) evaluate relative contribution made by each of them with regard to:

  (a) functions performed;

  (b) assets employed;

  (c) risks assumed;

  (d) reliable external market data indicating how such contribution would be evaluated.

(iii) Split the combined net profit in proportion to the relative net contribution.

(iv) The profit so apportioned is taken to arrive at the arm's length price in relation to the international transaction or specified domestic transaction.

• Transaction Net Margin Method (TNMM)

Typical kinds of transactions where the Transactional Net Margin Method may be used are:

(a) Provision of Services;

(b) Distribution of finished products where resale price method cannot be adequately applied;

(c) Transfer of semi finished goods.

The steps involved in the application of this method are:

(i) Identify the net profit margin realized by the enterprise from an international transaction or specified domestic transaction. The net profit margin may be computed in relation to costs incurred or sales effected or assets employed or any other relevant base;

(ii) Identify the net profit margin from comparable uncontrolled transaction or a number of such transactions having regard to the same base;

(iii) The net profit margin is adjusted to take into account the differences if any between the international transaction or specified domestic transaction and the comparable uncontrolled transaction. The differences should be those that could materially affect the net profit margin in the open market;

(iv) The adjusted net profit margin is taken into account to arrive at the arm's length price in relation to the international transaction or specified domestic transaction.

• Other Method

The CBDT notified the Other Method vide Notification No. 18/2012 [F. No. 142/5/2012-TPL], dated 23 May 2012, and Rule 10AB was inserted in the Rules for computation of the arm's length price.

As per the Other Method, it is possible to use "any method" which takes into account (i) the price which has been charged or paid, or (ii) would have been charged or paid for the same or similar uncontrolled transactions, with or between non-AEs, under similar circumstances, considering all the relevant facts. The various data that may be used for comparability purposes could be:

(i) Third party quotations

(ii) Valuation reports

(iii) Tender/Bid documents

(iv) Documents relating to negotiations

(v) Standard rate cards

(vi) Commercial and economic business models

It is relevant to note that the text of Rule 10AB does not describe any methodology, but only provides an enabling provision to use any method that has been used or may be used to arrive at the price of a transaction undertaken between non-AEs. Hence, it provides flexibility to determine the price in complex transactions where third party comparable prices or transactions may not exist. The wide coverage of this Rule would provide flexibility in establishing arm's length prices, particularly in cases where the application of the five specific methods is not possible due to reasons such

as difficulties in obtaining comparable data. This could be because of the uniqueness of transactions such as intangibles or business transfers, transfer of unlisted shares, sale of fixed assets, revenue allocation/splitting, guarantees provided and received, etc.

However, it would be necessary to analyse and document the reasons for rejection of all other five methods while selecting the "Other Method" as the most appropriate method. The OECD Guidelines also permit the use of any other method and state that the assessee retain the freedom to apply methods not described in OECD Guidelines to establish prices, provided those prices satisfy the arm's length principle.

How to determine the Most Appropriate Method

Although it is difficult to prescribe general principles for choice of the most appropriate method, the following broad categorization may be considered:

(i) CUP method may be used in case of loans, service fee, transfer of tangibles, sale and purchase of goods, etc.

(ii) Resale price method is most useful in case of marketing operations, especially in case of distributors not performing significant value addition to the product.

(iii) Cost Plus method is normally used where raw materials or semi-finished goods are sold between related parties, where related parties have concluded joint facility agreements or long-term buy and supply arrangements, or where the controlled transaction is the provision of services.

(iv) Profit split method is normally used in cases where the transactions are complex and interrelated.

(v) Transactional net margin method could be used in case of manufacturing operations, sale of raw materials or semi-finished goods or provision/receipt of services where cost plus method is not the most appropriate method, and marketing operations of finished products where resale price method is not the most appropriate method.

(vi) Other method may be used in case of royalties, commodities, transfer of intangibles and shares, etc.

For the purposes of determining the Most Appropriate Method, the comparability of an international transaction or specified domestic transaction

with an uncontrolled transaction shall be judged with reference to the following namely:

(a) the specific characteristics of the property transferred or services provided in either transactions;

(b) the functions performed, taking into account assets employed or to be employed and the risks assumed, by the respective parties to the transactions;

(c) the contractual terms (whether or not such terms are formal or in writing) of the transactions which lay down explicitly or implicitly how the responsibilities, risks and benefits are to be divided between the respective parties to be transaction;

(d) conditions prevailing in the markets in which the respective parties to the transaction operate, including the geographical location and size of the markets, the laws and government orders in force, costs of labour and capital in the markets, overall economic development and level of competition and whether the markets are wholesale or retail.

Primary and Secondary Adjustment

The Finance Act 2017 has introduced the concept of primary and secondary adjustments on transfer pricing adjustments. Section 92CE(3)(iv) defines primary adjustment as 'determination of transfer price, in accordance with the arm's length principle resulting in an increase in the total income or reduction in the loss, as the case may be, of the assessee.'

Further, Section 92CE(3)(v) defines 'Secondary adjustment' as an adjustment in the books of account of the assessee and its associated enterprise to reflect that the actual allocation of profits between the assessee and its associated enterprise are consistent with the transfer price determined as a result of primary adjustment, thereby removing the imbalance between cash account and actual profit of the assessee.

An assessee is required to make a secondary adjustment, where the primary adjustment to transfer price has been made in the following situations:

(i) Suo moto by the assessee in the return of income;

(ii) By the AO during assessment proceedings, and has been accepted by the assessee;

(iii) Adjustment determined by an Advance Pricing Agreement (APA) entered into by the assessee;

(iv) Adjustment made as per the Safe Harbour Rules under Section 92CB; or

(v) Adjustment arising as a result of resolution of an assessment by way of the mutual agreement procedure (MAP) under an agreement entered into under section 90 or section 90A for avoidance of double taxation.

The additional amount receivable from the associated enterprise as a result of the primary adjustment should be repatriated by the assessee into India within a prescribed time limit. If the same is not received by the assessee within the time-limit, then the primary adjustment will be deemed as an advance extended to the overseas associated enterprise and a secondary adjustment in the form of notional interest on the outstanding amount should also be offered to tax as an income of the assessee.

The above requirements for repatriating the adjustment amount into India and imputing a notional interest are triggered if the TP or primary adjustment exceeds rupees one crore.

Recently, the CBDT vide Notification No. 52/2017, F.No.370142/12/2017, has prescribed the time limit for repatriation of excess money and imputed per annum interest on excess money, in relation to the secondary adjustment introduced by the Finance Act, 2017 as per Section 92CE of the Act.

According to the notification, time limit for repatriation of excess money shall be on or before ninety days from the following:

(a) Due date of filing of the tax return under Section 139(1), in the below cases:

- Suo-moto adjustment
- APA, if the same has been entered into on or before the due date of filing return of income for the relevant previous year
- Safe harbor

(b) Date of order of the Assessing Officer or the Appellate Authority, in case of acceptance of the adjustment.

(c) End of the month in which APA has been entered into, if the same has been entered into after the due date of filing return of income for the relevant previous year.

(d) Date of giving effect to the resolution arrived under MAP by the AO will be the relevant date, where primary adjustment is determined by MAP resolution under the relevant DTAA.

For the imputed per annum interest income on excess money, the new rule provides for two options:

(i) For rupee denominated international transaction

The interest rate would be one-year marginal cost of fund lending rate of State Bank of India ('SBI') prevalent as on 1st April of the relevant previous year plus 325 basis points.

(ii) For foreign currency denominated international.

The interest rate would be six month London Interbank Offered Rate ('LIBOR') as on 30th September of relevant previous year plus 300 basis points.

An explanatory memorandum issued with the above rule mentions that the provision shall be applicable to primary adjustments exceeding Rs. 1 crore made in respect of the assessment year 2017-18 and onwards.

Further, with effect from 1st April 2018, it has been provided that the excess money may be repatriated from any of the associated enterprises of the assessee which is not a resident in India.

Finance Act, 2019 has inserted clause (2A) to section 92CE applicable from 1st September 2019. Accordingly, an alternate has been provided to taxpayers to pay a final and one-time tax at 18% (plus surcharge) on the un-repatriated amount to be treated as final payment of money in respect of such excess money not repatriated. However, no credit shall be allowed in respect of the amount of such tax. Further, no deduction shall be allowed under any other provision of the Act in respect of amount on which the tax is paid. Also, where this additional one-time tax is paid, the assessee shall not be required to make secondary adjustment under section 92CE of the Act.

Documentation and verification

Section 92D provides that every person who has undertaken an international transaction or specified domestic transaction shall keep and maintain such information and documents as may be specified by rules made by the Board. The Board may also specify by rules the period for which the information and documents are required to be retained. The documentation required to be made has been prescribed under Rule 10D.

Section 92D(1)(ii) provides that the person, being a constituent entity of an international group, shall also keep and maintain such information and document in respect of an international group as may be prescribed.

Further, the person referred to in clause (i) to sub-section (1) shall furnish the information and document referred to in the said sub section to the authority prescribed under sub-section (1) of section 286, in such manner, on or before the date, as may be prescribed.

Every person who has entered into an international transaction or specified domestic transaction shall keep and maintain the following information and documents:

Enterprise wise documents

A description of the ownership structure of the assessee enterprise with details of shares or other ownership interest held therein by other enterprises [clause (a), Rule 10D(1)].

A profile of the multinational group of which the assessee enterprise is a part along with the name, address, legal status and country of tax residence of each of the enterprises comprised in the group with whom international transactions, as the case may be, have been entered into by the assessee, and ownership linkages among them [clause (b), Rule 10D(1)]

A broad description of the business of the assessee and the industry in which the assessee operates, and of the business of the associated enterprises with whom the assessee has transacted [clause (c), Rule 10D(1)].

Transaction specific documents

Transaction specific documents include the following:

- The nature and terms (including prices) of international transactions entered into with each associated enterprise, details of property transferred or services provided and the quantum and the value of each such transaction or class of such transaction [clause (d), Rule 10D(1)].
- A description of the functions performed, risks assumed and assets employed or to be employed by the assessee and by the associated enterprises involved in the international transaction [clause (e), Rule 10D(1)].

- A record of the economic and market analyses, forecasts, budgets or any other financial estimates prepared by the assessee for the business as a whole and for each division or product separately, which may have a bearing on the international transactions entered into by the assessee [clause (f), Rule 10D(1)].
- A record of uncontrolled transactions taken into account for analyzing their comparability with the international transactions entered into, including a record of the nature, terms and conditions relating to any uncontrolled transaction with third parties which may be of relevance to the pricing of the international transactions [clause (g), Rule 10D(1)].
- A record of the analysis performed to evaluate comparability of uncontrolled transactions with the relevant international transaction [clause (h), Rule 10D(1)].

Computation related documents

Computed related documents include the following:

- A description of the methods considered for determining the arm's length price in relation to each international transactions or class of transaction, the method selected as the most appropriate method along with explanations as to why such method was so selected, and how such method was applied in each case [clause (i), Rule 10D(1)]
- A record of the actual working carried out for determining the arm's length price, including details of the comparable data and financial information used in applying the most appropriate method, and adjustments, if any, which were made to account for differences between the international transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions [clause (j), Rule 10D(1)].
- The assumptions, policies and price negotiations, if any, which have critically affected the determination of the arm's length price [clause (k), Rule 10D(1)].
- Details of the adjustments, if any, made to transfer prices to align them with arm's length price determined under these rules and consequent adjustment made to the total income for tax purposes [clause (l), Rule 10D(1)].

- Any other information, data or document, including information or data relating to the associated enterprise, which may be relevant for determination of the arm's length price [clause (m), Rule 10D(1)]

Rule 10D(3) provides that the information compiled, kept and maintained by the enterprise, under clauses (a) to (m) of sub rule (1), shall, to the extent possible, be further supported by 'authentic" documents that provide additional information of the nature specified therein.

The additional information that Rule 10D(3) requires, is as under:

(a) Official publications, reports, studies and databases from the Government of the country of residence of the associated enterprise, or of any other country;

(b) Reports of market research studies carried out and technical publications brought out by institutions of national or international repute;

(c) Price publications including stock exchange and commodity market quotations;

(d) Published accounts and financial statements relating to the business affairs of the associated enterprises;

(e) Agreements and contracts entered into with associated enterprises or with unrelated enterprises in respect of transactions similar to the international transactions;

(f) Letters and other correspondence documenting any terms negotiated between the enterprise and the associated enterprise;

(g) Documents normally issued in connection with various transactions under the accounting practices followed.

Rule 10D(4) provides that the data, information and documents on the basis of which the arm's length price has been determined should, as far as possible, be contemporaneous. At any rate, they should exist latest by the specified date, referred to in clause (iv) of section 92F.

Rule 10D(2) provides that nothing contained in sub-rule (1) shall apply in a case where the aggregate value, as recorded in the books of account of international transactions entered into by the assessee does not exceed one crore rupees:

However, the assessee shall be required to substantiate on the basis of material available with him, that income arising from international

transactions entered into by him has been computed in accordance with section 92 and submit report under section 92E.

The information and documents specified in sub rules (1) and (2) shall be kept and maintained for a period of eight years from the end of the relevant assessment year.

Country by Country ("CbC") Reporting and Master file ("MF")

Under Action 13 of Base Erosion & Profit Shifting ("BEPS") Action Plan, Organisation for Economic Co-operation and Development ("OECD") adopted a three-tiered approach regarding documentation; and suggested significant changes to the compliance and reporting of global information for risk assessment and for Transfer Pricing ("TP") purposes. The said approach includes:

a) Preparation of a Country-by-Country report to provide a global financial snapshot of a Multinational Enterprise ("MNE");

b) Maintenance of a master file to provide a high-level view of a group's business operations and global TP policies, and

c) Maintenance of a local file that will provide an entity level and transaction level TP analysis for each jurisdiction.

In keeping with commitment to implement the recommendations of the BEPS Action 13, India introduced CbC reporting and Master File regime in the Act through Finance Act 2016.

The core elements of the CbC reporting requirement and the concept of Master File were introduced [Section 286 and proviso to section 92D(1)] in the Act, while the detailed rules were awaited.

To take the initiative forward, the CBDT on 6 October 2017 released (for public consultation) draft rules in respect of CbC reporting and Master File related requirements in India. The draft rules provide detailed instructions. Thereafter, on 31 October 2017, the CBDT released the final rules on CbC reporting and Master File requirements in India vide notification no. 92/2017.

• CbC Reporting

The CbC Report requires aggregate tax jurisdiction-wide information relating to the global allocation of the income, the taxes paid, and certain indicators of the location of economic activity among tax jurisdictions in which the group operates. The report also requires listing of all the Constituent Entities for which financial information is reported (including the tax jurisdiction of incorporation, where different from the tax jurisdiction of residence), as well as the nature of the main business activities carried out by that Constituent Entity.

Section 286(1) provides that every constituent entity resident in India of an international group, the parent entity of which is not resident in India, notify the prescribed income-tax authority in the form and manner, on or before such date, as may be prescribed [Refer Rule 10DB below] —

a. whether it is the alternate reporting entity; or

b. the details of the parent entity or the alternate reporting entity, if any, of the international group, and the country or territory of which the said entities are resident.

Section 286(2) provides that every parent entity or alternate reporting entity (designated by parent) of an international group, that is resident in India, shall for every reporting accounting year, furnish a report in the form [Form No.3CEAD] and manner as may be prescribed, to the prescribed authority, within a period of twelve months from the end of the said reporting accounting year.

Further, section 286(4) provide that a constituent entity of an international group, resident in India, other than the entity referred to in sub-section (2), shall furnish the report referred to in the said sub-section, in respect of the international group for a reporting accounting year within the period as may be prescribed, if the parent entity is resident of a country or territory,—

- where the parent entity is not obligated to file the report of the nature referred to in sub-section (2);
- with which India does not have an agreement providing for exchange of the report of the nature referred to in sub-section (2); or
- there has been a systemic failure of the country or territory and the said failure has been intimated by the prescribed authority to such constituent entity:

As per Rule 10DB of the Rules CbC reporting will be applicable to an international group having consolidated revenues exceeding INR 5,500 crores [Rule 10DB(6)].

Further, MNE's not headquartered in India, having group companies resident in India will be required to notify [in Form no.3CEAC] Indian authorities of the details of their parent entity/alternate reporting entity and its jurisdiction [Rule 10DB(1)]. The said intimation shall be made at least two months prior to the due date for furnishing of report as specified under sub-section (2) of section 286 [Rule 10DB(2)].

The due date for submission of CbC report by an Indian constituent entity of an international group required to file the CbC report in India under Section 286(4) will be the due date as specified in Section 286(2) i.e. due date of filing of return of income in India. The due date was later revised for FY 2016-17 to March 31, 2018 vide Circular No. 26/2017 issued by CBDT.

Subsequently, the Finance Act, 2018 retrospectively made amendment to Section 286(2) that the due date for filing the CBC report in India under section 286(2) be within a period of 12 months from the end of the reporting accounting year (as against the return filing due date).

Additionally, with respect to Section 286(4), the Finance Bill 2018 also proposed that the due date of filing of CbC report under Section 286(4) would be the due date specified in Section 286(2) i.e. 12 months from the end of the reporting accounting year.

Thereafter, CBDT issued a press release dated 23 March 2018 providing a clarification that the due date of 31 March 2018 applies for furnishing of the CbC report under section 286(2) only (i.e. for parent entities resident in India). Thus, CBDT has clarified that the said due date would not be applicable to filing of CbC report in India under section 286(4) (i.e. for multinational group's having non-resident parent entities). The new due date is proposed to be prescribed.

The information requirements of the CbC report (as per existing Indian regulations) are similar to those prescribed by the OECD BEPS Action Plan 13. There are penalties prescribed for non-compliance. Refer to the 'Penalties' section below.

• Master file

The memorandum to the Finance Bill 2016 introduced the concept of Master File, whereby entities being constituent of an international group shall be required to maintain and furnish the Master File.

Thereafter, final rules on Master File requirements in India were prescribed vide notification no. 92/2017 dated 31 October 2017.

Rule 10DA of the Rules is newly inserted prescribing Information and documents to be kept and maintained under proviso to sub-section (1) of section 92D and to be furnished in terms of sub-section (4) of section 92D.

As per the rules, if the following mentioned conditions are fulfilled then the constituent entity would have to file the complete master file in Form 3CEAA (Part A and B):

- Consolidated group revenue exceeded INR 500 crores in accounting year as followed by foreign parent; and
- Indian entity's related party transactions (in same accounting year) exceeded INR 50 crores or, intangible related transaction exceeded INR 10 crores.

However, the rules require that every constituent entity (resident and non-resident) of the MNE (which has entered into international transactions) file Part A of the master file – in India; irrespective of meeting the aforementioned threshold.

As per the rules [Rule 10DA(1)] below is the list of information and documents to be kept and maintain relating to the international group. The contents of the Master File (as per existing Indian regulations) are largely aligned to those prescribed by the OECD, with few additional information.

(a) a list of all entities of the international group along with their addresses;

(b) a chart depicting the legal status of the constituent entity and ownership structure of the entire international group;

(c) a description of the business of international group during the accounting year including,-

  (I) the nature of the business or businesses;

  (II) the important drivers of profits of such business or businesses;

(III) a description of the supply chain for the five largest products or services of the international group in terms of revenue and any other products including services amounting to more than five per cent. of consolidated group revenue;

(IV) a list and brief description of important service arrangements made among members of the international group, other than those for research and development services;

(V) a description of the capabilities of the main service providers within the international group;

(VI) details about the transfer pricing policies for allocating service costs and determining prices to be paid for intra-group services;

(VII) a list and description of the major geographical markets for the products and services offered by the international group;

(VIII) a description of the functions performed, assets employed and risks assumed by the constituent entities of the international group that contribute at least ten per cent. of the revenues or assets or profits of such group; and

(IX) a description of the important business restructuring transactions, acquisitions and divestments;

(d) a description of the overall strategy of the international group for the development, ownership and exploitation of intangible property, including location of principal research and development facilities and their management;

(e) a list of all entities of the international group engaged in development and management of intangible property along with their addresses;

(f) a list of all the important intangible property or groups of intangible property owned by the international group along with the names and addresses of the group entities that legally own such intangible property;

(g) a list and brief description of important agreements among members of the international group related to intangible property, including cost contribution arrangements, principal research service agreements and license agreements;

(h) a detailed description of the transfer pricing policies of the international group related to research and development and intangible property;

(i) a description of important transfers of interest in intangible property, if any, among entities of the international group, including the name and address of the selling and buying entities and the compensation paid for such transfers;

(j) a detailed description of the financing arrangements of the international group, including the names and addresses of the top ten unrelated lenders;

(k) a list of group entities that provide central financing functions, including their place of operation and of effective management;

(l) a detailed description of the transfer pricing policies of the international group related to financing arrangements among group entities;

(m) a copy of the annual consolidated financial statement of the international group; and

(n) a list and brief description of the existing unilateral advance pricing agreements and other tax rulings in respect of the international group for allocation of income among countries.

The above information (in Form No.3CEAA) shall be furnished on or before the due date for furnishing the return of income as specified in sub-section (1) of section 139. However, for the accounting year 2016-17 was to be furnished at any time on or before the 31st day of March, 2018.

Further, as per Rule 10DA(4) of the Rules in case there are more than one constituent entities in India which is required to file master file, the group can designate one entity to file the master file on behalf of all the Indian constituent entity(s).

The constituent entity shall intimate (regarding its designation on behalf of the group) at least 30 days before the due date of filing of the report in Form No.3CEAB.

There are penalties prescribed for non-compliance. Refer to the 'Penalties' section below.

• Local file

The Indian Transfer Pricing regulations under section 92D of the Act read

with Rule 10D of the Rules require every person who has entered into an international transaction to maintain prescribed information / documents for substantiating the arm's length price of its transactions with the related parties, these regulations persist.

Currently, no changes have been proposed to the existing documentation requirements to align with the requirements of the Local File as per BEPS Action Plan 13. Thus, the existing Indian regulations on local transfer pricing documentation specified in Section 92D of the Act read with Rule 10D of the Rules continue to persist.

Report from an Accountant

Rule 10E requires to report from an Accountant in Form No. 3CEB by every person who has entered into an international transaction during a previous year under section 92E on or before 30th November.

Finance Act, 2020 has preponed the due date for filing the accountant's report to 31st October of the relevant assessment year.

Online filing of Form 3CEB

From AY 2012-13, CBDT has made it mandatory for enterprises to file their Form 3CEB online, with a view to make the process faster and less error prone.

Power of Assessing Officer

The primary onus is on the tax payer to determine an arm's length price in accordance with the rules and to substantiate the same with the prescribed documentation. Where such onus is discharged by the assessee and the data used for determining the arm's length price is reliable and correct, there can be no intervention by the Assessing Officer. This is made clear by sub section (3) of section 92C which provides that the Assessing Officer may intervene only if he, on the basis of material or information or document in his possession, is of the opinion that the price charged in the international transaction has not been determined in accordance with sub-sections (1) & (2) or information and documents relating to the international transaction have not been kept and maintained by the assessee in accordance with the provisions contained in section 92D(1) and the rules made thereunder; or the information or data used in the computation of arm's length price is not reliable or correct; or the assessee has failed to furnish within the specified time in information or document which he was required to furnish by a notice

issued under sub-section (3) of section 92D. If any one of such circumstances exists, the Assessing Officer may reject the price adopted by the assessee and determined the arm's length price in accordance with the same rules. However, an opportunity has to be given to the assessee before determining such price. Thereafter, as provided in section 92C(4) the Assessing Officer may compute the total income on the basis of the arm's length price so determined by him.

The first proviso to section 92C(4) recognizes the commercial reality and provides that even when a transfer pricing adjustment is made, the amount represented by the adjustment would not actually have been received in India or would have actually gone out of the country. Therefore, it has been provided that no deductions under section 10A or 10B or under chapter VIA shall be allowed in respect of the amount of adjustment.

Section 92CA(2A) inserted by Finance Act 2011 with effect from 1 June 2011 provides that where an international transaction not referred to the Transfer Pricing Officer by the Assessing Officer comes to the notice of the Transfer Pricing Officer, then such international transaction can be examined by the Transfer Pricing Officer as if it was referred to him. Further, section 92CA(2B) inserted by Finance Act 2012 with retrospective effect from 1 June 2002 provides that where an assessee has not furnished an accountant's report under section 92E and an international transaction comes to the notice of the Transfer Pricing Officer, then such international transaction can be examined by the Transfer Pricing Officer as if it was referred to him.

The CBDT on 10 March 2016 issued the revised procedural guidelines for scrutiny of TP cases i.e. Instruction No. 3/ 2016. It provides that TP cases would be referred to the TPO only if it meets the criteria for compulsory scrutiny. Further, cases which are selected for compulsory scrutiny on non–TP parameters, would be referred to the TPO only if the AO finds any additional TP transaction during the course of assessment. Such cases would be referred by the AO to the TPO only after giving an opportunity of being heard to the taxpayer. The AO would also be required to record his reasons and seek necessary approvals in all the cases before referring to the TPO. The guidelines categorically restrict the AO to determine the ALP of international transactions where cases are not referred to the TPO. Additionally, the guidelines provide mandatory TP scrutiny of the cases where TP adjustment in earlier years has been set aside by the Income Tax Appellate Tribunal ("ITAT") or by the HC or by the SC either fully or partly.

The second proviso to section 92C(4) refers to a case where the amount involved in the international transaction has already been remitted abroad after deducting tax at source and subsequently, in the assessment of the resident payer, an adjustment is made to the transfer price involved and, thereby, the expenditure represented by the amount so remitted is partly disallowed. Under the Act, a non-resident in receipt of income from which tax has been deducted at source has the option of filing a return of income in respect of the relevant income in such case. A non-resident could claim a refund or part of the tax deducted at source, on the ground that an arm's length price has been adopted by the Assessing Officer in the case of the resident and the same price should be considered in determining the taxable income of the non-resident. However, the adoption of arm's length price in such cases would not alter the commercial reality that the entire amount claimed earlier would have actually been received by the entity located abroad. It has therefore been made clear in the second proviso that income of one associated enterprise shall not be recomputed by reason of an adjustment made in the case of other associated enterprise on determination of arm's length price by the Assessing Officer.

Reference to Transfer Pricing Officer

Section 92CA provides that if any person has entered into an international transaction and the Assessing Officer considers it necessary or expedient so to do, may, with the previous approval of the Commissioner refer the computation of the arm's length price in relation to the said international transaction to the Transfer Pricing Officer.

On a reference by the Assessing Officer, the Transfer Pricing Officer shall serve a notice to the assessee requiring him to produce or cause to be produced, on a day to be specified, any evidence on which assessee would like to rely in support of the computation made by him of the arm's length price in relation to the international transaction.

The Finance Act 2011 has inserted sub-section (2A) in section 92CA which provides that where any other international transaction other than an international transaction referred under sub-section (1), comes to the notice of the Transfer Pricing Officer during the course of the proceedings before him, the provisions of this Chapter shall apply as if such other international transaction is an international transaction referred to him under sub-section (1).

The Finance Act 2012 has inserted sub-section (2B) in section 92CA so as to capture international transactions going unnoticed due to non-furnishing of the report under section 92E. Sub-section (2B) provides as below:

"Where in respect of an international transaction, the assessee has not furnished the report under section 92E and such transaction comes to the notice of the Transfer Pricing Officer during the course of the proceeding before him, the provisions of this Chapter shall apply as if such transaction is an international transaction referred to him under sub-section (1)"

However the above amendment does not empower the AO to assess or reassess under section 147 or pass an order enhancing the assessment or reducing the refund or otherwise increasing the liability under section 154 for any assessment year proceedings for which have been completed before 1.07.2012.

On the date specified or as soon thereafter, after hearing such evidence as the assessee may produce and after considering such evidence as the Transfer Pricing Officer may require on any specified points and after taking all relevant materials he has gathered, the Transfer Pricing Officer shall by order in writing determine the arm's length price in relation to international transaction and send a copy of his order to the Assessing Officer and to the assessee.

On receipt of the aforesaid order, the Assessing Officer shall proceed to compute the total income of the assessee having regard to the arm's length price determined by the Transfer Pricing Officer.

The Transfer Pricing Officer may amend any order passed by him, with a view to rectify any mistake apparent from the record under section 154 of the Act.

After rectification, the Transfer Pricing Officer shall send a copy of his order to the Assessing Officer, who shall thereafter proceed to amend the order of assessment in conformity with such order of the Transfer Pricing Officer.

Notifications issued by CBDT for referring the cases to TPO:

Erstwhile, selection process for the audit was based on the value of international transactions. A threshold limit of INR 5 crore in international transactions, in aggregate, was specified which was subsequently raised to INR 15 crore from tax year ended 31 March 2006 by the CBDT.

The CBDT, vide instruction 6/2014 dated 2 September 2014, announced a risk based approach for manual selection of TP cases for compulsory scrutiny / audit.

CBDT, vide instruction no. 8/2015 dated 31 August 2015, announced criteria for the manual selection of tax and transfer pricing cases for compulsory scrutiny during FY 2015-16.

On 16 October 2015, the CBDT, vide instruction no. 15/2015, provided a detailed scrutiny procedure to be followed by the AO before referring any case to the TPO.

Presently, the CBDT on 10 March 2016 issued the revised procedural guidelines for scrutiny of TP cases i.e. Instruction No. 3/ 2016. It provides that TP cases would be referred to the TPO only if it meets the criteria for compulsory scrutiny. Further, cases which are selected for compulsory scrutiny on non–TP parameters, would be referred to the TPO only if the AO finds any additional TP transaction during the course of assessment. Such cases would be referred by the AO to the TPO only after giving an opportunity of being heard to the taxpayer. The AO would also be required to record his reasons and seek necessary approvals in all the cases before referring to the TPO. The guidelines categorically restrict the AO to determine the ALP of international transactions where cases are not referred to the TPO. Additionally, the guidelines provide mandatory TP scrutiny of the cases where TP adjustment in earlier years has been set aside by the ITAT or by the HC or by the SC either fully or partly.

Time limit for completion of assessment:

The Finance Act 2016 has extended the limitation period of TP audits beyond the limitation period to allow the TPO at least 60 days for passing the TP order after excluding the period for which:

— the assessment proceedings before the TPO are stayed by any court; or

— the information is sought from any other country under the exchange of information provisions.

Such amendment is applicable from 1 June 2016.

The time limit for AOs/TPOs to pass the order is 48 months from the end of the tax year (section 153(1)). The Finance Act 2016 reduced such time limit to 45 months from the end of the tax year.

The Finance Act 2017, has further reduced the said time limit to 42 months from the end of the tax year for AY 2018-19 and 36 months from the end of the tax year for AY 2019-20 onwards.

Penalties

• For concealment

Section 271(1)(c)(iii) provides that if Assessing Officer or Commissioner (Appeals) dissatisfied that any person has cancelled the particulars of his income or furnished inaccurate particulars of such income, he may direct that such person shall pay by way of penalty, in addition to any tax payable by him, a sum which shall not be less than, but which shall not exceed three times the amount of tax sought to be evaded by reason of the concealment of particulars of his income or the furnishing of inaccurate particulars of such income. The said section has been omitted by Finance Act 2016. Section 271(1)(c) shall not apply to and in relation to any assessment for the assessment year commencing on or after the 1st day of April, 2017 and subsequent assessment years and penalty be levied under the newly inserted section 270A with effect from 1st April, 2017.

• Under reporting and misreporting of income

Section 271(1)(c) has been deleted by the Finance Act 2016 and in its place section 270A has been inserted which is applicable from 1 April 2017. It seeks to levy penalty on under reporting of income.

Section 270A inserted vide Finance Act 2016 prescribes penalty for under-reporting of income and misreporting of income. Section 270A (7) of the Act prescribes a penalty of 50% of the amount of tax payable on the under-reported income. Further, Section 270A(6)(d) provides that the underreported income for the purpose of Section 270A shall not include the amount of under-reported income represented by any addition made in conformity with the arm's length price determined by the Transfer Pricing Officer, where the assessee had a) maintained information and documents as prescribed under section 92D, b) declared the international transaction under Chapter X, and, c) disclosed all the material facts relating to the transaction.

Section 270A(8) of the Act provides that where under-reported income is in consequence of any misreporting thereof by any person, the penalty shall be equal to two hundred per cent of the amount of tax payable on under-reported income. Section 270A(9)(f) of the Act provides that the case of

misreporting of income shall be failure to report any international transaction or any transaction deemed to be an international transaction, to which the provisions of Chapter X apply.

- **Failure to keep and maintain information & document**

Section 271AA has been substituted by a new section with effect from 1 July 2012. It provides that without prejudice to the provisions of section 270A or section 271 or Section 271BA, if any person in respect of an international transaction:

(a) fails to maintain prescribed documents and information as required by sub section (1) or sub section (2) of section 92D;

(b) fails to report any such transaction which is required to be reported; or

(c) maintains or furnishes any incorrect information or documents

the Assessing Officer or Commissioner (Appeals) may direct that such person shall pay by way of penalty, a sum equal to 2% of the value of each international transaction entered into by such person. Further, Section 271AA(2) inserted vide Finance Act 2016 prescribes penalty for failure to furnish master file by prescribed date as INR 5,00,000.

- **Failure to furnish report**

Section 271BA provides that if any person fails to furnish a report from an Accountant as required by section 92E, the Assessing Officer may direct that such person shall take by way of penalty of INR 100,000.

- **Failure to furnish information and document**

Section 271G provides that if any person who has entered into an international transaction fails to furnish any such information or document as required by sub section (3) of section 92D, the Assessing Officer or the Commissioner (Appeals) may direct that such person shall pay, by way of penalty, a sum equal to two percent, of the value of the international transaction for each such failure.

The power to levy this penalty has also been extended now to the Transfer Pricing Officer.

- **Furnishing incorrect information in reports or certificates**

Finance Act 2017 introduced section 271J, provides for levy of penalty of INR 10,000 on accountants, merchant bankers and registered valuers in case of incorrect information being furnished by them in the reports

- **Failure to furnish information or documents under Section 286**

Finance Act 2016 introduced Section 286 which requires parent entity or the alternative reporting entity, resident in India, to furnish a prescribed report on or before the prescribed due date.

Section 271GB of the Act provides for penalty for failure to furnish the documents prescribed under Section 286. The penalty prescribed under Section 271GB are as follows:

Nature of penalty	Penalty (INR)
Failure to furnish the prescribed documents required to be maintained by the India parent entity of the international group: a. Where period of failure is equal to or less than 1 month b. Where period of failure is greater than 1 month c. Continuing default after service of penalty order	 5,000 per day 15,000 per day 50,000 per day
Furnishing of inaccurate particulars (subject to certain conditions)	5,00,000
Failure to produce the information and documents within 30 days (extendable by maximum 30 days)	INR 5,000 per day upto service of penalty order INR 50,000 per day for default beyond date of service of penalty order

Filing of appeal against the order of TPO

The Act permits the assessee to file an appeal with the Commissioner of Income Tax (Appeals) under the regular appellate procedure. However by the Finance Act 2009, the assessee has been given an option to approach the Dispute Resolution Panel (DRP) in cases where an addition has been proposed by the TPO.

The Finance Act 2009 inserted a new section 144C in the Act providing an alternate mechanism to resolve tax disputes of the foreign companies expeditiously.

The new scheme provides that whenever an AO proposes to make variations in the income or loss as a consequence of order by Transfer Pricing Office (TPO) or in the case of a non-resident or in the case of a foreign company, he shall forward a draft of the proposed order to any person in whose case the variation arises as a consequence of the order of the TPO. Any person, in whose case the variation arises as a consequence of the order of the TPO, on receipt of the draft order shall either accept the variation made by the assessing officer or file objections to variations with the DRP within 30 days of the receipt of the draft order. Finance Act, 2020 has expanded the scope of provisions under section 144C(1) to include cases where the assessing officer has proposed any variation which is prejudicial to the interests of the taxpayer (even though it may not result in any variation to the taxpayer's income or loss).

The DRP shall issue directions within 9 months from the end of the month in which the draft order is forwarded to the assessee.

Thereafter the AO is obliged to pass the final assessment order within 30 days from the end of the month in which such directions are received. Against the order of the AO, the assessee can file appeal before Income Tax Appellate Tribunal.

The scheme of DRP is available to a foreign company and to any person who has entered into an international transaction and whose assessment has been referred to TPO. Finance Act, 2020 has expanded the coverage of the scheme to apply to non-corporate non-residents assessee.

In pursuance of the above provisions the CBDT has issued Income Tax (Dispute Resolution Panel) Rules 2009 vide notification no. 84/2009 dated 20.11.2009. The rules inter alia contain the procedure for filing objections, hearing of objections, power to call for or permit additional evidence, issue of

directions, passing of assessment order, rectification of mistake and appeal against the assessment order.

The scheme did not provide for filing appeal by the tax department against the order passed in pursuance of the directions issued by the DRP. However the Finance Act 2012 had amended section 253 of the Act to provide that the CIT may direct the AO to file an appeal against final order passed by AO incorporating the directions of DRP, if the CIT objects to any of the directions issued by the DRP. The appeal can be filed within 60 days of the date on which the final order is passed by the AO. However, the same stands omitted as of now vide Finance Act, 2016 w.e.f. 1-6-2016 i.e., the tax department cannot file an appeal before ITAT against the order passed in pursuance of the directions issued by the DRP.

Alternatively, if the taxpayer does not file an objection, it may file an appeal with CIT (A) against the final assessment order passed by the AO, which also incorporates the order of the TPO, within 30 days of the receipt of the assessment order.

If the taxpayer is aggrieved by the order passed by the AO pursuant to the directions issued by the DRP or by the order passed by the CIT (A), the taxpayer may approach the ITAT. DRP is only an alternative mechanism, and the taxpayer has an option to either file its objections with DRP or file a regular appeal with the CIT(A).

Procedure relating to reference to DRP

Under section 144C (1), the AO shall forward a draft of the proposed order of assessment to the eligible assessee if he proposes to make, on or after the 1st day of October, 2009, any variation in the income or loss returned which is prejudicial to the interest of such assessee.

Sub –section (2) provides the option to the eligible assessee to either accept the draft order or file his objections against the draft order before the DRP. The exercise of option or filing of objections must be completed within 30 days from the date of the receipt of the draft order by him.

In the event of the assessee intimating to the AO the acceptance of the variation; or if no objections are received from the assessee within the period mentioned above, the AO shall pass the final assessment order notwithstanding the provisions relating to time period of passing the order contained in section 153 or section 153B of the Act. [Section 144C(3)&(4)]

Where the assessee has filed objections with the DRP, the Dispute Resolution Panel shall, issue such directions, as it thinks fit, for the guidance of the AO to enable him to complete the assessment. [Section 144C(5)]

Section 144C(6) provides that while issuing the directions, the DRP shall consider the following, namely:—

(a) draft order;

(b) objections filed by the assessee;

(c) evidence furnished by the assessee;

(d) report, if any, of the Assessing Officer, Valuation Officer or Transfer Pricing Officer or any other authority;

(e) records relating to the draft order;

(f) evidence collected by, or caused to be collected by, it; and

(g) result of any enquiry made by, or caused to be made by, it.

The DRP may, before issuing any directions make or cause to be made such further enquiry, as it thinks fit. [Section 144C(7)]

The DRP may confirm, reduce or enhance the variations proposed in the draft order so, however, that it shall not set aside any proposed variation or issue any direction under sub-section (5) for further enquiry and passing of the assessment order. [Section 144C(8)]

The Finance Act 2012 has added a clarificatory explanation to sub-section (8) providing that the power of the DRP to enhance the variation shall include and shall be deemed always to have included the power to consider any matter arising out of the assessment proceedings relating to the draft order, notwithstanding that such matter was raised or not by the eligible assessee. The explanation is effective retrospectively from 1.04.2009

If the members of the DRP differ in opinion on any point, the point shall be decided according to the opinion of the majority of the members. [Section 144C(9)]

Every direction issued by the DRP shall be binding on the AO. [Section 144C(10)]

In a case where the proposed directions by the DRP are prejudicial to the interest of the assessee or the interest of the revenue, the directions cannot be issued without giving an opportunity of being heard to the assessee or to the revenue as the case may be. [Section 144C(11)]

Sub – section (12) has set the time limit for the issue of directions to nine months from the end of the month in which the draft order is forwarded to the eligible assessee.

Upon receipt of the directions, the AO shall, in conformity with the directions, complete, the assessment without providing any further opportunity of being heard to the assessee, within one month from the end of the month in which such direction is received. This is notwithstanding anything to the contrary contained in section 153 or section 153B. [Section 144C(13)]

Under sub- section (14) of section 144C, the Board may make rules for the purposes of the efficient functioning of the DRP and expeditious disposal of the objections filed under sub-section (2) by the eligible assessee.

The Finance Act 2012 has introduced sub-section (14A) to section 144C which is effective from 1-4-2013. This amendment is collateral to the GAAR provisions introduced by the Finance Act 2012:

(14A) The provisions of this section shall not apply to any assessment or reassessment order passed by the AO with the prior approval of the Commissioner under sub-section (12) of section 144BA.

The following meanings are assigned to the various expressions used in this section-

(a) "Dispute Resolution Panel" means a collegium comprising of three Commissioners of Income-tax constituted by the Board for this purpose;

(b) "eligible assessee" means

  (i) any person in whose case the variation referred to in sub-section (1) arises as a consequence of the order of the Transfer Pricing Officer passed under sub-section (3) of section 92CA; and

  (ii) any foreign company.

Advance Pricing Agreement (APA)

The Finance Act 2012 has inserted sections 92CC and 92CD relating to APA. This provision is aimed to reduce the number of transfer pricing disputes and provides certainty to the tax payer. Advance pricing agreement is entered between CBDT with the approval of central government and the assessee w.r.t an international transaction wherein the arm's length price of the

international transaction is agreed upon by the parties in advance by applying the prescribed method(s).

APAs presents a proactive measure for resolving transfer pricing disputes in a cooperative manner. An APA can be entered into for a maximum period of five future years.

To add further impetus to the APA program, Finance Act, 2014 allowed provision for the rollback of APAs from 1 October 2014 and detailed rules for the same were notified later by the CBDT on 14 March 2015. Roll back provisions allowed applicability of the APA to prior 4 years, also. Accordingly, APA scheme provides certainty on the transfer price of the covered international transactions for a maximum period of 9 years.

Finance Act, 2020 has expanded the scope of APA to cover issues relating to attribution of profits to permanent establishments.

APA Scheme

A gist of India APA scheme is as follows:

i. **Eligibility**: Any person who has or proposes to enter into an international transaction is eligible to apply for an APA

ii. **Type of APA**: Indian APA scheme allows for all the types of APA i.e., unilateral APA, bilateral APA and multilateral APA. A unilateral APA is an arrangement between the tax payer and the Indian tax administration (CBDT); whilst a bilateral/multilateral APA involves not only the taxpayer and the Indian tax administration but also the taxpayer's affiliates (with whom it transacts) and their tax administration.

iii. **Filing fee** - Filing fee for the APA is based on the aggregate value of international transactions; and it ranges from Rupees 10 lakhs to Rupees 20 lakhs for main application. An additional fee of Rupees 5 lakhs is payable for rollback application.

iv. **Time for filing APA application** - APA can be applied for existing as well as proposed international transactions. For existing transactions, APA application needs to be filed before the commencement of the fiscal year for which it seeks to apply. For new transactions, APA application can be filed any time before the commencement of such transaction.

v. **Pre-filing application**- Taxpayer may opt for a pre-filing consultation with the APA authorities before making a formal application for APA. This can be done by filing application in the prescribed Form no.3CEC to the Principal Chief Commissioner of Income Tax (International Taxation) [PCCIT]. If in a pre-filing consultation, the suitability of entering into the APA is determined then the applicant should file a formal APA application.

vi. **APA Application -** APA application is to be filed in Form No.3CED.

vii. **Rollback scheme** - Some important points w.r.t rollback scheme are as follows:

(a) The rollback provisions would apply in respect of the 'same' international transaction covered under the main APA application. [clause (i), Rule 10MA(2)]

(b) In order to be eligible for applying the rollback provisions, the assessee should have filed Return of Income and Form No.3CEB (Accountants Report) on or before the statutory due date for each of the relevant rollback year. [clause (ii) & (iii), Rule 10MA(2)]

(c) Rollback is available for a block of 4 years. Rollback years cannot be selected by the applicant [clause (iv), Rule 10MA(2)]

(d) In case, the arm's length price of the covered international transaction is determined in an appeal by the Tax Tribunal for any year, before the signing of the APA, then such year would not be covered under the APA rollback [clause (i), Rule 10MA(3)]

(e) The application for rollback is to be filed in Form No 3CEDA.

viii. **Others**

(a) The advance pricing agreement entered into shall be binding—

i. on the person in whose case, and in respect of the transaction in relation to which, the agreement has been entered into; and

ii. on the [Principal Commissioner or] Commissioner, and the income-tax authorities subordinate to him, in respect of the said person and the said transaction.

The agreement shall not be binding if there is a change in law or facts having bearing on the agreement so entered.

(b) The Board may, with the approval of the Central Government, by an order, declare an agreement to be void ab initio, if it finds that the agreement has been obtained by the person by fraud or misrepresentation of facts.

Upon declaring the agreement void ab initio,—

i all the provisions of the Act shall apply to the person as if such agreement had never been entered into; and

ii notwithstanding anything contained in the Act, for the purpose of computing any period of limitation under this Act, the period beginning with the date of such agreement and ending on the date of order under sub-section (7) shall be excluded:

Provided that where immediately after the exclusion of the aforesaid period, the period of limitation, referred to in any provision of this Act, is less than sixty days, such remaining period shall be extended to sixty days and the aforesaid period of limitation shall be deemed to be extended accordingly.

(c) The assessee has right to appeal lies against the order of assessment or reassessment passed by AO u/s 92CD.

(d) There are procedures in place for renewal, amendments, withdrawals and revisions of APA.

Effect to advance pricing agreement

92CD. (1) Notwithstanding anything to the contrary contained in section 139, where any person has entered into an agreement and prior to the date of entering into the agreement, any return of income has been furnished under the provisions of section 139 for any assessment year relevant to a previous year to which such agreement applies, such person shall furnish, within a

period of three months from the end of the month in which the said agreement was entered into, a modified return in accordance with and limited to the agreement

(2) All other provisions of this Act shall apply accordingly as if the modified return is a return furnished under section 139.

(3) If the assessment or reassessment proceedings for an assessment year relevant to a previous year to which the agreement applies have been completed before the expiry of period allowed for furnishing of modified return under sub-section (1), the Assessing Officer shall, in a case where modified return is filed in accordance with the provisions of sub-section (1), proceed to assess or reassess or recompute the total income of the relevant assessment year having regard to and in accordance with the agreement.

(4) Where the assessment or reassessment proceedings for an assessment year relevant to the previous year to which the agreement applies are pending on the date of filing of modified return in accordance with the provisions of sub-section (1), the Assessing Officer shall proceed to complete the assessment or reassessment proceedings in accordance with the agreement taking into consideration the modified return so furnished.

(5) Notwithstanding anything contained in section 153 or section 153B or section 144C,—

(a) the order of assessment, reassessment or re-computation of total income under sub-section (3) shall be passed within a period of one year from the end of the financial year in which the modified return under sub-section (1) is furnished;

(b) the period of limitation as provided in section 153 or section 153B or section 144C for completion of pending assessment or reassessment proceedings referred to in sub-section (4) shall be extended by a period of twelve months.

(6) For the purposes of this section,—

(i) "agreement" means an agreement referred to in sub-section (1) of section 92CC;

(ii) the assessment or reassessment proceedings for an assessment year shall be deemed to have been completed where —

a. an assessment or reassessment order has been passed; or

b. no notice has been issued under sub-section (2) of section 143 till the expiry of the limitation period provided under the said section.

Also, the assesse is required to file annual compliance report in quadruplicate in Form 3CEF to PCCIT for all the APA covered years - rollback years and future years. It is required to be filed within 30 days of the due date of filing the income-tax return for that year, or within 90 days of signing the APA, whichever is later.

The PCCIT will forward the Annual Compliance Report to the Competent Authority and to the jurisdictional commissioner/ TPO for compliance audit.

TPO will have to submit its compliance audit report within 6 months of the receipt of Annual Compliance Report and send its report to the PCCIT. Based on the compliance audit report received from the TPO, the AO will pass the assessment order for the relevant assessment year.

Progress of APA and MAP in India

CBDT issued its first annual report on the APA programme, in India in April 2017. This report covers 5 APA cycles from FY 2012-13 to 2016-17.

The salient features of the report are as follows:

- 815 APA applications have been filed so far and out of that 152 applications have been concluded, including 88 APAs signed in FY 2016-17.
- 72 percent APA conclusions have been in the services sector, followed by 24 percent in the manufacturing sector, and the balance 4 percent for trading and other segments.
- In the services sector itself, IT industry rules with a higher share of 29 percent, banking industry 21 percent and the balance half comprising other industries.
- APA conclusions in 'other industries', e.g., Industrial goods, consumer goods and Pharmaceutical industry; was 11 percent, 4 percent and 7 percent, respectively.
- TNMM, at 73 percent of the cases, is the most used appropriate method for conclusion of the APAs.

- India has used other methods also, such as profit-split method and resale price method.
- 127 applications for bilateral APAs have been filed in India, 42 are with the USA, 39 with the UK, 17 with Japan and rest with other countries.
- 11 BAPAs have been signed so far - 5 relate to trading sector, 2 to manufacturing and 4 to services sector.
- The average duration for unilateral APA conclusion is 29 months and that for bilateral APAs is 39 months.

As per the recent update, India has completed its 6th year of the APA programme on March 31, 2018. During the last 5-year time, a total of 219 APAs - 199 unilateral and 20 bilateral, were concluded. 67 APAs - 58 unilateral and 9 bilateral were concluded during the last FY, 2017-18.

Important to note that India had so far signed bilateral APAs only with the UK and Japan. But during the last FY of the Report, 3 and 2 bilateral APAs were concluded with the US and the Netherlands, respectively.

Concluded APAs cover different industries and varied transactions. One unilateral APA, being the first on that transaction, was for AMP issues. The Indian APA authorities had so far adopted a cautious approach on APA for AMP transactions as the matter is sub judice with the apex court. But it is learnt that during the recent meeting of the competent authorities of India and the US IRS, it was decided to commence discussions on AMP even for a bilateral APAs.

Further, relevant update in respect of MAP in India are as follows:

- Indian Government has been actively resolving MAP cases for two years.
- Resolution has been reached with the US, UK, China and Japan.
- In last three years, since the effective opening of the bilateral negotiations between the two countries in January 2015, India has resolved maximum number of MAP cases with the US resulting in complete end of litigation in more than 400 cases of tax disputes.

Recently, the Indian Tribunal has upheld the persuasive value of the arm's length price determined under MAP to similar transactions with other AEs or in other years. Therefore, MAP may be useful to get the benefit of persuasive value for the other international transactions.

Safe Harbour

The safe harbour concept was introduced in the Indian TP Regulations in 2009 with an objective to provide a certain degree of certainty to taxpayers in the context of TP. CBDT was empowered by the Central Government to make safe harbor rules vide Finance Act, 2009 w.e.f. 1-4-2009.

In July 2012, the Prime Minister's Office constituted the Rangachary Committee to, inter alia, suggest clarifications needed to remove ambiguity and improve clarity on taxation of the IT sector and to finalize safe harbour rules sector by sector.

On 14 August 2013, the CBDT released draft safe harbour rules for public comments. After considering comments of various industry stakeholders, the CBDT issued the final safe harbour rules vide notification dated 18 September 2013 by insertion of rules 10TA to 10TG to the Rules. These newly inserted rules have been framed largely based on the recommendations of the Rangachary Committee. The rules cover international transactions in six categories/sectors, i.e. IT, IT-enabled services, contract R&D in the IT and pharmaceutical sectors, financial transactions (outbound loans and corporate guarantees) and auto ancillary manufacturing.

Further, the CBDT announced safe harbour rules in respect of specified domestic transactions undertaken by government companies engaged in the business of generating, transmitting or distributing electricity. As per the rules, the transfer price shall be considered at ALP if the tariff is determined in accordance with the provisions of the Electricity Act, 2003.

The Safe Harbour Rules are applicable for 5 years from AY 2013-14. Recently, CBDT made amendments in the safe harbor rules. In this respect, CBDT issued a notification on June 7, 2017. The amended safe harbour rules will be applicable for three years, from AY 2017-18 to AY 2019-20.

With the notification, dated 21st May 2020, CBDT notified changes to Rule 10TD and 10TE of the Income Tax Rules, 1962, relating to Safe Harbour Rules SHR that provide theat rates applicable from assessment year (AY) 2017-18 to 2019-20 will continue to apply for AY 2020-21 as well.

To exercise this option, the taxpayer is required to file specified form (Form No 3CEFA) with the AO on or before due date of furnishing the return of income with required details for:

- the relevant assessment year, in case the option is exercised only for that assessment year; or
- the first of the assessment years, in case the option is exercised for more than one assessment years.

The taxpayer can opt out of the safe harbour regime from the second year onwards, by filing a declaration to that effect with the AO.

The rules incorporate a time limit up to which the tax authorities can challenge the validity of the safe harbour option exercised by taxpayers.

Further, the CBDT vide notification of 20 December 2013 has provided the following clarifications with respect to safe harbour rules:

- If the taxpayer has opted for safe harbour but has reported rates or markup less than the rates or markups specified under safe harbour rules, then income has to be computed by the tax authorities on the basis of the safe harbour rates or markups.
- The rates or margins as specified in safe harbour rules are not to be considered as a benchmark by the TPO in cases where the taxpayer has not opted for the safe harbour rules. Hence, in cases where taxpayer has not opted for safe harbour and the case is under regular transfer pricing audit, such audit will be carried out without regard to the rates or markups specified in safe harbour rules.

Safe harbour rules shall not apply in respect of eligible international transactions entered into with an AE located in any country or territory notified under section 94A or in a no-tax or low-tax country or territory (i.e. maximum rate of income tax is less than 15%).

Recently, CBDT made amendments in the safe harbour rules. In this respect, CBDT issued a notification on June 7, 2017. The amendments in the notification are primarily in the applicable safe harbour rates. It also brought within the ambit of safe harbour rules, the receipt of low value-adding intra group services. Finance Act, 2020 has brought the issue of attribution of profits to permanent establishment within the ambit of safe harbor rules.

Revised safe harbour rates for specific nature of international transactions are tabulated below:

Sr. No.	Nature of international transaction	Conditions	Revised Safe Harbour rates
1.	Software development services	Annual transaction value <= INR 100 crore Annual transaction value >100 crore = < INR 200 crore	17% 18%
2.	IT enabled services	Annual transaction value <= INR 100 crore Annual transaction value >100 crore = < INR 200 crore	17% 18%
3.	Knowledge process Outsourcing services	Annual transaction value <= INR 200 crore and Employee Cost to Operating Expenses >= 60% Employee Cost to Operating Expenses < 60% and >= 40% Employee Cost to Operating Expenses < 40%	 24% 21% 18%
4.	Advancing intra group loan in Indian Rupees	CRISIL credit rating of Associated enterprise is between AAA to A or its equivalent BBB-, BBB or BBB+ or its equivalent between BB to B or its equivalent between C to D or its	1 year marginal cost of funds lending rate of SBI as on 1st April of the relevant previous year plus 175 basis points 325 basis points 475 basis points

Sr. No.	Nature of international transaction	Conditions	Revised Safe Harbour rates
		equivalent not available and the amount of loan advanced <= 100 crore as on 31st March of the relevant previous year	625 basis points 425 basis points
5.	Advancing intra group loan in foreign currency	CRISIL credit rating of Associated enterprise is: between AAA to A or its equivalent BBB-, BBB or BBB+ or its equivalent between BB to B or its equivalent between C to D or its equivalent not available and the amount of loan advanced <= 100 crore as on 31st March of the relevant previous year	6 month LIBOR of the relevant foreign currency as on 30th September of the relevant previous year plus 150 basis points 300 basis points 450 basis points 600 basis points 400 basis points
6.	Providing corporate guarantee		1% of the guaranteed amount
7.	Contract R&D services • Software development • Generic pharmaceutical drugs	Annual transaction value <= INR 200 crore	24%

Sr. No.	Nature of international transaction	Conditions	Revised Safe Harbour rates
8.	Manufacture and export of • core auto components • non-core auto component		 12% 8.5%
9.	Receipt of low value-adding intra-group services	Annual transaction value <= INR 10 crore	5%*

* Provided that the method of cost pooling, the exclusion of shareholder costs and duplicate costs from the cost pool and the reasonableness of the allocation keys used for allocation of costs to the assessee by the overseas associated enterprise, is certified by an accountant.

The safe harbour rates before amendment are tabulated below:

S No.	Nature of international transaction	Conditions	Safe Harbour Rates
1.	Software development services*	Annual transaction value > INR 500 crore Annual transaction value =< INR 500 crore	22% 20%
2.	IT enabled services*	Annual transaction value > INR 500 crore Annual transaction value =< INR 500 crore	22% 20%
3.	Knowledge process Outsourcing services*	No threshold for annual transaction value	25%
4.	Contract R&D services* • Software development • Generic pharmaceutical drugs		 30% 29%
5.	Manufacture and export of	90 % or more of total turnover are in nature of	

S No.	Nature of international transaction	Conditions	Safe Harbour Rates
	• core auto components • non-core auto component	Original Equipment Manufacture sales	12% 8.5%
6.	Advancing intra group loan	• To wholly owned nonresident subsidiary • Loan sourced in INR • Excludes loans by enterprises engaged in lending or borrowing in normal course of business • Excludes credit line or any other loan facility with no fixed term for repayment	Interest rate = / > base rate of SBI as on 30th June of the relevant year plus • 150 basis points [Loan =/< INR 50 crores] • 300 basis points [Loan > INR 50 crores]
7.	Providing explicit corporate guarantee	• Amount of guarantee is upto INR 100 crores • Amount of guarantee exceeds INR100 crores	2% of the guaranteed amount 1.75% of the guaranteed amount

*Applicable to service providers with insignificant risks

Multilateral exchange of information

Most treaties provide that the competent authorities are to exchange such information as is necessary for carrying out the provisions of the treaty and for preventing fraud or evasion of taxes. The treaties usually contain restrictions regarding the treatment and type of information that may be exchanged.

India has been an active participant in the G20 and OECD's BEPS project, and has implemented key BEPS actions requiring amendment to its tax laws like country-by-country reporting, limit on interest deduction, equalisation levy and a patent regime. It has also introduced the general anti-avoidance

rule [GAAR]. The BEPS actions requiring amendment to tax treaties is now being implemented by way of a multilateral instrument.

Furthermore, India has entered into a number of tax information exchange agreements (TIEAs) for receiving and providing information for tax purpose available with other countries/jurisdictions. Indian TIEAs are based on the 2002 Model Agreement on Exchange of Information on Tax Matters developed by the OECD Global Forum Working Group on Effective Exchange of Information, with certain variations.

Pursuant to the approval of the Cabinet, India's Finance Minister on 7 June 2017 participated in the signing of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting [multilateral instrument / MLI] at Paris. The MLI was signed by 68 countries including Australia, Canada, China, Cyprus, France, Germany, Hong Kong, Japan, Luxembourg, Netherlands, Singapore and the United Kingdom. Interestingly, the United States, has not signed the MLI and Mauritius has committed to sign by 30 June 2017.

As on 21 December 2017, out of the 68 countries, India has activated the exchange relationship with 50 countries.

The MLI covers inter alia, two minimum standards agreed on BEPS, relating to prevention of treaty abuse (addressed to some extent by the Indian GAAR) and improvement of dispute resolution under the mutual agreement procedure [MAP]. The other key area covered by the MLI relates to avoidance of the permanent establishment [PE] status, which is a big area of dispute between taxpayers and Revenue authorities in India.

It is interesting to note that the MLI provides significant flexibility to signatories. For example, a country can decide which tax treaties will be covered by the MLI and which will be outside its purview. Moreover, each country can also opt out of a provision of the MLI (entirely or partly), provided it is not a minimum standard. At the signing of the MLI, India has given a provisional list of expected reservations and notifications. The provisional list indicates that India proposes to cover all existing comprehensive tax treaties under the MLI.

Other Important Developments

Interest Deduction Rule [Section 94B]

The Finance Act, 2017 has introduced a new provision called 'Limitation on interest deduction in certain cases'. This provision sets the norm according to

which an Indian Company or a Permanent Establishment (PE) of a foreign company would be eligible to claim a deduction of interest expenses against its taxable income. The key features are as below:

- Applies only if the interest charge claimed exceeds one crore rupees;
- Restricts claim on interest costs;
- Applies to interest clause or similar consideration in respect of debts issued by a non-resident;
- The non-resident should be an associated enterprise of the borrower;
- Interest will be tax deductible only to the extent of 30% of earnings before interest, taxes, depreciation and amortization (EBITDA) of the borrower;
- Any interest in excess of the above (referred to as 'excess interest') will be allowed to be carried forward for eight assessment years immediately succeeding the assessment year for which the excess interest expenditure was first computed.

It is pertinent to note that even guarantee and back-to-back deposit loan (by extending the line of credit against an overseas deposit) arrangements are also covered. If an overseas parent extends a guarantee on behalf of the Indian subsidiary to a third party lender (say, a bank), then such interest costs also will be covered by the new provisions. Another case is where the overseas parent deposits funds with an overseas lender who in turn requests the latter's Indian arm under a line of credit to extend the loan to the Indian subsidiary.

R&D circular [Circular No.6/2013 dated 29 June, 2013] - Guidelines on characterization of Indian development centres (IDC)

India has emerged as an important location for R&D centres (for MNEs). Traditionally, these captive contract R&D service providers have been characterised – for TP purposes - as routine contract R&D service providers exposed to low/ limited risk, warranting a routine cost plus return.

Indian Revenue have had divergent views on the matter i.e. contending that the R&D centres (of MNEs) in India have played a crucial role in developing the intangibles and accordingly these development centres should be characterised as full-fledged entrepreneurs/ significant risk bearing entities.

Accordingly, the CBDT issued Circular No.6/2013 on 29 June, 2013 which provides guidelines on characterisation of Indian development centres (IDC).

Following parameters are outlined for characterizing a contract R&D service provider as low risk entity entitled to a cost plus return:

- Foreign principal (FP) performs most of the economically significant functions (such as the conceptualisation and design of the product and providing strategic direction and framework, etc.) involved in the research or product development cycle either through its own employees or through its associated enterprises, while the IDC carries out the work assigned to it by the FP.
- FP or its associated enterprises provides funds/ capital and other economically significant assets including intangibles for research or product development. FP or its AEs also provides remuneration to the IDC for the work carried out by the latter.
- IDC works under the direct supervision of the FP or its associated enterprises, which actually controls or supervises the research or product development through its strategic decisions to perform core functions as well as monitor activities on a regular basis.
- IDC does not assume or has no economically significant realized risks.
- IDC has no ownership right (legal or economic) on the outcome of the research which vests with the FP.

CBDT has focused on the functional analysis and the related aspects of decision making, control, capital, supervision and monitoring, etc. in order to ascertain whether or not the IDC is a contract R&D centre with an insignificant risk. Further, by emphasizing on the 'substance' and 'conduct over contract', the CBDT has made an attempt to align it with the international guidance provided by the OECD and United Nations.

Advertising, Marketing and Promotion (AMP) Expenses

Indian Revenue Authorities, over the years, have made some high-pitch TP adjustments on issue relating to AMP expense. The number of cases and TP adjustment amount has increased multifold. Currently, there are no specific guidelines in the Indian transfer pricing regulations to address the AMP expense related aspects; however, the Indian courts have provided useful insights, thereto. The OECD has acknowledged the fact that AMP

expenditure by a distributor or licensee is an integral part of the distribution function. In this context, the focus has been clearly on the functional profile and rights of the distributor. Based on the facts and having regard to the arm's length principle, it is therefore imperative to evaluate the need for separate remuneration (if any) for such marketing activities. OECD TP Guidelines[1] provide that such remuneration could take different forms, such as decrease in the purchase price of the product or a reduction in the royalty rate.

The United Nations Practical Manual on Transfer Pricing for Developing Countries (UN TP Manual)[2] provides for the allocation of market penetration, marketing expansion and market maintenance strategy-related costs between entities within a MNE. It is essential to know which entity or entities have the legal ownership of the intangibles. The UN TP Manual supports the concept of "economic ownership", i.e. where a marketer incurs significant marketing expenditure, which adds value to an affiliate's intangible, or creates its own local marketing intangible, the marketer is entitled to a share of the returns from its exploitation.

In the Indian context, the key principles outlined by the Indian judiciary, has been discussed in detail in the next section under Important Judicial Precedents. Broadly, the consensus is that that increased AMP expenditure does not pre-suppose contribution to brand building by the Indian entity for its overseas AE.

Applicability of TP regulations in case of international transaction relating to Issue of Shares:

The Mumbai High Court has provided the much-needed guidance in relation to the applicability of TP provisions to issuance of shares.

The facts and salient aspects of the ruling are outlined below:

— The taxpayer, a wholly owned subsidiary of a Mauritius entity namely Vodafone Tele-Services (India) Holdings Ltd (holding company), issued equity shares of face value of INR 10 at a premium of INR 8,591 per share to its holding company.

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[1] OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*, OECD, July 2010.

[2] United Nations, United Nations Practical Manual on Transfer Pricing for Developing Countries, United Nations

— During TP assessment proceedings, the TPO disputed the valuation of shares and re-computed the value per share (based on the Net Asset Value (NAV) after inter-alia considering preceding years TP adjustments) to INR 53,775. The TPO treated the shortfall in the value of shares (INR 53,775 less INR 8,591 per share) as deemed loan by the taxpayer to its foreign parent and charged a notional interest at 13.5%. Accordingly, the TPO made a TP adjustment for the alleged shortfall in the value of shares as well as the notional interest thereon to the taxable income of the taxpayer.

— Aggrieved by the order of the TPO, the taxpayer filed a writ petition challenging the jurisdiction applicability of TP regulations to the issue of equity shares before the Mumbai HC.

— The Hon'ble HC disposed the writ petition directing the Dispute Resolution Panel (DRP) to decide the issue of jurisdiction. The DRP held that the Revenue has jurisdiction to apply TP provisions in the instant case, as share premium is an income arising from issue of shares and there is income potentially arising or affected by short receipt of share premium. Aggrieved, the taxpayer filed the current writ before the Honourable Mumbai HC.

— The taxpayer had challenged the following TP adjustments made by the revenue:

— Alleged undervaluation of shares issued by the taxpayer in favour of its AE;

- Imputing of notional interest on such alleged undervaluation of shares, by treating the shortfall as loan advanced by the taxpayer to the AE.

— On 10 October 2014, the Mumbai High Court held that the TP regulations are applicable only to international transactions that give rise to taxable income. Neither the capital receipt on issue of equity shares nor the shortfall (if any) in share premium can be considered as taxable income within the ambit of the Act. Further, there is no specific provision in the Act for treating inflow of funds from shares issued to non-residents as taxable income. Hence, TP provisions do not apply to issue of equity shares to a non-resident.

The above ruling is a welcome relief for taxpayers that have been facing huge transfer pricing adjustments on account of alleged undervaluation of shares and subsequent recharacterization of the same as a loan.

Further, the Bombay High Court in the case of Shell India Markets Pvt Ltd v. ACIT and others [Writ petition 1205 of 2013] followed its earlier decision in Vodafone (supra) and held that the TP provisions should not be applied to issue of equity shares in the absence of any income arising from a particular transaction.

Further, on 28 January 2015, the Union Cabinet decided to accept the order of the High Court of Bombay in the case of Vodafone (supra). The decision will also have a bearing on similar cases as the government has decided not to appeal on such cases in higher courts. This decision has attained finality on the long standing issue of whether TP provisions are applicable to the issue of shares.

Important Judicial Precedents:

1. Bangalore Tribunal in the case of Tally Solutions decided that there is nothing in section 92CA that requires the AO to first form a "considered opinion" before making a reference to the TPO. It is sufficient if he forms a prima facie opinion that it is necessary and expedient to make such a reference. The making of the reference is a step in the collection of material for making the assessment and does not visit the assessee with civil consequences. There is a safeguard of seeking prior approval of the CIT. Moreover, by virtue of CBDT's Instruction No.3 of 2003 dated 20.5.2003 it is mandatory for the AO to refer cases with aggregate value of international transactions more than INR 5 crores to the TPO The argument that the "Excess Earning Method" adopted by the TPO is not a prescribed method is not acceptable. A sale of IPR is not a routine transaction involving regular purchase and sale. There are no comparables available. The "Excess Earning Method" is an established method of valuation which is upheld by the U.S Courts in the context of software products. The "Excess Earning Method" method supplements the CUP method and is used to arrive at the CUP price i.e. the price at which the assessee would have sold in an uncontrolled condition.

2. In the case of Diageo India Pvt. Ltd v ACIT 47 SOT 252 it was decided that If one enterprise controls the decision making of the other or if the decision making of two or more enterprises are controlled by same person, these enterprises are required to be treated as 'associated enterprises'. Though the expression used in the statute is 'participation in control or management or capital',

essentially all these three ingredients refer to de facto control on decision making.

The argument, based on Quark Systems 38 SOT 307 (SB), that exceptionally high and low-profit making comparables are required to be excluded from the list of TNMM comparables is not acceptable. Merely because an assessee has made high profit or high loss is not sufficient ground for exclusion if there is no lack of functional comparability. While there is some merit in excluding comparables at the top end of the range and at the bottom end of the range as done in the US Transfer Pricing Regulations, this cannot be adopted as a practice in the absence of any provisions to this effect in the Indian TP regulations. (Benefit of +/- 5% adjustment as directed in UE Trade Corporation 44 SOT 457 to be given); The adjustment made by the TPO with regard to the advertisement expenditure incurred by the assessee was without jurisdiction because the AO had not made any reference on this issue to the TPO. As the reference to the TPO is transaction specific and not enterprise specific, the TPO Officer has no power to go into a matter which has not been referred to him by the AO. Even the CBDT Instructions are clear on this (3i Infotech Ltd 136 TTJ 641 followed)(A.Y.2006-07).

3. In the case of Siva Industries & Holdings Ltd Chennai tribunal held that in case of grant of loan by assessee to its foreign subsidiary in foreign currency out of its own funds. For determining ALP, it is the international LIBOR rate that would apply and not the domestic prime lending rate.

4. Pune Tribunal held the following in the case of Bringtons Carpets Asia (P) Ltd v Dy CIT 57 DTR 121 assessee having cited six comparables, TPO /AO was not justified in rejecting the same and applying domestic transactions of the assessee when the AO/TPO has accepted said six external comparables in the subsequent assessment year and there is similarity of facts in both the years, further the assessee is entitled to economic adjustments in the circumstances of under capacity utilization of the company, matter was set aside for examining the issue de novo. (AY 2006-07)

5. While determining arm's length price, it is profit as per books of account that has to be considered for computing net margin of assessee and not adjusted book profits. (AY 2006- 07). Refer, Geodis Overseas (P) Ltd v Dy CIT 45 SOT 375 (Delhi Tribunal).

6. Bangalore Tribunal has held that transaction of supply of raw material by non-resident AE to a domestic "Third Party" entity for manufacture, is an international transaction between assessee (an Indian company) and AE, requiring determination of ALP under Section 92(1);

   Tribunal observed the terms of agreements and held that it was a 'concerted action' or 'arrangement' which is brought out in a form which apparently is intended and framed in such a manner as not to attract the provisions of Section 92B of the Act. Refer, Novo Nordisk India Pvt Ltd Vs DCIT, IT(TP)A No.122/Bang/2014

7. The Delhi High Court, while confirming the order of the Tribunal, held that rendering of services by assessee to Indian third-party customers, in the given facts and circumstances, is not regarded as a deemed international transaction under Section 92B(2) of the ITA, given that none of the conditions provided under section 92B(2) were fulfilled. Refer, CIT Vs. Stratex Net Works (India) Pvt. Ltd., [2013] 33 taxmann.com 168 (Delhi)

8. The Hon'ble Delhi High Court has pronounced its ruling on TP adjustment on account of AMP expenditure incurred by Indian distributors as part of their distribution business in India. The High Court, while upholding that AMP expenditure could be considered as an international transaction, held that increased AMP expenditure does not pre-suppose contribution to brand building by the Indian entity for its overseas AE. As per the court, universal application of bright line test to segregate AMP into routine and non-routine AMP is unwarranted. Further, the Court also held that such application of bright line test and to apply cost plus method to determine ALP would amount to adding provisions to the statute and rules, which are non-existent. Refer, Sony Ericsson Mobile Communications India (P.) Ltd. v CIT, [2015] 55 taxmann.com 240 (Delhi)

9. The Delhi Tribunal pronounced an important ruling on marketing intangibles. The Tribunal upheld the adjustment made by the TPO wherein the TPO has attempted to make an economic adjustment on the margins of the comparables to account for differences in intensity of marketing function.

   This ruling is distinct from other rulings on the issue of AMP, as in the present case the TPO has attempted to shift from its previous approach of treating excess AMP expense as a separate international

transaction. Instead, the TPO has classified marketing activity as a function undertaken by a distributor. Refer case of Luxottica India Eyewear Pvt. Ltd. vs ACIT Cir-15(2), New Delhi (ITA No. 1492/ 2015, ITA 1205/2016 and ITA 344/2017) and ACIT Cir 15(2) vs Luxottica India Eyewear Pvt. Ltd. (ITA No. 1117/2015).

10. The High Court held that since the Revenue was unable to demonstrate with tangible material that there was an international transaction involving AMP expenses between the assessee and AE, the question of determining ALP did not arise. It held that merely because the AE had financial interest in the assessee it could not be presumed that the AMP expenses incurred by the assessee was on behalf of the AE. It held that even though Section 92B read with Section 92F included arrangement, understanding or actions in concert within the ambit of international transaction there has to be tangible evidence to show that the parties acted in concert. It further held that the clauses of trade name license agreement do not indicate that the assessee was under obligation to incur AMP expenses for building the brand of its AE and accordingly dismissed the appeal of the Revenue. Refer, DCIT v Whirlpool of India Ltd., [2015] 64 taxmann.com 324 (Delhi)

11. The Tribunal has held that "the accretion of brand value, as a result of use of the brand name of foreign AE under the technology use agreement- which has been accepted to be an arrangement at an arm's length price, does not result in a separate international transaction to be benchmarked". Refer Hyundai Motor India Limited Vs DCIT, (I.T.A. No. 739 and 853 /Chny/2014, 563 and 614 /Chny/2015, 842 and 761/Chny/16 and CO 73/Chny/16 AYs: 2009-10, 2010-11 and 2011-12)

12. The Tribunal in a recent ruling deletes the TP adjustment in the context of AMP – not being an international transaction (under section 92B of the Act. Focus of the ruling is primarily on bright line test (BLT) not to be applied for making TP adjustment. The Tribunal has relied upon the case of Thomas Cook (India) Ltd. (supra) and after considering the available High Court judgements. [Refer: I.T.A. No./7744/Mum/2012 (A.Y 2008-09); 1792/Mum/2014 (A.Y. 09-10); 105/Mum/2015, (A.Y.10-11); 903/Mum/2016, (A.Y. 11-12);674/Mum/2017, (A.Y- 12-13) – Nivea India Pvt. Ltd.].

13. Delhi High Court ruled in favour of the taxpayer wherein it was upheld that, Tax authorities cannot question the commercial rationale of legitimate business expenses incurred by the taxpayer as long as it is demonstrated that the transaction is at arm's length by application of the prescribed methods. Financial health of the taxpayer can never be a criterion to judge allowability of an expense. Thus, the taxpayer need not show that any expenditure incurred by him for the purpose of business has actually resulted in profit or income. OECD guidelines can be relied upon for guidance wherever applicable. Refer, CIT vs. EKL Appliances Ltd, [2012] 24 taxmann.com 199 (Delhi HC).

14. Delhi High Court rejected assessee's contention that no benchmarking is required where the AEs have only recovered costs without charging any mark up. High Court ruled that even though the transaction involves only a recovery of cost, as the transaction is between two AEs, it is necessary to test whether an uncontrolled entity for the same or comparable services charges an amount less than or equal to or more than what was charged to the Taxpayer by the AEs. Application of Section 92(3), which does not permit application of ALP if it has the effect of reducing tax incidence, cannot be inferred merely because the AEs recover costs without a mark-up. A comprehensive transfer pricing analysis is required to test the appropriateness of the costs that are allocated as well as for determining applicability of Section 92(3). The HC also observed that while examining whether an independent entity would have paid for such services, the Tax Authorities cannot question the commercial judgment of the assessee. Refer CIT vs. Cushman and Wakefield India Pvt Ltd., [2014] 46 taxmann.com 317

15. Mumbai Tribunal held that margin determined for 96% of assessee's ITeS transactions with US AE-entities under MAP proceedings should be applied for remaining 4% transactions with non-US AE-entities absent distinction in facts or nature of transactions.. Refer J.P. Morgan Services P. Ltd. vs. DCIT, [2016] 70 taxmann.com 228

16. Delhi Tribunal has allowed the selection of foreign AEs (engaged in sales and distribution activities or secondary manufacturing) as tested party, being the least complex entity, while benchmarking assessee's international transactions; draws support from assessee's APA, wherein CBDT approved selection of foreign AEs as tested

party with TNMM as the most appropriate method and also approved concept of benchmarking considering regional comparables. Tribunal observed that assessee's Functional, Assets & Risk ('FAR') analysis as well as international transactions for APA years and the year under appeal were identical and adequate financial data for comparison on region basis / country basis were available. Refer Ranbaxy Laboratories Ltd Vs ACIT, [2016] 68 taxmann.com 322

17. Delhi High Court has upheld Tribunal's order considering foreign exchange gain/loss arising out of revenue transactions as an item of operating revenue/cost. Further, the High Court observed that assessee, for subsequent AYs, had entered into an APA with the CBDT, by which the 'cost plus pricing methodology' had been impliedly accepted. Accordingly, dismisses Revenue's appeal stating that no substantial question of law arises for consideration. Refer, Pr. Commissioner Vs. Ameriprise India Pvt Ltd., ITA 206/2016.

18. Bangalore Tribunal rejected TPO's determination of Nil ALP for management fees paid to AE, noted that assessee had filed the agreement and relevant record under which the management fees were paid to the AE and Department had accepted the management fees under the APA.

    Thus, the tribunal held that even though APA was not applicable for the subject year, making a separate adjustment by TPO by determining ALP of management fees at Nil was contrary to the stand of the department itself while agreeing to APA. Refer AXA Technologies Shared Services Pvt. Ltd Vs DCIT, [2017] 80 taxmann.com 197.

19. Mumbai Tribunal in the case of Watson Pharma Pvt Ltd (ITA No. 1423/Mum/2014) analysed the concept of location savings in a TP context placing its reliance on the OECD Guidance on Transfer Pricing Aspects of Intangibles as per BEPS Action Plan 8 which indicates that if reliable local market comparables are available and can be used to determine arm's length prices, specific comparability adjustments for location savings should not be required.

20. Instrumentarium Corporation Limited, Finland (ITA No. 1548 and 1549/Kol/2009): In this case, the Special Bench analysed the provisions of section 92(3) of the Act and acceded to the view of the Revenue that the exemption from the TP provisions apply only in cases where the TP adjustment results in reducing the taxable profit

or enhancing the losses of the taxpayer. The Special Bench held that there is no provision for corresponding deduction of the TP adjustment in the hands of the Indian AE. The tax base erosion would have taken place only in situation where the Indian AE would have actually allowed interest income to the taxpayer, which is not the fact of the case. Based on the above, the bench held that there was no case of tax base erosion.

The Special Bench also held that the provision of section 92(3) of the Act provides for determining the impact on profit or losses only for the year under consideration and not for taking into consideration the impact of any TP adjustment in the subsequent years.

Tax administration cannot be expected to have a clairvoyance of whether or not the Indian AE will actually make sufficient profits in future in the set off period so as to subsume the losses of the Indian AE from the transaction with the taxpayer. The possibility of set off of future profits, against the losses incurred by the AE cannot be taken into account for determining the overall tax impact.

21. In the case of Pr. CIT vs Kusum Healthcare Pvt. Ltd. (I.T.A. No. 765/ 2016), the Delhi High Court held that every outstanding invoice beyond the credit free period cannot be classified as a separate international transaction under the explanation to Section 92B of the Act. Further, once the taxpayer has factored in the impact of working capital requirement due to outstanding receivables in its pricing/profitability, no further adjustment on account of outstanding receivable is required.

22. In a similar case of M/S Valuelabs, (Previously Known As Valuelabs) Hyderabad. Versus ACIT, 2020(7) Tmi 282, the Hyderabad Tribunal held that agreement between the assessee and its AE vis-à-vis terms of payment within stipulated period of 90 days cannot form basis for holding the existence of International transaction between assessee and its AE, where outstanding is not received within stipulated period. Further, It was held that there was no merit in making ALP adjustment u/s. 92C(3) towards Interest @ 7% on Outstanding Receivables from AEs on hypothetical and notional basis.

23. In a recent ruling, Vodafone India Services Private Limited vs DCIT [ITA No. 565/Ahd/17, AY 2012-13], the Tribunal held that the entire arrangement involves several parties acting in concert including non-resident associated enterprises. Section 92F (v) of the Act provides

that irrespective of whether an arrangement, understanding, or action in concert is legally enforceable or not, it falls within the ambit of "transaction" for the purpose of TP provisions. Further, as the non-resident associated enterprises were parties to such action in concert, it becomes an "international transaction".

The Tribunal rejected the assessee's reliance on the Supreme Court decision in Vodafone International Holdings BV wherein the Supreme Court held that the arrangement was not an international transaction, on the ground that the Supreme Court only dealt with the legal ownership of the entities and not the factual rights.

Besides the above, the Tribunal further held that that just because an income/ expense is not taken into account in computation of taxable income, an international transaction cannot be said to be regarded as outside the ambit of "international transaction". What is material is whether the transaction in question is capable of producing an income chargeable to tax or not.

Lastly, The Tribunal also analysed the applicability of deemed international transaction provision under section 92B(2) of the Act. The Tribunal observed that the foreign AE and parent entity of the assessee but also decided the terms & conditions of the agreement. Hence, the transaction falls under section 92B(2).

The said judgement is significant and lays down guiding principles for structuring deals. It emphatically makes it clear that Indian TP regulations are very wide and covers all actions with the involvement of non-resident associated enterprise. Factual rights preside over legal rights for the application of TP provisions.

Chapter 10
General Anti-Avoidance Rules

(Chapter X-A, General Anti-Avoidance Rule (GAAR), apply in respect of any assessment year beginning on or after April 1, 2018.)

Introduction

This chapter is applicable to all assesses, and aim to curb the transactions entered with the intention to avoid tax. Simultaneously section 144BA was inserted in the Act which provides the administrative procedure to be followed by the department in respect of cases involving impermissible transactions as per this chapter.

AO on the basis of evidence or material before him may declare an arrangement as impermissible avoidance arrangement; having done so may make a reference to the principal commissioner or commissioner in order to determine the consequence of such arrangement in accordance with GAAR. The principal commissioner or commissioner is duty bound to hear the assessee before issuing any order.

An approving panel is also set up for issue of directions where assessee objects to the proposed action by the principal commissioner or commissioner and the principal commissioner or commissioner is not satisfied with the explanation of the assessee. Appeal can be made to ITAT against the order passed under section 144BA.

Further, assessee can also obtain an advance ruling from the AAR for the determination whether the arrangement proposed to be undertaken is impermissible arrangement as referred to in Chapter X-A or not.

Applicability of General Anti-Avoidance Rule [Section 95]

The section overrides the Act and provides that--

— an arrangement entered into by an assessee may be declared to be an impermissible avoidance arrangement; and

— the consequence in relation to tax arising therefrom may be determined subject to the provisions of this Chapter.

Explanation clarifies that provisions of this chapter can be applied to any step in, or a part of, the arrangement also.

Meaning and scope of impermissible avoidance agreement [Section 96]

Section 96(1) defines impermissible avoidance arrangement to mean an arrangement, the main purpose or one of the main purposes of which is to obtain a tax benefit and it—

(a) creates rights, or obligations, which are not ordinarily created between persons dealing at arm's length;

(b) results, directly or indirectly, in the misuse, or abuse, of the provisions of this Act;

(c) lacks commercial substance or is deemed to lack commercial substance under section 97, in whole or in part; or

(d) is entered into, or carried out, by means, or in a manner, which are not ordinarily employed for bona fide purposes.

Under section 96(2) even if the main purpose of the step in or part of the arrangement is to obtain a tax benefit, unless it is proved to the contrary by the assessee, the whole arrangement shall be presumed to have been entered into, or carried out, for the main purpose of obtaining a tax benefit.

Meaning of arrangement lacking commercial substance

As per section 97(1) an arrangement shall be deemed to lack commercial substance if—

(a) the substance or effect of the arrangement as a whole, is inconsistent with, or differs significantly from, the form of its individual steps or a part; or

(b) it involves or includes—

  (i) round trip financing;

  (ii) an accommodating party;

  (iii) elements that have effect of offsetting or cancelling each other; or

(iv) a transaction which is conducted through one or more persons and disguises the value, location, source, ownership or control of funds which is the subject matter of such transaction; or

(c) it involves the location of an asset or of a transaction or of the place of residence of any party which is without any substantial commercial purpose other than obtaining a tax benefit (but for the provisions of this Chapter) for a party; or

(d) it does not have a significant effect upon the business risks or net cash flows of any party to the arrangement apart from any effect attributable to the tax benefit that would be obtained (but for the provisions of this Chapter).

Irrelevant considerations for determining whether transaction lacks commercial substance or not

The following shall not be taken into account while determining whether an arrangement lacks commercial substance or not, namely:—

(i) the period or time for which the arrangement (including operations therein) exists;

(ii) the fact of payment of taxes, directly or indirectly, under the arrangement;

(iii) the fact that an exit route (including transfer of any activity or business or operations) is provided by the arrangement.

Meaning of round trip financing

Round trip financing includes any arrangement in which, through a series of transactions—

(a) funds are transferred among the parties to the arrangement; and

(b) such transactions do not have any substantial commercial purpose other than obtaining the tax benefit (but for the provisions of this Chapter),

without having any regard to—

(A) whether or not the funds involved in the round trip financing can be traced to any funds transferred to, or received by, any party in connection with the arrangement;

(B) the time, or sequence, in which the funds involved in the round trip financing are transferred or received; or

(C) the means by, or manner in, or mode through, which funds involved in the round trip financing are transferred or received.

Meaning of accommodating party

A party to an arrangement shall be an accommodating party, if the main purpose of the direct or indirect participation of that party in the arrangement, in whole or in part, is to obtain, directly or indirectly, a tax benefit (but for the provisions of this Chapter) for the assessee whether or not the party is a connected person in relation to any party to the arrangement.

Consequence of impermissible avoidance arrangement [Section 98]

If an arrangement is declared to be an impermissible avoidance arrangement, then the consequences, in relation to tax, of the arrangement, including denial of tax benefit or a benefit under a tax treaty, shall be determined depending upon each circumstance of the case, including by way of but not limited to the following, namely:—

(a) disregarding, combining or recharacterising any step in, or a part or whole of, the impermissible avoidance arrangement;

(b) treating the impermissible avoidance arrangement as if it had not been entered into or carried out;

(c) disregarding any accommodating party or treating any accommodating party and any other party as one and the same person;

(d) deeming persons who are connected persons in relation to each other to be one and the same person for the purposes of determining tax treatment of any amount;

(e) reallocating amongst the parties to the arrangement—

  (i) any accrual, or receipt, of a capital or revenue nature; or

  (ii) any expenditure, deduction, relief or rebate;

(f) treating—

  (i) the place of residence of any party to the arrangement; or

  (ii) the situs of an asset or of a transaction,

at a place other than the place of residence, location of the asset or location of the transaction as provided under the arrangement; or

(g) considering or looking through any arrangement by disregarding any corporate structure.

For the above purposes—

(i) any equity may be treated as debt or vice versa;

(ii) any accrual, or receipt, of a capital nature may be treated as of revenue nature or vice versa; or

(iii) any expenditure, deduction, relief or rebate may be recharacterised.

Treatment of connected person and accommodating party [Section 99]

In determining whether a tax benefit exists—

(i) the parties who are connected persons in relation to each other may be treated as one and the same person;

(ii) any accommodating party may be disregarded;

(iii) such accommodating party and any other party may be treated as one and the same person;

(iv) the arrangement may be considered or looked through by disregarding any corporate structure.

Application of chapter X-A [Section 100]

The provisions of this Chapter shall apply in addition to, or in lieu of, any other basis for determination of tax liability.

Chapter to be applied in accordance with prescribed guidelines [Section 101]

The provisions of this Chapter shall be applied in accordance with such guidelines and subject to such conditions and the manner as may be prescribed.

As per Rule 10U of the Income-tax Rules, 1962, Chapter XA shall not apply in respect of the following:

- An arrangement where the total tax benefit in aggregate to all the concerned parties in a particular financial year does not exceed Rs. 3 Crores (Rs. 30 million)

- A Foreign Institutional Investor, who is an assessee under the Act, who has not taken benefit of an agreement referred to in section 90 or section 90A as the case may be and who has invested in listed securities, or unlisted securities, with the prior permission of the competent authority, in accordance with the Securities and Exchange Board of India (Foreign Institutional Investor) Regulations, 1995 and such other regulations as may be applicable, in relation to such investments
- A non-resident in relation to investments made in a Foreign Institutional Investor by way of offshore derivative instrument (eg. total return swaps or participatory notes) or otherwise i.e. Participatory note holder, directly or indirectly
- any income accruing or arising to, or deemed to accrue or arise to, or received or deemed to be received by, any person from transfer of investments made before April 1, 2017 by such person.

In order to provide certainty to investors, all investments made before April 1, 2017 would not be subject to GAAR.

As per Rule 10UA of the Income-tax Rules, 1962, for the purposes of sub-section (1) of section 98, where a part of an arrangement is declared to be an impermissible avoidance arrangement, the consequences in relation to tax shall be determined with reference to such part only.

Rule 10UB provides that for the purpose of section 144BA(1), the Assessing Officer before making a reference to the Commissioner in Form No. 3CEG issue a notice in writing to the assessee seeking objections if any to the applicability of chapter XA. The notice issued shall contain the following:—

i. Details of the arrangement to which the provisions of Chapter X-A are proposed to be applied;

ii. the tax benefit arising under the arrangement;

iii. the basis and reason for considering that the main purpose of the identified arrangement is to obtain tax benefit;

iv. the basis and the reasons why the arrangement satisfies the condition provided in clause (a), (b), (c) or (d) of sub-section (1) of section 96; and

v. the list of documents and evidence relied upon in respect of (iii) and (iv).

This rule further provides that where the Commissioner is satisfied that the provisions of Chapter X-A are not required to be invoked with reference to an arrangement after considering the reference received from the Assessing Officer under section 144BA(1) or after the reply of the assessee in response to the notice issued under section 144BA(2), he shall issue directions to the Assessing Officer in Form No. 3CEH.

Similarly, the Commissioner before making a reference to the Approving Panel under section 144BA(4), shall record his satisfaction regarding the applicability of the provisions of Chapter X-A in Form No. 3CEI and enclose the same with the reference.

Rule 10UC lays down the time-limits for completing the proceedings as under:

i. No directions under section 144BA(3) shall be issued by the Commissioner after the expiry of one month from the end of the month in which the date of compliance of the notice issued under section 144BA(2) falls;

ii. No reference shall be made by the Commissioner to the Approving Panel under sub-section (4) of section 144BA after the expiry of two months from the end of the month in which the final submission of the assessee in response to the notice issued under section 144BA(2) is received;

iii. The Commissioner shall issue directions to the Assessing Officer in Form No.3CEH within a period of one month from the end of month in which the reference is received by him. While, the said time-limit is increased to two months in cases where the final submissions of the assessee in response to the notice issued under section 144BA(2) is received by the Commissioner.

As per Rule 10UD of the Income Tax Rules, 1962, a reference under sub-section (4) of section 144BA to an Approving Panel shall be made in the Form No. 3CEIA along with a copy of Form No. 3CEI and such other documents which the Principal Commissioner or the Commissioner deems fit and to be submitted in four sets, either in Hindi or English.

Rule 10UE lays down the procedure before the Approving Panel as under:

i. A reference received under rule 10UD shall be caused to be circulated by the Chairperson of the said Panel among the other members within seven days from the date of receipt of such reference.

ii. The Chairperson of the Approving Panel shall cause to be issued the notice to the Assessing Officer and the assessee affording an opportunity of being heard specifying therein the date and place of hearing.

iii. The meetings of the Approving Panel shall take place at such place as the Approving Panel may decide.

As per Rule 10UF of the Income Tax Rules, 1962, for attending the meeting of an Approving Panel, the Chairperson and other members of the said Panel shall be entitled to –

i. a sitting fee of six thousand rupees per day; and

ii. travelling allowances including transportation charges for local travel and daily allowances (including accommodation) as admissible to an officer of the rank of Special Secretary to the Government of India.

Also along with the above, the expenditure of an Approving Panel shall be met from the budgetary grants of the Department of Revenue in the Ministry of Finance of the Central Government.

Considering the subjectivity around GAAR, stakeholders and industry associations requested the government to issue directions or clarifications on various issues. CBDT constituted a working group in June 2016 to provide their comments on the issue. CBDT on January 27, 2017 issued clarifications on implementation of GAAR which are briefly covered as under:

1) Tax treaty v. GAAR

If there is limitation of benefit clause in tax treaty that sufficiently addresses tax avoidance, GAAR will not be invoked. However, if some tax avoidance strategies are not addressed by LOB clause, those can be tackled by GAAR.

GAAR will not be invoked merely on the argument on that the taxpayer is located in a tax efficient jurisdiction. If the jurisdiction of a FPI is finalised based on non-taxed commercial considerations and the main purpose of the engagement is not to obtain tax benefits, GAAR would not apply.

2) Application of specific provisions v. GAAR

If the law allows taxpayer to select between two alternatives of implementing a transaction, GAAR cannot be invoked by tax authorities to challenge the alternative selected by the taxpayer.

Even if an arrangement satisfies specific anti-avoidance rule (SAAR) provided in law, it can still be subject to GAAR as SAAR may not address all situations of abuse of the law by taxpayers. GAAR provisions are generic and therefore can co-exist with SAAR.

If a treaty benefit claim is made in one year by taxpayer and the tax payer opts to be governed by the domestic law in another year, GAAR will not deny such a claim.

3) Judicial Interpretation

GAAR will be invoked only in deserving cases which are highly aggressive and artificial and not there is a difference in interpretation. There is a two-step approval process in place GAAR provisions can be invoked.

If the approving authorities (Commissioner / Approver Panel) has rejected the tax officer's request to invoke GAAR provisions in respect of an arrangement in any year, GAAR cannot be invoked in respect of such arrangement in subsequent years provided the facts and circumstances remain the same.

GAAR would not apply to an arrangement in respect of which an advance ruling has been obtained from the Authority for Advance Rulings.

GAAR will not be applied to an arrangement sanctioned by the Court where the Court has explicitly and adequately considered the tax implications of the arrangement.

4) Grandfathering benefit

Grandfathering benefit would be available to an investor on shares acquired after March 31, 2017, if the shares acquired by such investor through conversion of compulsorily convertible instruments (eg. compulsorily convertible preference shares or debentures) issued before April 1, 2017 provided the terms of conversion were finalised at the time of original acquisition of such instruments. Also grandfathering provisions would be available for shares acquired in a share split or consolidation or through bonus issue, provided the original shares were acquired before April 1, 2017.

Grandfathering benefit is not available to lease contracts and loan arrangements as the same are not 'investments'.

5) GAAR – as deterrent

An impermissible avoidance arrangement will be disregarded by application of GAAR provisions and necessary consequences will follow (including penalty).

Period of time for which an arrangement exists is only a relevant factor and not a sufficient factor to determine whether an arrangement lacks substance and accordingly, a definite timeline of existence of arrangement is not required.

GAAR is an anti-avoidance provision with deterrent consequences. Therefore, in event of a particular consequence being applied in the hands of one of the participants as a result of GAAR provisions, corresponding adjustment in the hands of another participant will not be made.

GAAR provision apply to tax benefit enjoyed in Indian jurisdiction due to an impermissible arrangement or part of arrangement and does not extend to tax consequences, on a net basis or otherwise, across territories. Further, the exemption limit for tax benefit upto Rs. 3 crores cannot be restricted to a single taxpayer alone and impact on all parties to the arrangement to be considered.

Meaning of key terms used in the chapter X-A [Section 102]

In this Chapter, unless the context otherwise requires,—

(1) "arrangement" means any step in, or a part or whole of, any transaction, operation, scheme, agreement or understanding, whether enforceable or not, and includes the alienation of any property in such transaction, operation, scheme, agreement or understanding;

(2) "asset" includes property, or right, of any kind;

(3) “benefit” includes a payment of any kind whether in tangible or intangible form;

(4) "connected person", means any person who is connected directly or indirectly to another person and includes —

(a) any relative of the person, if the person is an individual;

(b) any director of the company or any relative of such director, if the person is a company;

(c) any partner or member of a firm or association of persons or body of individuals or any relative of such partner or member if the person is a firm or association of persons or body of individuals;

(d) any member of the Hindu undivided family or any relative of such member, if the person is a Hindu undivided family;

(e) any individual who has a substantial interest in the business of the person or any relative of such individual;

(f) a company, firm or an association of persons or a body of individuals, whether incorporated or not, or a Hindu undivided family having a substantial interest in the business of the person or any director, partner, or member of the company, firm or association of persons or body of individuals or family, or any relative of such director, partner or member;

(g) a company, firm or association of persons or body of individuals, whether incorporated or not, or a Hindu undivided family, whose director, partner, or member has a substantial interest in the business of the person, or family or any relative of such director, partner or member;

(h) any other person who carries on a business, if—

(i) the person being an individual, or any relative of such person, has a substantial interest in the business of that other person; or

(ii) the person being a company, firm, association of persons, body of individuals, whether incorporated or not, or a Hindu undivided family, or any director, partner or member of such company, firm or association of persons or body of individuals or family, or any relative of such director, partner or member, has a substantial interest in the business of that other person;

(5) "fund" includes—

(a) any cash;

(b) cash equivalents; and

(c) any right, or obligation, to receive, or pay, the cash or cash equivalent;

(6) "party" includes a person or a permanent establishment which participates or takes part in an arrangement;

(7) "relative" shall have the meaning assigned to it in the Explanation to clause (vi) of sub-section (2) of section 56;

(8) a person shall be deemed to have a substantial interest in the business, if—

(a) in a case where the business is carried on by a company, such person is, at any time during the financial year, the beneficial owner of equity shares carrying twenty per cent or more, of the voting power; or

(b) in any other case, such person is, at any time during the financial year, beneficially entitled to twenty per cent or more, of the profits of such business;

(9) "step" includes a measure or an action, particularly one of a series taken in order to deal with or achieve a particular thing or object in the arrangement;

(10) "tax benefit" means—

a) a reduction or avoidance or deferral of tax or other amount payable under this Act; or

b) an increase in a refund of tax or other amount under this Act; or

c) a reduction or avoidance or deferral of tax or other amount that would be payable under this Act, as a result of a tax treaty; or

d) an increase in a refund of tax or other amount under this Act as a result of a tax treaty; or

e) a reduction in total income or an increase in loss,

in the relevant previous year or any other previous year.

(11) "tax treaty" means an agreement referred to in sub-section (1) of section 90 or sub-section (1) of section 90A.

Chapter 11
Concessional Tax Rates for NRIs

Chapter XII-A has been introduced in the Income-tax Act, 1961 with effect from June 01, 1983. This chapter contains seven sections viz. 115C to 115I.

The provisions of this chapter are applicable to a non-resident Indian who invests in certain foreign exchange assets and who derives investment income and/or long-term capital gains in respect thereof.

A non-resident Indian is defined to mean an individual who is not resident in India as defined in section 6 of the Act. It is irrelevant whether he is a citizen of India or not so long as he is a person of Indian origin. A person is deemed to be a person of Indian origin if he or either of his parents or any of his grandparents were born in undivided India.

According to clause (b) of section 115C a "foreign exchange assets" means any specified assets, which the assessee has acquired or purchased with, or subscribed to in convertible foreign exchange.

As per clause (f) of section 115C the following are specified assets.

(i) Share in an Indian company;

(ii) Debentures issued by an Indian company which is not a private company as defined in the Companies Act, 2013;

(iii) Deposits with an Indian company which is not a private company as defined in the Companies Act, 2013;

(iv) Any securities of the Central Government as defined in clause (2) of section 2 of the Public Debt Act, 1944;

(v) Such other assets as notified by the Central Government.

Section 115D makes special provisions for computation of "investment income" of a non-resident Indian. Clause (c) of section 115C defines an "Investment Income" to mean any income derived from a foreign exchange asset.

According to section 115D(1), while computing the "Investment income" of a non-resident Indian, no deduction is allowed under any provision of the Act in respect of any expenditure or allowance. Thus making the gross investment income taxable at the rate specified in section 115E, unless the assessee

exercises the option under section 115I of being not governed by chapter XIIA.

Section 115D(2) further provides that no deduction be allowed to a non-resident Indian assessee under chapter VIA (i.e. sections 80A to 80U) from his "investment income" or income by way of long term capital gains or both. However, it does not prohibit for allowance of rebate under section 88 [CIT v. K. C. John [2003] 264 ITR 715 (Kerala HC)].

Clause (d) of section 115C defines "long term capital gains" to mean income chargeable under the head "capital gains" relating to a capital asset being a foreign exchange asset which is not a short term capital assets.

Further, section 115D(2) also provides that no deduction be allowed under sub section (2) of section 48 while computing investment income or income by way of long-term capital gains.

Section 115E provides for tax rate on investment income and long term capital gains. Under this section, the investment income and long-term capital gains of non-resident Indians are to be treated as a separate block and charged to tax at flat rates. Investment income to be taxed at 20% plus surcharge and long term capital gains from transfer of specified assets to be taxed at 10% plus surcharge.

Non-Resident Ordinary (NRO) deposit acquired with convertible foreign exchange in a banking company, which is not a private company as per Companies Act, 1956, shall be treated as a 'foreign exchange asset' under section 115C(b). The interest on such NRO deposit shall be treated as investment income under section 115C(c) which is liable to be taxed as section 115E. [V. Ravi Narayanan, In re [2008] 300 ITR 62 (AAR Delhi)]

The point for consideration is whether the benefit of the confessional tax rate is applicable to short term capital gains by treating the same as investment income?

Similar question arose before the Mumbai Tribunal in Sunderdas Haridas v. ACIT [1998] 67 ITD 89. In that case, the facts were, the assessee, being a non-resident Indian to whom the provisions of Chapter XIIA of the Act applied, claimed that the short-term capital gain was of the nature of investment income as defined under section 115C and so should be taxed at concessional rate of 20% stipulated in section 115E. The Assessing Officer rejected the claim on the ground that the concessional rate applied only to long-term capital gains and investment income, which did not include the

short-term capital gain. The Commissioner (Appeals) concurred with the Assessing Officer.

In appeal by the assessee, the Tribunal held that the word "investment income" used in section 115E does not include within its scope short-term capital gains. If this word is so construed as to include short-term capital gains within its scope the expression "income by way of long-term capital gains or both" figuring in section 115D and 115E would be rendered otiose.

Further, the Tribunal observed that income derived from an asset can be only of two types i.e. income as normally construed or capital gains. The Act has consistently made a distinction between short term capital gains and long term capital gains, both for applying the tax rates and set off of losses. If the benefit of concessional tax rate is extended even to short term capital gains by including the short term capital gains within the scope of the expression "investment income" used in section 115E, such an approach would overlook the distinction consistently made in the Act between the short term capital gains and long term capital gains and also render the expression "long term capital gains or both" redundant. The same is reiterated by the Bombay HC in the case of CIT v. Sham L. Chellaram [2015] 373 ITR 292.

Long-term capital gains earned by a non-resident on transfer of bonus shares which resulted from original investment of shares made out of convertible foreign exchange is eligible to be taxed at concessional rate of 10 per cent under section 115E. [Smt. Deivanayagam Maruthini v. DDIT [2012] 51 SOT 163 (Chennai Tribunal)]

In Hari Gopal Chopra v. CIT, [1999] 237 ITR 135, the authority for advance ruling held that every nationalized bank is deemed to be an Indian Company for purpose of the Income tax Act and assets deposited in such a bank would be specified assets within meaning of section 115C.

Section 115F sets out the circumstances on fulfillment whereof "long term capital gains" arising from transfer of a foreign exchange asset are not to be charged, if the assessee invests net proceeds realized on such transfer within six months from the date of transfer in any of the 'specified assets' as defined in section 115C(f) or in saving certificate referred to in section 10(4B).

If the entire net proceeds so realized are so invested within the stipulated period, then, the whole of the "long term capital gains" is exempt from tax. However, if only a portion of the net proceeds so realized is so invested within the stipulated period, the exemption from tax in respect of long term capital gains is allowed on proportion basis.

In order to earn the exemption as stated above, the new asset must be continue to be held by the assessee for at least three years from the date of its acquisition. In case where the new assets is transferred or converted, otherwise than by a transfer, into money by the assessee within a period of three years from the date of acquisition, the amount of capital gains arising from the transfer of the original assets exempted from tax on the basis of the acquisition of the new assets is deemed to be long term capital gains chargeable to tax in the year in which the transfer or conversion (otherwise than by transfer) into money, of the new asset takes place.

The bonus shares acquired by the assessee, where the original shares were acquired by investing in convertible foreign exchange, were covered by section 115C(b), and the same were eligible for benefit under section 115F. [Sanjay Gala v. ITO [2011] 46 SOT 482 (Mumbai Tribunal)]. The same is reiterated by the Hyderabad Tribunal in the case of Shashi Parvatha Reddy v. DCIT(IT) [2017] 167 ITD 587.

Section 115G prescribes that, in the following circumstances a non resident Indian, although having taxable income, need not file a return of income under section 139(1), if

(a) the non resident Indian's income consists only of "investment income" or income by way of "long term capital gains" or both

and

(b) the tax deductible at source from such income has been deducted.

Section 115H enables a non resident Indian assessee to avail the benefit of Chapter XII-A in relation to investment income derived from debentures (not shares) and deposit with an Indian public limited company and also from Central Government securities or other specified asset even for a subsequent year wherein he become resident in India. In order to avail such benefit, the assessee has to furnish a declaration in writing alongwith his return of income for such subsequent years to that effect. On such declaration having been filed, the provisions of chapter XII-A shall continue to apply in relation to such income for such subsequent year and every year thereafter until the transfer or conversion (other than by transfer) into money of such assets.

In Dr. M. Manohar v. ACIT [2011] 339 ITR 49, the Madras High Court held that where assessee received interest on investment made out of foreign funds which was chargeable to tax at concessional rate under section 115H,

said special treatment could not be extended to interest on interest redeposited with original sum.

In the case of CIT v. M.C. George [2011] 243 CTR 404, a question arose before the Kerala High Court whether transfer of specified asset without affecting its character would affect its identity as a foreign exchange asset for purpose of section 115H. In the instant case, assessee, as a non-resident Indian, made deposits in Indian bank in convertible foreign exchange under Non-Resident Non-Repatriable Scheme (NRNR). Later on, assessee became a resident of India and he transferred NRNR accounts from banks in which original deposits were made to other scheduled banks.

Assessing Officer held that assessee was not entitled to concessional rate of tax under section 115H, read with section 115E, for reason that transferred NRNR deposits had ceased to be foreign exchange assets.

The High Court held that so long as original source of deposit was convertible foreign exchange, transfer of such foreign exchange asset, namely, deposit, from one bank to another bank would not affect its identity as a foreign exchange asset and, therefore, assessee was entitled to concessional rate of tax on interest earned from NRNR deposits under section 115H, read with section 115E.

Section 115I gives an option to a non resident Indian to elect that he should not be governed by the special provisions of chapter XII –A for any particular assessment year. Such option can be exercised by making a declaration in the relevant column of return of income for that assessment year. In case where such an option is exercised by a non-resident Indian, the whole of his total income including “investment income” and “long term capital gains” is to be charged to tax under the general provisions of the Act.

Special provisions for computing income by way of royalties etc. in the case of foreign companies

Section 44D of the Act lays down special provision for computing income by way of royalties and fees for technical services received by foreign companies from Government or an Indian concern. Where such income is received in pursuance of an agreement made after March 31, 1976, section 44D(b) provides that the gross amount of income by way of royalties for fees for technical services received by such foreign companies without any deduction, expenditure or allowance is chargeable to tax at the rates specified in section 115A.

Section 115A provides that royalties or fees for technical services received by foreign companies will be taxed at concessional rate of 20% only if the agreement with an Indian concern under which these royalties or fees for technical services are received is approved by the Central Government or relates to a matter that is covered under the Industrial policies.

The Act has amended clause (b) of section 44D by inserting a sun-set clause and has made this section inoperative in respect of agreements entered after March 31, 2003.

With a view to harmonies the provisions relating to the income from royalty or fees for technical services attributable to a fixed place of profession or permanent establishment in India with similar provisions in various DTAA, the Act has inserted a new section 44DA in the Act. This section provides that income by way of royalty or fees for technical services received from Government or an Indian concern in pursuance of an agreement made by a non-resident or a foreign company with Government or the Indian concern after March 31, 2003 shall be computed under the head 'Profits and gains of business or profession' in accordance with the provisions of the Act. However, the provisions of the said section shall apply only if the non-resident or a foreign company carries on business in India through permanent establishment situated in India or performs professional services from a fixed place of profession situated in India, and the right, property or contract in respect of which the royalty or fees for technical services are paid is effectively connected with such permanent establishment or fixed place of profession, as the case may be. It has also been provided that no deduction shall be allowed –

(i) in respect of any expenditure or allowance which is not wholly and exclusively incurred for the business of such permanent establishment or fixed place of profession in India; and

(ii) in respect of amounts, if any, paid (otherwise than towards reimbursement of actual expenses) by the permanent establishment to its head office or to any of its other offices.

The section also requires that every non-resident or a foreign company shall keep and maintain books of account and other documents in accordance with the provisions of section 44AA and get the accounts audited by an accountant as defined in the explanation to section 288 to and furnish alongwith the return of income, the report of such audit in the prescribed form duly signed and verified by such accountant.

Tax on dividend, royalty and technical service fee in the case of foreign companies [Section 115A]

Section 115A of the Act, provides that the income of a non-resident or a foreign company, by way of

(i) dividends; or

(ii) interest received from Government or an Indian concern on monies borrowed or debt incurred by Government or the Indian concern in foreign currency not being interest received from infrastructure debt fund set up in accordance with the guidelines as may be prescribed, which is notified by the Central Government in the Official Gazette for the purpose of this clause or interest of the nature and extent referred to in section 194LC; or

(iii) income received in respect of units, purchased in foreign currency, of mutual fund under section 10(23D) or Unit Trust of India; shall be taxed @ 20%; or

(iv) interest received from infrastructure debt fund set up in accordance with the guidelines as may be prescribed, which is notified by the Central Government in the Official Gazette for the purpose of this clause; or

(v) interest of the nature and extent referred to in section 194LC; or

(vi) interest of the nature and extent referred to in section 194LD; or

(vii) distributed income being interest referred to in sub-section (2) of section 194LBA; shall be taxed @ 5%.

If a non-resident or a foreign company includes any income by way of royalty or fees for technical services received from Government or Indian concern in pursuance of an agreement made by the foreign company with Government or the Indian concern after March 31,1997 and where such agreement is with an Indian concern and the agreement is approved by the Central Government or where it relates to a matter included in the industrial policy of the Government of India and the agreement is an accordance with that policy, the income tax shall be payable @ 10%.

If the royalty is in consideration for the transfer of all or any rights (including granting of a license) in respect of copyright in any book to an Indian concern or in respect of any computer software to a person resident in India shall be taxed @ 10% provided that-

(a) such book is on a subject, which are permitted according to the Import Trade Control Policy of the Government of India for the period commencing on April 1,1977 and ending with March 31,1978 be imported into India under an open General License;

(b) Such computer software is permitted according to the Import Trade Control Policy of the Government of India under an open General License.

It has also been provided that no deduction in respect of any expenditure or allowance shall be allowed under section 28 to 44C and section 57 in computing the aforesaid income of non-resident and foreign companies. Further, no deduction shall be allowed under chapter VIA of the Act. However, if, the gross total income includes the aforesaid incomes, the deduction under chapter VIA shall be allowed from the gross total income as reduced by the said incomes.

It has further been provided that it shall not be necessary for the assessee to furnish a return of their income under section 139(1); if

(a) the total incomes in respect of which they are assessable under the Act consists only incomes referred above and

(b) the tax deductible at source under the provisions of Part B of Chapter XVII has been deducted from such income and the rate of such deduction is not less than the rate specified (effective from 1st April 2020, vide Finance Act, 2020). .

Tax on income from units purchased in foreign currency or capital gains arising from their transfer in case of Offshore Fund [Section 115AB]

Section 115AB(1) provides that where the total income of the assessee, being overseas financial organization (hereinafter referred to as Offshore Fund) includes:

(a) Income received in respect of units purchased in foreign currency or

(b) Income by way of long term capital gains arising from the transfer of units purchased in foreign currency;

the income tax payable shall be aggregate of:

(i) the amount of income tax calculated on the income in respect of units referred above, @ 10% plus surcharge;

(ii) the amount of income tax calculated on the income by way of long term capital gains referred above, @ 10% plus surcharge and

(iii) the amount of income-tax with which the offshore fund would have been chargeable had its total income been reduced by aforementioned income.

According to section 115AB(2), when the gross total income of Offshore Fund consists only of income from units or income by way of long term capital gains arising from the transfer of units, or both, no deduction shall be allowed to the assessee under sections 28 to 44C or section 57(i) or 57(iii) or under chapter VIA and nothing contained in the provisions of the second proviso to section 48 shall apply to income referred to in clause (b) of sub-section (1);.

Further where the gross total income of the Offshore Fund includes any income from units or income by way of long term capital gains arising from the transfer of units, or both, the gross total income shall be reduced by the of amount of such income and the deduction under chapter VIA shall be allowed as if the gross total income as so reduced were the gross total income of the assessee

"Overseas financial organization" is defined so as to mean any fund, institution, association or body, whether incorporation or not, established under the laws of a country outside India, which has entered into an arrangement for investment in India with any public sector bank or public financial institution or a mutual fund specified under section 10(23D) and such arrangement is approved by the SEBI established under the Securities and Exchange Board of India Act, 1992 for this purpose.

Effective from April 1, 2003 income of units of specified mutual funds is exempt under section 10(35) of the Income-tax Act.

Similarly, effective from April 1, 2005 long-term capital gains in respect of units of equity oriented funds or unit of a business trust is exempt under section 10(38) of the Income-tax Act. However, vide Finance Act 2018, long-term capital gains on sale of equity oriented mutual funds or units of a business trust are brought back under the tax net (section 112A) subject to satisfaction of the specified conditions.

Tax on income from bonds or shares purchased in foreign currency or capital gains arising from the transfer in case of non-resident [Section 115AC]

According to section 115AC(1), where the total income of an assessee, being a non-resident includes:

(a) income by way of interest, on bonds of an Indian company, issued in accordance with such scheme as notified by the Central Government in this behalf or bonds of a public sector company, sold by the Government and purchased by him in foreign currency; or

(b) income by way of dividends on Global Depository Receipts subject to conditions specified; or

(c) income by way of long term capital gains arising from the transfer of such bonds or shares the income tax payable shall be @10%

Accordingly to section 115AC(2) provides that where the gross total income of the non-resident consists only of the aforesaid income no deduction shall be allowed to him under section 28 to 44C or section 57(i) or 57(iii) or under chapter VIA.

Section 115AC(3) provides nothing contained in the first and second proviso s to section 48 shall apply for the computation of long-term capital gains arising out of the transfer of long term capital asset, being bonds or Global Depository Receipts referred to in section 115AC(1)(c).

By virtue of section 115AC(4), it shall not be necessary for a non-resident to furnish under section 139(1), a return of income if his total income in respect of which he is assessable under the Act during the previous year consisted only of income referred to in section 115AC(1)(a) / 115AC(1)(b), and the tax deductible at source under the provisions of chapter XVIIB has been deducted from such income.

Section 115AC(5) provides that where the assessee acquired Global Depository Receipts or bonds in an amalgamated or resulting company by virtue of his holding Global Depository Receipts or bonds in the amalgamating or demerged company, in accordance with the provisions of sub section (1), the concessional tax treatment accorded to the original Global Depository Receipts or bonds, would continue to apply such Global Depository Receipts or bonds.

Tax on income of Foreign Institutional Investors from Securities or Capital gains arising from their transfer [Section 115AD]

Section 115AD(1) provides that when the total income of specified fund or Foreign Institutional Investor includes:

(a) income received in respect of securities (other than units referred to in section 115AB); or

(b) income by way of short term or long-term capital gains arising from the transfer of such securities,

the income tax payable shall be the aggregate of:

(i) the amount of income tax calculated on the income in respect of securities referred to in section 115AD(1)(a), if any, included in the total income @ 20% in case of Foreign Institutional Investor and @10% in case of specified fund;.

(ii) the amount of income tax calculated on the income by way of short term capital gains referred to in section 115AD(1)(b), if any, included in the total income @ 30%. However, if the transaction of sale of equity share in a company or a unit of equity oriented fund is entered into on or after October 1, 2004, then such transaction is chargeable under Security Transaction Tax and therefore in such case short term capital gains shall be payable @ 15%;

(iii) the amount of income tax calculated on the income by way of long term capital gains referred to in section 115AD(1)(b), if any included in the total income @ 10%, and

(iv) Further, with effect from AY 2019-20, long-term capital gains arising from the transfer of specified securities like equity shares or a unit of an equity oriented fund or a unit of a business trust (on an amount exceeding Rs.1 lakh) is taxable at the rate of 10%.

(v) the amount of income tax with which the foreign Institutional Investor would have been charged had its total income reduced by the amount of income referred in section 115AD(1)(a) and 115AD(1)(b).

As per section 115AD(1A), Notwithstanding anything contained in sub-section (1), in case of specified fund, the provision of this section shall apply only to the extent of income that is attributable to units held by non-resident

(not being a permanent establishment of a non-resident in India) calculated in the prescribed manner

By virtue of section 115AD(2), where the gross total income of specified Fund or Foreign Institutional Investor consists only of income in respect of securities referred to in section 115AD(1)(a), no deduction shall be allowed to it under section 28 to 44C or section 57(i) or 57(iii) or under chapter VIA. Further, where the gross total income of the Foreign Institutional Investor includes any income referred to in section 115AD(1)(a) or section 115AD(1)(b), the gross total income shall be reduced by the amount of such income and the deduction under chapter VIA shall be allowed as if the gross total income as so reduced, were the gross total income of the specified Fund or Foreign Institutional Investor.

Further, as per section 115AD(3), nothing contained in the first and second provisos of section 48 shall apply for the computation of capital gains arising out of the transfer of securities referred to in section 115AD(1)(b).

Clause (a) of Explanation to section 115AD defines the expression the expression "permanent establishment" shall have the meaning assigned to it in clause (iiia) of section 92F

Clause (b) of Explanation to section 115AD defines the expression "securities" shall have the meaning assigned to it in clause (h) of section 2 of the Securities Contracts (Regulation) Act, 1956

Clause (c) of Explanation to section 115AD defines the expression “securities means the meaning assigned to section 2(h) of the Securities Contracts (Regulation) Act, 1956

Clause (d) of Explanation to section 115AD defines the expression "specified fund" shall have the same meaning assigned to it in clause (c) of the Explanation to clause (4D) of section 10.

In case of Foreign Institutional Investor’s loss incurred from transactions in derivatives was to be treated as capital loss and not as business loss [Platinum Investment Management Ltd. v. DDIT [2013] 33 taxmann.com 298 (Mumbai Tribunal)]

Tax on non-resident sportsman or sports association [Section 115BBA]

Section 115BBA provides that the income of an assessee who is a sportsman (including an athlete) or an entertainer, who is not citizen of India

and is a non-resident will be chargeable to tax at the flat rate of 20% plus surcharge of the gross payment due to them. This rate will also be applicable in respect of income derived by non-resident sportsmen from their other activities like participating in advertisement and writing in newspapers etc.

Further, income of a non-resident sport association or institution includes any amount guaranteed to be paid or payable in relation to any game or sports played in India shall be chargeable to tax @ 20% plus surcharge.

It has also been prescribed that in such cases, there will be no necessity for filing the return of income by such non-resident, once tax has been deducted at source. It has been prescribed that the person responsible for paying any sum to these non-resident sport bodies/players will be required to deduct the tax at source @ 20% plus surcharge of the gross payments.

Calcutta High court in the case of Indocom v. CIT (335 ITR 485) held that payments made to the umpires or match referees do not come within the purview of section 115BBA because the umpires and match referees are neither sportsman nor are they non-resident sports associations or institutions so as to attract the provisions of section 115BBA.

In the case of Pilcom v. C.I.T. West Bengal [2020] 425 ITR 312 (SC)] Non-resident Sports Associations had participated in an event, where cricket teams of these Associations had played various matches in the country. Though the payments were described as Guarantee Money, they were intricately connected with the event where various cricket teams were scheduled to play and did participate in the event. The source of income, was in the playing of the matches in India

The mandate under Section 115 BBA (1)(b) is also clear in that if the total income of a Non-resident Sports Association includes the amount guaranteed to be paid or payable to it in relation to any game or sports played in India, the amount of income tax calculated in terms of said Section shall become payable. The expression 'in relation to' emphasises the connection between the game or sport played in India on one hand and the Guarantee Money paid or payable to the Non-resident Sports Association on the other. Once the connection is established, the liability under the provision must arise.

The Judgement is cogent in its approach as it first determines that Income chargeable to tax is derived from India, covered under section 9(1) of the Act, Secondly the income so generated is taxable under section 115BBA of the Act and at last the machinery provision section 194E become applicable

once income under section 115BBA of the Act is chargeable to tax by Indian Revenue Department.

Special provisions relating to conversion of Indian branch of a foreign bank into a subsidiary Indian company [Section 115JG]

Where a foreign company is engaged in the business of banking in India through its branch situate in India and such branch is converted into a subsidiary Indian company thereof, in accordance with the scheme framed by the Reserve Bank of India, then, subject to conditions notified by central government,—

(i) the capital gains arising from such conversion shall not be chargeable to tax;

(ii) the provisions relating to treatment of unabsorbed depreciation, set off or carry forward and set off of losses, tax credit and the computation of income in the case of the foreign company and the Indian subsidiary company shall apply with such exceptions, modifications and adaptations as may be specified in that notification.

In case of failure to comply with any of the conditions notified, all the provisions of this Act shall apply to the foreign company and the said Indian subsidiary company without any benefit, exemption or relief under section 115JG(1).

In case in a previous year, any benefit, has been claimed and granted to the foreign company or the Indian subsidiary company and, subsequently, there is failure to comply with any of the conditions notified then,—

(i) such benefit, exemption or relief shall be deemed to have been wrongly allowed;

(ii) the Assessing Officer may, re-compute the total income of the assessee for the said previous year and make the necessary amendments; and

(iii) the provisions of section 154 shall apply and the period of four years shall be reckoned from the end of the previous year in which the failure to comply with the condition takes place.

Every notification issued under this section shall be laid before each House of Parliament.

Special provisions relating to foreign company said to be resident in India [Section 115JH]

Section 115JH provides that where a foreign company is said to be resident in India in any previous year and such foreign company has not been resident in India in any of the previous years preceding the said previous year, then, notwithstanding anything contained in this Act and subject to the conditions as may be notified by the Central Government in this behalf, the provisions of this Act relating to the computation of total income, treatment of unabsorbed depreciation, set off or carry forward and set off of losses, collection and recovery and special provisions relating to avoidance of tax shall apply with such exceptions, modifications and adaptations as may be specified in that notification for the said previous year:

However, where the determination regarding foreign company to be resident in India has been made in the assessment proceedings relevant to any previous year, then, the provisions of section 115JH(1) shall also apply in respect of any other previous year, succeeding such previous year, if the foreign company is resident in India in that previous year and the previous year ends on or before the date on which such assessment proceeding is completed.

In case in a previous year, any benefit, has been claimed and granted to the foreign company or the Indian subsidiary company and, subsequently, there is failure to comply with any of the conditions notified then,—

(i) such benefit, exemption or relief shall be deemed to have been wrongly allowed;

(ii) the Assessing Officer may re-compute the total income of the assessee and make the necessary amendment as if the exceptions, modifications and adaptations referred to in sub-section (1) did not apply; and

(iii) the provisions of section 154 shall apply and the period of four years shall be reckoned from the end of the previous year in which the failure to comply with the condition takes place.

Every notification issued under this section shall be laid before each House of Parliament. Notification No. 29/2018 dated 22nd June 2018 has been issued by Central Board of Direct Taxes in this regard.

Chapter 12
Basic Tax Rates Applicable for Non Resident Taxation in India

Introduction

In this section various taxes applicable to non-residents are discussed, in brief.

Slab Rates

The income tax rates in India are different for different categories and status of tax payers. The Income Tax rates for Individuals, HUFs, AOP, BOI and Co-operatives are progressive in nature, where a lower tax rate is imposed on low-income earners compared to those with higher income, making it based on the taxpayer's ability to pay. That means it takes a larger percentage from high-income earners than it does from low-income earners. Individuals, HUFs, AOP, BOI and Co-operatives are taxed as per different slab rates (varies from Nil to 30%). However, Firms and Companies are taxed on fixed rate basis, except for certain specified incomes.

When income exceeds a specified limit(s), Surcharge on Income Tax is charged at specified rate on income tax. The specified limit(s) for charging Surcharge and Surcharge rates are different for different categories of tax payers.

Further, cess (Health and Education) is charged at specified rate on (income tax + Surcharge, both).

From Assessment Year 2021-22, Individuals and HUFs (including Resident Individual below 60 years of age, Senior Citizen, Very Senior Citizen, Non-resident Individual, Hindu Undivided Family (HUF), Association of Persons (AOP), Body of Individuals (BOI) and Artificial Judicial Person (AJP)) will have option for computation of income and income tax liability as per provisions of Section 115BAC.

New Income Tax Slab for Non-residents : Individual / HUF / AOP / BOI(New Regime) – AY 2020-21 (Section 115BAC):

Income Tax Slab	Income Tax
Below 2.5 Lacs	No Tax
2.5 Lacs- 5.0 Lacs	5% (taxable income - 2,50,000). In case, taxable income is upto Rs. 5 lacs, the tax payable shall be nil on account of Tax Relief u/s 87A)
5.0 Lacs- 7.5 Lacs	₹ 12,500/- + 10% of (total income - 5,00,000)
7.5 Lacs – 10.0 Lacs	₹ 37,500/- + 15% of (total income - 7,50,000)
10.0 Lacs – 12.5 Lacs	₹ 75,000/- + 20% of (total income - 10,00,000).
12.5 Lacs – 15.0 Lacs	₹ 125,000/- + 25% of (total income - 12,50,000
Above 15 Lacs	₹ 187,500/- + 30% of (total income - 15,00,000)
Surcharge (subject to Marginal Relief)	10% of Income Tax, in case taxable income is above ₹ 50 lacs. 15% of Income Tax, in case taxable income is above ₹ 1 crore. 25% of Income Tax, in case taxable income is above ₹ 2 crore. 37% of Income Tax, in case taxable income is above ₹ 5 crore.
Health and Education Cess	4% of (Income Tax + Surcharge).

Note – The above rate is applicable if a non-resident does not avails exemptions that are available to reduce tax. Non-Resident (NR) also has the option to pay tax as per earlier rates if NR thinks exemptions and tax saving instruments are beneficial for him.

Old Income Tax Slab for Non-resident : Individual / HUF / AOP / BOI (Not opting computation of Income under proposed Section 115BAC (Old Regime) – AY 2020-21:

Income Tax Slab	Income Tax
Below 2.5 Lacs	No Tax
2.5 Lacs- 5.0 Lacs	5% of (taxable income – 2,50,000)
5.0 Lacs- 10.0 Lacs	₹ 12,500/- + 20% of (taxable income - 5,00,000)
Above 10 Lacs	₹ 112,500/- + 30% (taxable income - 10,00,000)
Surcharge (subject to Marginal Relief)	10% of Income Tax, in case taxable income is above ₹ 50 lacs. 15% of Income Tax, in case taxable income is above ₹ 1 crore. 25% of Income Tax, in case taxable income is above ₹ 2 crore. 37% of Income Tax, in case taxable income is above ₹ 5 crore.
Health and Education Cess	4% of (Income Tax + Surcharge).

Non-resident : Corporate (Foreign Company)

Nature of Income	Tax Rate
Royalty received from Government or an Indian concern in pursuance of an agreement made with the Indian concern after March 31, 1961, but before April 1, 1976, or fees for rendering technical services in pursuance of an agreement made after February 29, 1964 but before April 1, 1976 and where such agreement has, in either case, been approved by the Central Government	50%
Any other income	40%
Surcharge (subject to Marginal Relief)	2% of income tax, in case taxable income is above ₹ 1 crore.

Nature of Income	Tax Rate
	5% of income tax, in case taxable income is above ₹ 10 crores.
Health and Education Cess	4% of (Income Tax + Surcharge).

Taxability of Income

• Income from Salary

If any Non-resident earns any salary in India in any financial year or in any part of financial year, then the NR has to pay income tax as per the income tax slab that is applicable to him for the total income earned in India.

• Income from interest in Resident Accounts

A NR might have earned interest on deposits (not being term deposits) in a savings account. The interest earned in Fixed deposits and savings accounts etc., are to be added to the total income and taxed as per income tax slab applicable. As per section 80TTA, deduction up to Rs. 10,000 is allowed on interest income from bank savings accounts.

• Income from House Property

Income from a property which is situated in India is taxable for an NR. The calculation of such income shall be in the same manner as for a resident. This property may be rented out or lying vacant. An NRI is allowed to claim a standard deduction of 30%, deduct property taxes, and take benefit of an interest deduction if there is a home loan. The NRI is also allowed a deduction for principal repayment under Section 80C. Stamp duty and registration charges paid on the purchase of a property can also be claimed under Section 80C. Income from house property is taxed at slab rates as applicable. Example; Nandini owns a house property in Goa and has rented it out while she lives in Bangkok. She has set up the rent payments to be received directly in her bank account in Bangkok. Nandini's income from this house which is in India shall be taxable in India.

• Income from Dividend

The dividend income, in the hands of a non-resident person (including FPIs and nonresident Indian citizens (NRIs)), is taxable at the rate of 20% ((plus

applicable surcharge and cess) without providing for deduction under any provisions of the Income-tax Act. However, where the dividend is [As amended by Finance Act, 2020] received in respect of GDRs of an Indian Company or Public Sector Company (PSU) purchased in foreign currency, the tax shall be charged at the rate of 10% (plus applicable surcharge and cess) without providing for any deductions. The relevant sections under which tax is charged are as under:

Section	Assessee	Particulars	Tax Rate
Section 115AC	Non-resident	Dividend on GDRs of an Indian Company or Public Sector Company (PSU) purchased in foreign currency	10% (plus applicable surcharge and cess)
Section 115AD	FPI	Dividend income from securities (other than income from units of specified mutual fund or units of UTI purchased in foreign currency)	20% (plus applicable surcharge and cess)
Section 115E	Non-resident Indian	Dividend income from shares of an Indian company purchased in foreign currency.	20% (plus applicable surcharge and cess)
Section 115A	Non-resident or foreign co.	Dividend income in any other case	20%(plus applicable surcharge and cess)

- **Income from Interest earned in Non Resident Ordinary Rupee (NRO), Non Resident External (NRE) and Foreign Currency Non-Resident (FCNR) accounts**

Interest on NRE and FCNR account is tax-free. Interest on NRO account is taxable. It will be added to the total income and taxed as per income tax slab applicable.

• Income from Rent

A tenant who pays rent to an NRI owner must remember to deduct TDS at 30% (plus applicable surcharge and health and education cess). The income can be received to an account in India or the NRI's account in the country he is currently residing. Example; Maria pays a monthly rent of Rs 30,000 to her NRI landlord. She must deduct 30% as TDS (plus applicable surcharge and applicable cess) TDS before transferring the money to the landlord's account. Maria must also get a Form No. 15CA prepared and submit it online to the Income Tax Department. This form has to be submitted online. In some cases, a certificate from a chartered accountant in Form 15CB is, also, required before uploading Form No. 15CA online. In Form No. 15CB, a chartered accountant (CA) certifies details of the payment, TDS rate, and TDS deduction as per Section 195 of the Income Tax Act, if any DTAA (Double Tax Avoidance Agreement) is applicable, and other details of nature and purpose of the remittance. Form No. 15CB is not required when:

- Remittance does not exceed Rs 5,00,000 (in total in a financial year). Only Form No. 15CA has to be submitted in this case.
- If lower TDS has to be deducted and a certificate is received under Section 197 for it or lower TDS from the Assessing Officer.

  Neither is required if the transaction falls under Rule 37BB of the Income Tax Rules, 1962, where 33 items are listed.
- In all other cases, if there is a remittance outside India, the person who is making the remittance will have to obtain a certificate from a CA in Form No. 15CB and after receiving the certificate submit Form No. 15CA to the government online.

• Income from Business and Profession

Any income earned by an NR from a business controlled or set up in India is taxable to the NR in the form of branch office of project office is taxable to the Non-Resident. The standard corporate income tax rate is 40% on net profit of such offices of foreign companies. Taking into account applicable surcharge and health and education cess, the highest effective rate is 43.68% for foreign companies.

• Income from Real Estate capital gains

An NRI who sells a house property and earns capital gains is liable to pay

tax it is same as resident Indian. But for NRIs, Long-term capital gains are subject to a TDS of 20% (plus applicable surcharge and health and education cess). Short-term capital gains are subject to a TDS of 30% (plus applicable surcharge and health and education cess) (u/s 195 of the Act). The gains are considered short-term if the house is sold within two years of purchase. Gains on other long-term assets are taxed at 20% (plus applicable surcharge and health and education cess), gains from other short-term assets are taxed at the normal tax rates (plus applicable surcharge and health and education cess).

A NRI can get an exemption if he invests in a house property as per Section 54 of the Act within one year before the date of transfer or 2 years after the date of transfer or complete construction of a house within 3 years after the date of transfer of the capital asset or

If he invests in capital gain bonds as per Section 54EC, it should be done within 6 months of date of transfer.

- **Income from capital gains in other assets**

Income from capital gains earned from other assets like stocks, mutual funds will be taxed.

Long-term – 10% tax, without indexation, is applicable for capital gains from all direct equity and equity mutual funds if the gains are more than Rs. 1,00,000.

Short-term capital gains are taxed at 15% (plus applicable surcharge and health and education cess). Long-term Capital Gains on mutual funds other than equity funds are taxed at 20% (plus applicable surcharge and health and education cess) with indexation for listed funds and 10% (plus applicable surcharge and health and education cess) without indexation for non-listed funds.

Short Term Capital Gains on non-equity mutual funds are taxed at 30% (plus applicable surcharge and health and education cess).

- **Special Provision Related to Investment Income**

When an NR invests in certain Indian assets, he is taxed at 20%. If the special investment income is the only income the NR has during the financial year, and TDS has been deducted on that, then such an NR is not required to file an income tax return.

Investments that Qualify for Special Treatment are: -

i. Shares in a public or private Indian company

ii. Debentures issued by a publicly-listed Indian company (not private)

iii. Deposits with banks and public companies

iv. Any security of the Central Government

v. Other assets of the Central Government as specified for this purpose in the official gazette.

• Receipt of Gifts

Gifts received from relatives are exempt from tax under Income Tax Act.

Gifts received from non-relatives up to the value of Rs. 50,000 are exempt from tax. Beyond that, the gift value is added to the total income and taxed as per applicable income tax slab.

Chapter 13

Tax Deduction at Source in respect of Payments to Non Residents

The tax deduction at source ('TDS') is one of the methods of collecting Income tax. The other methods are:

(a) Advance tax

(b) Self assessment tax

(c) Regular collection after assessment

(d) Tax collection at source.

Under the TDS method, the person who makes the payment or credit the amount to non-resident, he requires to deduct the prescribed amount of tax from such payment/credit and deposit the same with the Central Government.

Payment to non-resident sportsmen or sports association [Section 194E]

Section 194E enjoins upon a person responsible for making any payment of any income, referred to in section 115BBA or to a non-resident sportsman (including an athlete) or to an entertainer who is not a citizen of India and who is a non-resident or to a non-resident sports association or institution to deduct at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by issue of cheque or draft or by any other mode, whichever is earlier, income tax thereon at the rate of 20 per cent plus surcharge and cess.

The following payments to non-resident sportsman (including an athlete are covered by section 115BBA:

(a) income by way of participation in India in any game or sport;

(b) income by way of advertisements; and

(c) income by way of contribution to articles relating to any game or sport in India in newspapers, magazines or journals.

Any income by way of winnings from lotteries, cross word puzzles, races including horse races and gambling or betting are not covered by this section.

The amount guaranteed to be paid or payable to any non-resident sports association or institution in relation to any game (other than winnings from lotteries, cross word puzzles, races including horse races and gambling or betting) or sports played in India are subject to tax deduction under section 194E.

Income by way of interest from infrastructure debt fund [Section 194LB]

An infrastructure debt fund, which is responsible for paying to a non-resident shall deduct tax @ 5%, at the time of credit or payment whichever is earlier.

Income by way of interest from Indian company [Section 194LC]

Indian company is required to deduct tax @5% (4% in case of clause (ib) w.e.f 1.4.2020) on interest payable in the following cases to non- residents, at the time of credit or payment whichever is earlier.

(i) in respect of monies borrowed in foreign currency, from a source outside India, in any of the following forms-

(a). under a loan agreement on or after July 1, 2012 but before July 1, 2023 or

(b). by way of issue of any long-term bond (including long-term infrastructure bond) at any time on or after October 1, 2014 but before July 1, 2023.

as approved by the Central Government in this behalf;

(ia) in respect of monies borrowed by issue of rupee denominated bond from a source outside India before July 1, 2023 and

(ib) in respect of monies borrowed by it from a source outside India by way of issue of any long term bond or rupee denominated bond on or after the 1st day of April 2020 but before 1st day of July 2023, which is listed only on a recognized stock exchange located in any International Financial Services Centre.

(ii) to the extent to which such interest does not exceed the amount of interest calculated at the rate approved by the Central Government in this behalf, having regard to the terms of the loan or the bond and its repayment.

Other sums [Section 195]

Section 195(1) enjoins upon any person responsible for paying to a non-resident, or to a foreign company, any interest (other than interest on securities under section 194LB or 194LC or 194LD) or any other sum chargeable under the provisions of the Act (not being income chargeable under the head "salaries") to deduct tax at rate in force at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by the issue of a cheque or draft or by any other mode, whichever is earlier.

The first proviso to section 195(1) provides that in the case of interest payable by the Government or a public sector bank within the meaning of section 10(23D) or a public financial institution within the meaning of section 10(23D), deduction of tax is to be made only at the time of payment thereof in cash or by the issue of cheque or draft or by any other mode and not at the time of credit.

The Explanation to section 195(1) enacts deeming provisions for the purpose of this section and provides that any interest or other sum as aforesaid credited to any account, whether called "Interest payable account" or "Suspense account" or by any other name, in the books of account of the person liable to pay such income, the provisions of section 195 would apply accordingly.

i. For this purpose, the payer himself is treated as "person responsible for paying" such amount. If, the payer is a company, the company itself including the principal officer thereof, is the person responsible for paying such amount.

ii. Where the sum payable to a non-resident Indian represents consideration for the transfer of any foreign exchange asset (other than a short term capital asset), the "authorized dealer" responsible for remitting such sum or crediting such sum to Non-resident (external) Account of the payee shall be the "person responsible for the paying".

Explanation 2 to section 195(1) clarifies that obligation to deduct tax under section 195(1) has always meant to extend to all persons resident or non-residents, whether or not the non-resident has –

(i) A residence or place of business or business connection in India; or

(ii) Any other presence in any manner whatsoever in India

Section 195(2) provides that, where the person responsible for paying any such sum chargeable under the Act, other than interest on securities and salary, to a non-resident considers that the whole of such sum would not be income chargeable in the case of the recipient, then, he may make an application in such form and manner to the Assessing Officer to determine in such manner, as may be prescribed, appropriate proportion of such sum so chargeable and upon such determination, tax is to be deducted under section 195(1) only on that proportion of sum which is so chargeable.

Section 195(3) enables, subject to the rules made under section 195(5), any person who is entitled to receive any interest or other sum on which income tax is not to be deducted under section 195(1) to make an application in Form No. 15C or Form No. 15D as per the provisions of rule 29B to the Assessing Officer for the grant of a certificate in Form no. 15E authorizing him to receive such interest or other sum without deducting tax thereon under section 195(1).

A certificate granted under section 195(3) shall remain in force till the expiry of the period specified therein or if is cancelled by the Assessing Officer before the expiry of such period, till such cancellation [Section 195(4)].

Section 195(5) empowers the Board (CBDT) to make rules having regard to the convenience of taxpayers or the interest of revenue, by notification in the Official Gazette specifying:

- in the cases in which, and the circumstances under which, an application may be made for the grant of a certificate under section 195(3);
- the condition subject to which such certificate may be granted; and
- providing for all other matters connected therewith.

Under Section 195(6), deductor of tax at source is required to file the information relating to payment in the forms Nos. 15CA and 15CB and in the manner prescribed in rule 37BB. Form No. 15CA may have to accompanied with a certificate obtained from a chartered accountant in Form No. 15CB.

As per section 195(7), authorises CBDT to issue the notification specifying the class of persons or cases where the person responsible for paying to non-resident, any sum, whether or not chargeable under the provisions of this Act, shall make an application in such form and manner to the Assessing Officer to determine in such manner, as may be prescribed, to determine the appropriate proportion of sum chargeable, and tax shall be deducted on sums so chargeable.

Important judicial precedents & board circulars:

1. In DCIT v. Tata Yodogawa Ltd. [1999] 68 ITD 47 (Patna Tribunal), the assessee entered into technical collaboration agreement, duly approved by the Government of India and the RBI, with Austrian company. In terms of the agreement, the assessee was required to remit by way of lump sum technical knowhow fees to the foreign company in three installments. The Assessing Officer asked the assessee to deduct taxes on the installments of payments being made to the said company as they were fees for technical services. On appeal, the Commissioner (Appeals) held that the deduction of tax at source was not called for in view of the provisions of Double Taxation Avoidance Agreement (DTAA) between India and Austria.

   The Patna Tribunal on appeal by the Department held that in the instant case the technical services for which the payment were made, were rendered in Austria and not in India and in view of the Article 7 of the DTAA between India and Austria are taxed in Austria and not in India. In view of this there was no question of deduction of tax at source from the payment in question. The same has been reiterated by Madras Tribunal in the case of TVS Suzuki Ltd. v. ITO [2000] 73 ITD 91.

2. In Kanchanaganga Sea Foods Ltd. v. CIT [2010] 325 ITR 540 (SC), assessee-company was engaged in sale and export of sea food and for that purpose it obtained permit to fish in exclusive economic zone of India. To exploit fishing rights, it entered into an agreement, chartering two fishing vessels with a non-resident company. Charter fee was payable from earnings from sale of fish and for that purpose 85 per cent of gross earnings from sale of fish was to be paid to non-resident company. Actual fishing operations were done outside territorial waters of India but within exclusive economic zone. Thereafter, chartered vessels with entire catch were brought to Indian Port, catch were certified for human consumption, valued, and after

customs and port clearances, non-resident company received 85 per cent of catch. The apex court held that the non-resident company effectively received charter fee in India and same would be chargeable to tax under section 5(2). Therefore, assessee was liable to deduct tax under section 195 on payment made to non-resident company.

3. In BIOCON Biopharmaceuticals (P.) Ltd. v. ITO [2013] 144 ITD 615, the Bangalore Tribunal held that:

   a. Where non-resident company provides technology/know-how in form of capital contribution, tax is required to be deducted at source on issue of shares;

   b. Where there was no transfer of capital asset, and joint venture agreement allowed assessee only right to use know-how, issue of shares for same constitutes royalty.

4. The Mumbai Tribunal in Raymond Ltd v. ITO, [2003] 86 ITD 791, has opined that an adjustment of the amount payable to the non-resident or deduction thereof by the non-resident from the amounts due to the resident – payer of the income would fall to be considered under 'any other mode' indicated in section 195(1). Such adjustment or deduction also is equivalent to actual payment. Commercial transactions very often take place in the aforesaid manner and the provisions of section 195 could not be defeated by contending that an adjustment or deduction of the amount payable to the non-resident could not be considered as actual payment.

5. The assessee cannot deduct tax at lower rate without getting an authorization or certificate from the assessing officer under section 195(2). [CIT v. Chennai Metropolitan Water Supply & Sewerage Board [2012] 348 ITR 530 (Madras High Court)]

6. The apex court in the case of G.E. India Technology Centre (P) Ltd v CIT [2010] 327 ITR 456 distinguishing the SC decision in the case of In Transmission Corporation of A.P. Ltd. And Another Vs. CIT [239 ITR 587 (SC)] has held that obligation to withhold tax is limited to the appropriate portion of income which is chargeable to tax under the provisions of Act and forms part of gross amount payable. It was held that:

   In Transmission Corpn. of A.P. Ltd.'s case (supra) it was held that tax at source (TAS) was liable to be deducted by the payer on the gross

amount if such payment included in it an amount which was exigible to tax in India. It was held that if the payer wanted to deduct TAS not on the gross amount but on the lesser amount, on the footing that only a portion of the payment made represented "income chargeable to tax in India", then it was necessary for him to make an application under section 195(2) of the Act to the tax authorities and obtain their permission for deducting TAS at lesser amount. Thus, it was held by this Court that if the payer had a doubt as to the amount to be deducted as TAS he could approach the tax authorities to compute the amount which was liable to be deducted at source. In our view, section 195(2) is based on the "principle of proportionality". The said sub-section gets attracted only in cases where the payment made is a composite payment in which a certain proportion of payment has an element of "income" chargeable to tax in India. It is in this context that the Supreme Court stated, "If no such application is filed, income-tax on such sum is to be deducted and it is the statutory obligation of the person responsible for paying such 'sum' to deduct tax thereon before making payment. He has to discharge the obligation to TDS". If one reads the observation of the Supreme Court, the words "such sum" clearly indicate that the observation refers to a case of composite payment where the payer has a doubt regarding the inclusion of an amount in such payment which is exigible to tax in India. In our view, the above observations of this Court in Transmission Corpn. of A.P. Ltd.'s case (supra) which is put in italics has been completely, with respect, misunderstood by the Karnataka High Court in Samsung Electronics Co. Ltd. [2009] 185 Taxman 313 to mean that it is not open for the payer to contend that if the amount paid by him to the non-resident is not at all "chargeable to tax in India", then no TAS is required to be deducted from such payment. This interpretation of the High Court completely loses sight of the plain words of section 195(1) which in clear terms lays down that tax at source is deductible only from "sums chargeable" under the provisions of the Income-tax Act, i.e., chargeable under sections 4, 5 and 9 of the Income-tax Act.

7. In Vodafone International Holdings B.V. v. Union of India [2012] 341 ITR 1, the Supreme Court held that section 195 casts an obligation on payer to deduct tax at source from payments made to non-residents which payments are chargeable to tax and, therefore, where sum paid or credited by payer is not chargeable to tax then no

obligation to deduct tax would arise. Section 195 would apply only if payments are made from a resident to non-resident and not between two non-residents situated outside India. Where there was a transaction of 'outright sale' between two non-residents of a capital asset (share) outside India and moreover, said transaction was entered into on principal-to-principal basis, no liability to deduct tax at source arose under section 195.

8. The Chennai Tribunal in the case of Hyundai Motor India Ltd. v. DCIT, [2017] 81 taxmann.com 5, held that where assessee took loans from foreign banks, mere fact that loan agreements were signed in local offices of said banks in India, those local affiliates did not constitute their Permanent Establishment in India and, thus, interest paid to foreign banks was not taxable in India. Accordingly, the assessee did not have any tax withholding obligations, under section 195, in respect of these payments.

9. The Madras High Court in the case of CIT v. Farida Leather Company [2016] 287 CTR 565 has held that no tax withholding liability arises on payment of commission to non-residents abroad if the services are rendered outside India. The HC also held that such services rendered by the non-resident agent could at best be called as a service for completion of the export commitment and would not fall within the definition of "fees for technical services" under section 9(1)(vii) of the Income-tax Act; thus, provisions of section 195 of the Act would not apply in the instant case.

10. The Kolkata Tribunal in case of Electrosteel Casting Ltd. V. ITO (International Taxation) 2019 (10) Tmi 133 (ITAT Kolkata) held that since expenses on technical services utilized for setting up a new office and godown for the purpose of boosting its exports and as the technical services when not utilized for the business activities of production in India and it was for services which were utilized in the business carried out outside India, the same is not taxable in India.

11. The Mumbai High Court in the case of Marks & Spencer Reliance India Pvt. Ltd. (ITA No.893 of 2014) held that the cost reimbursement made by the taxpayer to the overseas entity under a secondment agreement is not chargeable to tax in India and that the taxpayer has not defaulted in withholding any tax in India on such payments.

12. The CBDT vide its circular no. 740 dated April 17, 1996 has clarified that the branch of a foreign company/concern in India is a separate

entity for purpose of taxation. Interest paid/payable by such branch to its head office or any branch located abroad would be liable to tax in India and would be governed by the provisions of section 115A of the Act. If DTAA with the country of the parent company is assessed to tax provides for lower rate of taxation, the same would be applicable. Consequently, tax would have to be deducted accordingly on the interest remitted as per the provisions of section 195 of the Income tax Act, 1961.

13. The CBDT vide Instruction No 2/2014 instructed that in cases where the assessee does not withhold taxes under section 195 of the Act, the Assessing Officer is required to determine the income component involved in the sum on which the withholding tax liability is to be computed and the payer would be considered as being in default for non-withholding of taxes only in relation to such income component.

Income from Units [Section 196B]

Section 115AB of the Income tax Act provides that in a case of an Offshore Fund, the income in respect of units purchased in foreign currency and income by way of long term capital gains arising from the transfer of such units shall be taxed at the rates of 10% thereof.

Section 196B therefore, enjoins on the person responsible for making such payment to deduct tax at 10% plus surcharge at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by the issue of a cheque or draft or by any other mode, whichever earlier.

Income from foreign currency bonds or Global Depository Receipts ('GDRs') [Section 196C]

Section 115AC provides that, where the total income of an assessee, being a non-resident includes income by of interest on bonds or dividends on GDRs issued in accordance with such scheme as the Central Government may, by notification in the Gazette specify in this behalf or on bonds or shares of public sector company, sold by the Government and purchased by a non-resident in foreign currency or income by way of long term capital gains arising from the transfer of such bonds as referred therein is to be taxed @ 10%.

By virtue of section 196C the person responsible for making the payment has to deduct tax @ 10% plus applicable surcharge and cess at the time of

making payment thereof in cash or by issue of cheque or draft or any other mode, whichever is earlier.

There was a proviso that clarified that no such deduction is to be made in respect of any dividends referred to in section 115-O which has now been omitted by Finance Act 2020, w.e.f. Assessment Year 2021-22.

Income of Foreign Institutional Investors (FII) from securities [Section 196D]

Section 115AD provides that where the total income of a FII includes any of the following kinds of income, not being income by way of interest referred to in section 194LD, then, tax shall be payable at the rate specified against the income.

(a) Income received in respect of securities (other than units referred to in section 115AB) @ 20%.

(b) Income by way of short-term capital gains arising from the transfer of such securities @ 30%. In case of the short-term capital gains covered by section 111A i.e. short term capital gain arising on equity share in a company or unit of an equity oriented fund and the transaction is chargeable to securities transaction tax, the rate applicable will be @15%.

(c) Income by way of long-term capital gains arising from the transfer of such securities @ 10%.

In consequence, section 196D (1) provides that the person responsible for making the payment shall, at the time of credit of such income to the account of payee or at the time of payment thereof by any mode, whichever is earlier, deduct income tax thereon @ 20% plus applicable surcharge and cess.

As per section 196D(1A), with effect from 01.11.2020, where any income in respect of securities referred to in clause (a) of sub-section (1) of section 115AD, not being income by way of interest referred to in section 194LD, is payable to a specified fund [referred to in clause (c) of the Explanation to clause (4D) of section 10], the person responsible for making the payment shall, at the time of credit of such income to the account of the payee, or at the time of payment thereof by any mode, whichever is earlier, deduct the income-tax thereon at the rate of 10% plus applicable surcharge and cess providing no deduction shall be made in respect of an income exempt under clause (4D) of section 10.

However, as per section 196D(2), no deduction shall be made from any income, by way of capital gains arising from the transfer of securities referred to in section 115AD, payable to a FII.

Non furnishing of PAN [Section 206AA]

In case of non-availability of the PAN, tax is to be deducted at higher of the following-

- Rates specified in the Act;
- Rates in force;
- 20%.

The provisions of section 206AA shall not apply to a non-resident for any payment of interest on long-term bonds under section 194LC.

Further, the Finance Act 2016 provides relaxation effective 1 June 2016 whereby, tax shall not be deducted at a higher rate in case of non-residents not having PAN, subject to prescribed conditions as covered below:

- The deductee to furnish following details for non-deduction of tax at higher rates:
    i. name, e-mail id, contact number;
    ii. address in the country or specified territory outside India of which deductee is a resident;
    iii. a certificate of his being resident in any country or specified territory outside India from the Government of that country or specified territory if the law of that country or specified territory provides for issuance of such certificate
    iv. Tax Identification Number of the deductee in the country or specified territory of his residence and in case no such number is available, then a unique number on the basis of which the deductee is identified by the Government of that country or the specified territory of which he claims to be a resident.

In case of DDIT v. Serum Institute of India Ltd. [2015] 68 SOT 254, the Pune Tribunal held that where tax has been deducted on the strength of the beneficial provisions of DTAAs, the provisions of section 206AA of the Act cannot be invoked to insist on tax deduction at 20%, having regard to the overriding nature of the provisions of section 90(2) of the Act.

In case of DCIT v. Infosys BPO Ltd. [2015] 154 ITD 816, Bangalore Tribunal held that there is no scope of deduction of tax at the rate of 20% as per section 206AA (when assessee does not have tax identification number – PAN) of the Income-tax Act, 1961 when the benefit DTAA is available to the assessee.

Above propositions were also upheld in the decision of the Special bench of Hyderabad Tribunal in the case of Nagarjuna Fertizers & Chemicals Ltd. [2017] 55 ITR(T) 1 and the Delhi High Court in the case of Danisco India (P.) Ltd. v. Union of India [2018] 301 CTR 360.

In the case of Bosch Ltd. v. ITO [2013] 141 ITD 38, the Bangalore Tribunal held that grossing up of the amount under section 195A is to be done at the rates in force for the financial year in which such income is payable and not at 20 per cent as specified under section 206AA.

Chapter 14
Advance Rulings

Backdrop

The provisions relating to advance ruling were inserted in 1993 under the Income tax Act, 1961. Initially they were applicable to non-residents only. The finance (No.2) Act, 1998 has extended these provisions to residents, in specified cases.

Meaning of Advance ruling [Section 245N]

As per section 245N(a), advance ruling means:

(a) a determination by the Authority in relation to a transaction which has been undertaken or is proposed to be undertaken by a non-resident applicant and such determination shall include the determination of any question of law or fact specified in the application;

(b) a determination by the authority in relation to the tax liability of a non-resident arising out of a transaction which has been undertaken or is proposed to be undertaken by a resident applicant with such non-resident, and such determination shall include the determination of any question of law or fact specified in the application;

(c) a determination by the Authority in relation to the tax liability of a resident applicant, arising out of a transaction which has been undertaken or is proposed to be undertaken by such applicant and such determination shall include the determination of any question of law or fact specified in the application;

(d) a determination or decision by the authority in respect of an issue relating to computation of total income which is pending before any income tax authority or the Appellate Tribunal and such determination or decision of any question of law or fact relating to such computation of total income specified in the application.

(e) a determination or decision by the authority whether an arrangement, which is proposed to be undertaken by any person being a resident or a non-resident, is an impermissible avoidance arrangement as referred to in Chapter X-A or not.

Meaning of applicant

The applicant has been defined in section 245N(b) which means any person who is:

(i) a non-resident who proposes to enter into a transaction or has already entered into a transaction in India; or

(ii) a resident who proposes to enter into such transaction with the non-resident party; or

(iii) a resident falling within any such class or category or persons as the Central Government may by notification in the official Gazette specify in this behalf (Public Sector Undertakings have been notified vide Notification No. 725(E) dated August 3, 2000); or

(iv) a resident who has undertaken or proposed to undertake a transaction if the tax liability exceeds the defined threshold. (Notification No. 73/2014 dated November 28, 2014 has notified the threshold limit for one or more transactions valuing Rs. 100 crores or more in total); or

(v) a resident or non-resident in respect of impermissible transaction avoidance arrangement referred to in Chapter - X,

and

who makes application under section 245Q(1).

(vi) an applicant as defined in clause (c) of section 28E of the Customs Act, 1962 (52 of 1962)

(vii) an applicant as defined in clause (c) of section 23A of the Central Excise Act, 1944 (1 of 1944)

(viii) an applicant as defined in clause (b) of section 96A of the Finance Act, 1994 (32 of 1994)

- The Authority for Advance Ruling in Lloyd Helicopters International Pty. Ltd. v. CIT [(2001) 249 ITR 162 (AAR)] has held that, it is permissible for an applicant under section 245Q to approach the Advance Ruling Authority for question which pertain to taxability of its non-resident employees serving in India.

Applicability for Non-resident

Section 245N stipulates that a non-resident can make an application under Chapter XIXB. However, it does not say in specific terms that he should be a non-resident as on the date of the application. Therefore, status 'resident' or 'non-resident' for the purpose has to be determined with reference to a previous year (which is a financial year) and not with reference to a particular date as held by the Authority for Advance Ruling in Monte Harris v. CIT, [1996] 218 ITR 413 (AAR Delhi).

In Monte Harri's case, the AAR observed that it is difficult to say which 'previous year' should be taken into account for purpose of section 245N. It cannot be 'previous year' in which the application is made for an application may be made very early in a financial year and may even have to be disposed of long before the end of the financial year. In such cases, the full picture of the applicants' stay in India during the previous year may not be always available by the date of the application or even by the date of its disposal by the authority. The only 'previous year' with reference to which the status of the applicant is determinable for purpose of section 245N must be the 'previous year' preceding the financial year in which the application is made.

In Dr. Rajnikant R. Bhatt v. CIT, [1996] 222 ITR 562 (AAR Delhi), on the date of the original application, the applicant was not a non-resident, hence his application was rejected by AAR. However, on the date of the second revised application he was non-resident the AAR held that his application is maintainable.

Authority for Advance Ruling [Sections 245-O, Section 245-OA & 245P]

Under section 245-O of the Act, the Authority for Advance Ruling consists of:

- a chairman, who is retired judge of the Supreme Court or the Chief Justice of a High Court or for at least seven years a Judge of a High Court,
- a Vice-chairman, who has been Judge of a High Court,
- a revenue Member,
    - from the Indian Revenue Services, who is, or is qualified to be, a Member of the Board; or

- from the Indian Customs and Central Excise Service, who is, or is qualified to be, a Member of the Central Boar of Excise and Customs,

on the date of occurrence of vacancy and

- a law Member from the Indian Legal Service, who is, or is qualified to be, an Additional Secretary to the Government of India on the date of occurrence of vacancy.

In the event of the occurrence of any vacancy in the office of the Chairman by reason of his death, resignation or otherwise, the senior-most Vice-chairman shall act as the Chairman until the date on which a new Chairman, appointed in accordance with the Provisions of this Act to fill such vacancy, enters upon his office.

In case the Chairman is unable to discharge his functions owing to absence, illness or any other cause, the senior-most Vice-Chairman shall discharge the functions of the Chairman until the date on which the Chairman resumes his duties.

The head quarter of the Authority is in Delhi. The Central Government vide Notification No. (No.1/2015)/SO 812(E) dated March 20, 2015 notified the creation of two additional benches of the AAR including one at National Capital Region (NCR) and one new bench at Mumbai, with effect from the date of publication of this notification in the Gazette of India (Extraordinary).

Amendments to Section 245-O vide Finance Act 2018 provided that the Authority for Advance Rulings constituted under the Income-tax Act shall cease to act as an Authority for Advance Rulings for the purposes of the Customs Act, 1962 on and from the date of appointment of the Customs Authority for Advance Rulings. The Finance Act, 2017 has introduced the qualifications, terms and conditions of service of Chairman, Vice-Chairman and other Members with effect from a date yet to be notified.

No proceeding of the Authority will be invalid merely on grounds of the existence of any vacancy or defect in the constitution of the Authority.

Application for advance ruling [Section 245Q]

An application for obtaining advance ruling shall be made in quadruplicate and accompanied by a fee of Rs.10,000/- or such fee as may be prescribed in this behalf whichever is higher, in the following forms:

	Applicant	Form No
a)	A Non-resident	34C
b)	A Resident: (i) Seeking advance ruling in relation to a transaction with a non resident	34D
	(ii) Seeking advance ruling in relation to the tax liability of a resident applicant arising out of a transaction which has been undertaken or proposed to be undertaken by such applicant	34DA
	(iii) Falling such class or category of persons as notified by the Central Govt. i.e. public sector companies	34E
c)	A resident or non-resident in respect of impermissible transaction avoidance arrangement referred to in Chapter – X	34EA

The fees payable along with application for advance ruling shall be in accordance with the following table:

Category of Applicant	Category of case	Fee (Rs.)
• A non-resident applicant. • A resident seeking advance ruling in relation to the tax liability of a non-resident arising out of transaction undertaken or proposed to be undertaken by him with a nonresident. • A resident seeking advance ruling in relation to his tax liability arising out of one or more transactions valuing Rs.100 crore or more in total which has been undertaken or is proposed to be undertaken by him	Amount of one or more transaction, entered into or proposed to be undertaken, in respect of which ruling is sought does not exceed Rs. 100 crore.	200,000
	(iv) Amount of one or more transaction, entered into or proposed to be undertaken, in respect of which ruling is sought exceeds Rs. 100 core but does not exceed Rs. 300 crore.	500,000
	Amount of one or more transaction, entered into or proposed to be undertaken, in respect of which ruling is sought exceeds Rs. 300 crore	1,000,000
Any other applicant	In all cases	10,000

An applicant may withdraw an application within thirty days from the date of the application.

Procedure on receipt of application [Section 245R]

The authority on receipt of an application will send a copy to the Principal Commissioner or Commissioner and if necessary, call upon him to furnish the relevant records. Such records shall be returned to the Principal Commissioner or Commissioner as soon as possible. After examining the application and the records the authority may either allow or reject the application.

No application be proceeded

(I) The authority shall not allow the application, where the question raised in the application is

(a) is already pending before any income tax authority or Appellate Tribunal or Court except a resident falling within any such class or category or persons as the Central Government may by notification in the official Gazette specify in this behalf i.e. a public sector company; or

(b) involves determination of fair market value any property; or

(c) relates to a transaction or issue which is designed *prima-facie* for the avoidance of income tax except:

- a resident falling within any such class or category or persons as the Central Government may by notification in the official Gazette specify in this behalf i.e. a public sector company; or
- a resident or non-resident in respect of impermissible transaction avoidance arrangement referred to in Chapter - X.

- **Already pending**

  The words 'already pending' should be interpreted to mean 'already pending as on the date of the application' and not with reference to any future date.[Monte Harris v. CIT [1996] 218 ITR 413 (AAR Delhi)]

The words 'already pending' do not include an application by the resident payer under section 195 to determine the amount of tax deduction from payments to a non-resident.[Ericsson Telephone Corporation India v. CIT [1997] 224 ITR 203 (AAR Delhi)]

Where the applicant non-resident company had been awarded a contract by the Orissa State Government and the latter had approached the Assessing Officer in terms of section 195(2) to determine the appropriate proportion of the payments to tax, the matter cannot be considered as a 'pending proceeding'. [Hyder Consulting Ltd. v. CIT [1999] 236 ITR 640 (AAR Delhi)]

The Delhi High Court in the case of Hyosung Corporation [2016] 382 ITR 371 dealt with the issue of relevant date in the context of the words 'already pending' as mentioned in proviso to Section 245R(2) of the Act. The Delhi High Court held as under:

- The words 'already pending' in section 245R should be interpreted to mean 'already pending as on date of application and not with reference to any future date'.
- The mere fact that a standard pre-printed notice to assess the return of income was issued by the Tax Authority before the event of filing of the AAR application would not result in pendency of the question raised in the application before the Tax Authority.
- A notice under section 142(1) of the Act issued prior to the filing of application, wherein the very same question was raised that was the subject matter of the AAR's applications would constitute a bar, in terms of clause (i) to proviso to section 245R(2).
- The SLP filed by the Department in this case, has also been dismissed by the Supreme Court, 244 Taxman 286.

Mere issuance of a notice under Section 143(2) of the Act which merely stated that the Assessing Officer would like some further information on certain points in connection with the return of income, which does not form part of subject matter of application filed before the AAR, this cannot be regarded as an issue being already pending before the AAR. [LS Cable & System Ltd v. CIT [2016] 385 ITR 99 (Delhi HC)].

The AAR cannot reject the applicant's application by invoking proviso to Section 245R(2) of the Act in case where the scrutiny notice under Section 143(2) of the Act is issued by the Assessing Officer even prior to filing of application before AAR. This is since the said notice does not ad-dress any specific question and it does not even disclose application of mind to the income-tax return filed by the applicant. The SLP filed by the Department in this case, has also been dismissed by the Supreme Court, 246 Taxman 57. [Sage Publications Ltd. U.K. v. DCIT [2016] 387 ITR 437 (Delhi HC)]

- **Avoidance of tax**

  The applicant companies were fully owned subsidiaries of a British company had invested in the shares of an Indian Bank. If the British company had directly invested in India, capital gains arising on their sale would have been taxable both in India and England. Whereas investment through applicant companies of Mauritius, no capital gain tax was payable in India in view of DTAA between India and Mauritius. The authority found this arrangement as for avoidance of tax and rejected the application of the applicant company. [X Ltd., In re [1996] 220 ITR 377 (AAR Delhi)]

  An application for advance ruling concerning liability to interest under sections 234B & 234C in respect of tax on capital gains arising from transaction of purchases and sale of shares is maintainable [Y Ltd., In re [1996] 221 ITR 172 (AAR Delhi)]

Performance of natural justice

No application shall be rejected unless an opportunity has been given to the applicant being heard. Where the application is rejected reasons for such rejection shall be given in the order. A copy of every such order shall be sent to the applicant and to the Principal Commissioner or the Commissioner.

Pronouncement of advance ruling

If an application is allowed, the authority shall, after examining such further material as may be placed before it by the applicant or obtained by the authority, pronounce its advance ruling on the question specified in the application.

The applicant can, on request appear either in person or through a duly authorized representative. The authority shall pronounce its advance ruling in writing within six months of the receipt of application.

A copy of the advance ruling pronounced by the Authority duly signed by the members and certified in the prescribed manner, shall be sent to the applicant and to the Principal Commissioner or Commissioner, as soon as may be, after such pronouncement.

Proceedings on hold [Section 245RR]

No income tax authority or the Appellate Tribunal shall proceed to decide any issue in respect to which an application has been made by an applicant, being a resident, under section 245Q.

Applicability of advance ruling [Section 245S]

The advance ruling shall be binding only:

(a) on the applicant who had sought it;

(b) in respect of the transaction in relation to which the ruling had been sought, and

(c) on the Principal Commissioner or Commissioner, and the income tax authorities subordinate to him, in respect of the application and the said transaction..

The advance ruling shall be binding unless there is change in law or facts on the basis of which the advance ruling has been pronounced.

Advance ruling to be void [Section 245T]

Where the authority finds, on a representation made to its by the Principal Commissioner or Commissioner or otherwise, that the advance ruling pronounced by it has been obtained by the applicant by fraud or misrepresentation of facts, it may, by order declare such ruling to be *void ab-initio* and thereupon all the provisions of the Act shall apply (after excluding the period beginning with the date of such advance ruling and ending with the date of order declaring such order as void) to the applicant as if such advance ruling had never been made.

Powers of the Authority [Section 245U]

The authority shall have all the powers of a civil court in respect of:

(a) discovery and inspections;

(b) enforcing the attendance of any person including any officer of banking company and examining him on oath;

(c) Issuing commissioner and compelling the production of books of account and other records.

The Authority would be deemed to be a Civil Court for the purpose of section 195 of the Code of Criminal Procedure, 1973 and every proceeding before the authority shall be deemed to be a judicial proceeding under sections 193 and 228 and for the purpose of section 196 of the Indian Penal Code.

Procedure of Authority [Section 245V]

The Authority shall have powers to regulate its own procedure in all matters arising out of the exercise of its powers under the Act.

Important Judicial Precedents & Board Circulars:

1. A resident, who is liable to withhold tax on the payment to be made to non-residents can apply for an advance ruling [McLeod Russel Kolkata Ltd In re. (2008) 215 CTR 230(AAR)]

2. It would be very difficult to enforce the condition that an Applicant is a non-resident at the time of making an application as the residential status would be determined on the basis of his stay in India throughout the previous year. Accordingly if a person were a non-resident in the previous year immediately preceding the previous year in which the application is made, the application would be maintainable. [Robert W Smith (1995) 212 ITR 275, Monte Harris (1996) 218 JB 413, P.NO. 20 of 1995 (1999) 237 ITR 382]

3. A ruling can be sought even if alternate remedy to make an application under section 195(2) in respect of determination of applicability of TDS provisions or rate of TDS is available. [Airport Authority of India, IN RE (2008) 299 ITR102 (AAR)]

4. As per the provisions of Rule 19 of the Authority for Advance Rulings (Procedure) Rules, 1996, the ruling given by the AAR may be rectified by the AAR at the time before the said ruling is given effect to by the Assessing Officer. Such rectification, however, is possible in respect of any mistake apparent from the record. In case of General Electric Pension Trust, IN RE, (2007) 289 ITR 335 (AAR), it has been held that where there was some material available with applicant at

time of hearing but it was not filed then such material cannot be furnished by invoking Rule 19.

5. As the AAR is an independent authority; circulars issued by the Board may not be binding on it. However, benevolent circulars being for the benefit of the assessee would be required to be followed in view of the decisions of the Hon'ble Supreme Court in various pronouncements including that of UCO Bank vs. CIT reported in [1999] 237 ITR 889 (SC)

   The SC held that we do not think that we can hold that an advance ruling of the Authority can only be challenged under Article 136 of the Constitution before this Court and not under Articles 226 and/or 227 of the Constitution before the High Court. In L. Chandra Kumar v. Union of India and Others (supra), a Constitution Bench of this Court has held that the power vested in the High Courts to exercise judicial superintendence over the decisions of all courts and tribunals within their respective jurisdictions is part of the basic structure of the Constitution. Therefore, to hold that an advance ruling of the authority should not be permitted to be challenged before the High Court under Articles 226 and/or 227 of the Constitution would be to negate a part of the basic structure of the Constitution. Columbia Sportswear Company Vs Director of Income Tax, Bangalore (SLP (C) No. 3318 & 31543 of 2011)

6. The AAR ruling should be first challenged before the High Court unless it appears to the Supreme Court that the SLP raises substantial questions of general importance or a similar question is already pending before the Supreme Court for decision. [Columbia Sportswear Co. vs. DIT, 346 ITR 161 (SC)

Chapter 15
Equalisation Levy

Introduction

The Finance Act, 2016 introduced a new Chapter VIII titled “Equalisation Levy” through Finance Act, 2016 as a levy for additional resource mobilisation purportedly to address the challenges of taxation of e-commerce transactions. This Chapter constitutes a code in itself providing for the charge of levy, its exceptions, consequences of default, appellate remedy, penalties etc. The purpose behind the introduction of this Chapter appears to be to bring within the tax net transactions whose source is in India and the benefit therefrom is received by the service recipient in India, though the service provider is situated outside India.

This Chapter extends to the whole of India except the State of Jammu & Kashmir.

The CBDT issued notification no. 37 of 2016 dated May 27, 2016 stating that the provisions of Chapter VIII in the Finance Act, 2016 relating to the equalisation levy would come into effect from June 1, 2016. In other words, any payments being made for the specified services provided on or after June 1, 2016 shall attract the equalisation levy.

By amendment through the Finance Act 2020, the provisions of Chapter – VIII shall apply to consideration received or receivable for e-commerce supply or services made or provided or facilitated on or after the 1st day of April, 2020.

As per section 164(d), “equalisation levy” means the tax leviable on consideration received or receivable for any specified service [or e-commerce supply or services] under the provisions of Chapter VIII. (Amended by Finance Act 2020)

By Finance Act 2020, two definitions has been inserted under section 164(ca) and 164 (cb) as under:

i. "e-commerce operator" means a non-resident who owns, operates or manages digital or electronic facility or platform for online sale of goods or online provision of services or both

ii. "e-commerce supply or services" means—

i. online sale of goods owned by the e-commerce operator; or

ii. online provision of services provided by the e-commerce operator; or

iii. online sale of goods or provision of services or both, facilitated by the e-commerce operator; or

iv. any combination of activities listed in clause (i), (ii) or clause (iii);';

Specified service means online advertisement, any provision for digital advertising space or any other facility or service for the purpose of online advertisement and includes any other service as may be notified by the Central Government in this behalf.

Thus, currently, the levy is restricted to online/ digital advertisement and related services. However, in the future, additional services may be notified by the Government for the levy.

Charge of Equalisation levy on specified services

As per section 165, there shall be charged an equalisation levy at the rate of 6% of the amount of consideration for any specified service received or receivable by a person, being a non-resident from—

a. a person resident in India and carrying on business or profession; or

b. a non-resident having a Permanent Establishment (PE) in India;

collectively known as “Liable persons”.

The equalisation levy shall not be charged, where—

a. the non-resident providing the specified service has a PE in India and the specified service is effectively connected with such PE;

b. the aggregate amount of consideration for specified service received or receivable in a previous year by the non-resident from a person resident in India and carrying on business or profession, or from a non-resident having a PE in India, does not exceed Rs. 100,000; or

c. where the payment for the specified service by the person resident in India, or the PE in India is not for the purposes of carrying out business or profession.

Furthermore, this Chapter is not applicable to the State of Jammu and Kashmir (now Union Territory,(UT)) as per section 160(1). In other words, when the service recipient is situated in the UT of Jammu and Kashmir, the provisions of this Chapter should not apply.

A new section 165A has been inserted through Finance Act 2020, on and from 1st day of April 2020, to provide equalisation levy at the rate of 2%. of the amount of consideration received or receivable by an e-commerce operator from e-commerce supply or services made or provided or facilitated by it—

(i) to a person resident in India; or

(ii) to a non-resident in the specified circumstances as referred to in sub-section (3); or

(iii) to a person who buys such goods or services or both using internet protocol address located in India.

The equalisation levy under section 165A shall not be charged, where –

(i) where the e-commerce operator making or providing or facilitating e-commerce supply or services has a permanent establishment in India and such e-commerce supply or services is effectively connected with such permanent establishment;

(ii) where the equalisation levy is leviable under section 165; or

(iii) sales, turnover or gross receipts, as the case may be, of the e-commerce operator from the e-commerce supply or services made or provided or facilitated as referred to in sub-section (1) is less than 2 crore rupees during the previous year.

For the purposes of section 165A, "specified circumstances" mean –

(i) sale of advertisement, which targets a customer, who is resident in India or a customer who accesses the advertisement though internet protocol address located in India; and

(ii) sale of data, collected from a person who is resident in India or from a person who uses internet protocol address located in India.

Collection and recovery of equalisation levy on specified services

Section 163, which deals with collection and recovery of the levy

(equalisation levy referred to in sub-section (1) of section 165), places the onus on the Liable Persons to deduct the amount of levy from the amount paid or payable to a non-resident in respect of the specified service and pay the levy so collected during a calendar month to the Government by the 7th day of the immediately following month. It has also been provided that the liability to pay the equalisation levy shall trigger whether or not the Liable Person deducts the same from the payment of the non-resident.

A new section 166A has been inserted through Finance Act 2020, which provides that equalisation levy referred to in sub-section (1) of section 165A, shall be paid by every e-commerce operator to the credit of the Central Government for the quarter of the financial year ending with the date specified in column (2) of the Table below by the due date specified in the corresponding entry in column (3) of the said Table below:

Serial number	Date of ending of the quarter of financial year	Due date of the financial year
1	30th June	7th July
2	30th September	7th October
3	31st December	7th January
4	31st March	31st March

As per section 170, simple interest @ 1% per month or part thereof shall be paid by the Liable Person (assessee or e-commerce operator) for delay in making the payment of equalisation levy. There are penal consequences in case of failure to deduct or pay equalisation levy and failure to furnish annual return.

Equalisation Levy Rules

The CBDT had notified the Equalisation Levy Rules, 2016, which lay down the procedural framework for implementation, including prescribing forms for filing of annual return and appeals. These rules have been amended vide equalisation levy (Amendment) Rules, 2020 notified through Notification no. 87/2020 dated 28th October, 2020.

Chapter 16
Securitization Trusts

Tax on income from securitization trusts [Section 115TCA]

Section 115TCA(1) provides that any income accruing or arising to, or received by, a person, being an investor of a securitisation trust, out of investments made in the securitisation trust, shall be chargeable to income-tax in the same manner as if it were the income accruing or arising to, or received by, such person, had the investments by the securitisation trust been made directly by him.

Section 115TCA(2) provides that the income paid or credited by the securitisation trust shall be deemed to be of the same nature and in the same proportion in the hands of the person referred to in sub-section (1), as if it had been received by, or had accrued or arisen to, the securitisation trust during the previous year.

Section 115TCA(3) provides that the income accruing or arising to, or received by, the securitisation trust, during a previous year, if not paid or credited to the person referred to in sub-section (1), shall be deemed to have been credited to the account of the said person on the last day of the previous year in the same proportion in which such person would have been entitled to receive the income had it been paid in the previous year.

Further, section 115TCA(4) provides that the person responsible for crediting or making payment of the income on behalf of securitisation trust and the securitisation trust shall furnish, within such period, as may be prescribed, to the person who is liable to tax in respect of such income and to the prescribed income-tax authority, a statement in such form and verified in such manner, giving details of the nature of the income paid or credited during the previous year and such other relevant details, as may be prescribed. Rule 12CC of the Income-tax Rule prescribes Form no. 64E and 64F, as applicable, to be furnished by 30th June of the financial year following the previous year during which the income is distributed.

Section 115TCA(5) provides that any income which has been included in the total income of the person referred to in sub-section (1), in a previous year, on account of it having accrued or arisen in the said previous year, shall not

be included in the total income of such person in the previous year in which such income is actually paid to him by the securitisation trust.

Explanation to section 115TCA defines "securitisation trust" to mean a trust, being a -

i. "special purpose distinct entity" as defined in clause (u) of sub-regulation (1) of regulation 2 of the Securities and Exchange Board of India (Public Offer and Listing of Securitised Debt Instruments) Regulations, 2008 made under the Securities and Exchange Board of India Act, 1992 (15 of 1992) and the Securities Contracts (Regulation) Act, 1956 (42 of 1956), and regulated under the said regulations; or

ii. "Special Purpose Vehicle" as defined in, and regulated by, the guidelines on securitisation of standard assets issued by the Reserve Bank of India; or

iii. trust set-up by a securitisation company or a reconstruction company formed, for the purposes of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (54 of 2002), or in pursuance of any guidelines or directions issued for the said purposes by the Reserve Bank of India,

which fulfils such conditions, as may be prescribed.

Income in respect of investment in securitization trust [Section 194LBC]

Section 194LBC(2) provides that where any income is payable to an investor, being a non-resident (not being a company) or a foreign company, in respect of an investment in a securitisation trust specified in clause (d) of the Explanation occurring after section 115TCA, the person responsible for making the payment shall, at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by issue of a cheque or draft or by any other mode, whichever is earlier, deduct income-tax thereon, at the rates in force.

Further, explanation (b) to section 194LBC provides that where any income as aforesaid is credited to any account, whether called "suspense account" or by any other name, in the books of account of the person liable to pay such income, such crediting shall be deemed to be the credit of such income to the account of the payee, and the provisions of this section shall apply accordingly.

Tax on income of unit holder and business trust [Section 115UA]

Section 115UA(1) provides that any income distributed by a business trust to its unit holders shall be deemed to be of the same nature and in the same proportion in the hands of the unit holder as it had been received by, or accrued to, the business trust.

Section 115UA(2) provides that the total income of a business trust shall be charged to tax at the maximum marginal rate, subject to the provisions of section 111A and section 112.

Section 115UA(3) provides that if in any previous year, the distributed income or any part thereof, received by a unit holder from the business trust is of the nature as referred to in section 10(23FC) or section 10(23FC)(a) or section 10(23FCA), then, such distributed income or part thereof shall be deemed to be income of such unit holder and shall be charged to tax as income of the previous year.

Further, section 115UA(4) provides that any person responsible for making payment of the income distributed on behalf of a business trust to a unit holder shall furnish a statement to the unit holder and the prescribed authority, within such time and in such form and manner as may be prescribed, giving the details of the nature of the income paid during the previous year and such other details as may be prescribed. Rule 12CA of the Income-tax Rule has prescribed Form no. 64A and 64B, as applicable, to be furnished by 30th June of the financial year following the previous year during which the income is distributed.

Certain income from units of a business trust [Section 194LBA]

Section 194LBA(1) provides that where any distributed income referred to in section 115UA, being of the nature referred in clause (23FC) or clause (23FCA)] of section 10, is payable by a business trust to its unit holder being a resident, the person responsible for making the payment shall at the time of credit of such payment to the account of the payee or at the time of payment thereof in cash or by the issue of a cheque or draft or by any other mode, whichever is earlier, deduct income-tax thereon at the rate of ten per cent.

Section 194LBA(2) provides that where any distributed income referred to in section 115UA, being of the nature referred to in section 10(23FC), is payable by a business trust to its unit holder, being a non-resident (not being a company) or a foreign company, the person responsible for making the payment shall at the time of credit of such payment to the account of the payee or at the time of payment thereof in cash or by the issue of a cheque or draft or by any other mode, whichever is earlier, deduct income-tax thereon at the rate of 5% in case of income of the nature referred to in sub-clause (a) and 10% in case of income of the nature referred to in sub-clause (b) of the said clause.

Sub-section (2A) of section 194LBA has been inserted by Finance Act, 2020, nothing contained in sub-section (2) shall apply in respect of income of the nature referred to in sub-clause (b) of clause (23FC) of section 10, if the special purpose vehicle referred to in the said clause has not exercised the option under section 115BAA.

Section 194LBA(3) provides that where any distributed income referred to in section 115UA, being of the nature referred to in section 10(23FCA), is payable by a business trust to its unit holder, being a non-resident (not being a company), or a foreign company, the person responsible for making the payment shall at the time of credit of such payment to the account of the payee or at the time of payment thereof in cash or by the issue of a cheque or draft or by any other mode, whichever is earlier, deduct income-tax thereon at the rates in force.

Chapter 17
Base Erosion and Profit Shifting

Arguably, international tax issues are now high on the political agenda. Growth of multinational enterprises are putting a strain on the international tax rules, which were designed more than a century ago. Weaknesses in the current rules create opportunities for base erosion and profit shifting (BEPS), requiring bold moves by policy makers to restore confidence in the system and ensure that profits are taxed where economic activities take place and value is created.

In February 2013, OECD and G20 countries adopted a 15-point Action Plan to address BEPS in September 2013. The Action Plan identified 15 actions along three key pillars:

- introducing coherence in the domestic rules that affect cross-border activities, reinforcing
- substance requirements in the existing international standards, and
- improving transparency as well as certainty.

Since then, all G20 and OECD countries have worked on an equal footing and the European Commission also provided its views throughout the BEPS project. Developing countries have been engaged extensively.

The Action Plans are as, briefly, discussed below-

Action Plan 1 – Addressing the Challenges of Digital Economy:

The said Action Plan suggests following three strategies for taxing transactions in the digital economy –

- New nexus based on significant economic presence
- Withholding tax on digital transactions
- Equalisation Levy

Action Plan 1 does not recommend any of these options. Thus, Countries may select and introduce any of these options in their tax laws. Out of the above, India has introduced Equalisation Levy in the domestic tax law vide Finance Act, 2016. With this new levy under section 165 of the Finance Act,

2016 any Business to Business (B2B) payment made to a non-resident in respect of online advertising is withheld by the resident taxpayer. The equalisation levy does not apply when a non-resident service provider maintains a PE, in which case the income tax rate of 40% applies and expenses may be deducted from the tax base. Further, in March 2020, Government of India introduced additional provisions for charging equalisation levy in respect of e-commerce transactions by inserting a new Section 165A through Finance Act, 2020. Under the new provisions, an equalisation levy of 2% is levied on every e-commerce transaction of an e-commerce operator whose sales, turnover or gross receipts from e-commerce transactions are INR two crore or more during the previous year. Equalisation levy is charged broadly in respect of two types of transactions. One is e-commerce transaction which is in the form of supply of goods or services by or through e-commerce operator where such supply is made to a resident or to a customer who avails such services by using internet protocol address located in India. The second concerns e-commerce transaction with a non-resident, where such transaction is in the form of sale of advertisement which targets Indian customers or sale of data which is collected from a person in India. However, no equalisation levy is levied where such e-commerce operator has PE in India and such transactions are effectively connected with such PE. Further, where the transaction is covered under the existing provisions, i.e. under Section 165 at the rate of 6%, no separate levy under Section 165A shall be levied.

Provisions related to business connection arising due to significant economic presence (including digital transactions) are now part of section 9(1)(i) of the Act as laid down by Finance Act 2018. The Indian SEP test is divided into two limbs: The first limb is triggered if aggregate of payments arising from transactions are carried out by a non-resident in India, including the download of data or software exceeding a certain threshold in India. The second limb applies if such business activities are conducted in a systematic and continuous way in interaction with a certain number of users. The SEP applies even when there is no local agreement signed, independently of the existence of a fixed placed of business of the non-resident who may or may not provide services to local customers. The Finance Act 2020, has further clarified certain aspects relating to Significant Economic Presence. The transaction carried out by a non-resident with any person in India will be subject to the scope of SEP. Also, the words “through digital means” has been removed, thereby intending that activity through any means may include in the scope of SEP. Vide Explanation 2A of Section 9 (1) (i) of the

Act, the provisions of Significant Economic Presence will be applicable from AY 2022-23. The threshold amount and number of users to be covered by the said provisions of significant economic presence are yet to be prescribed. India has also updated its position on PE in the OECD Model Convention 2017.

Action Plan 2 - Neutralizing the effect of hybrid mismatch arrangements:

The recommendations are designed to neutralize mismatches by targeting the following types of arrangements: those with deduction/no inclusion (D/NI) outcomes, double deduction (D/D) outcomes and indirect deduction/no inclusion (indirect D/NI) outcomes. The objective of said action plan is to put an end to multiple deductions for a single expense, deductions without corresponding taxation or the generation of multiple foreign tax credits for one amount of foreign tax paid. The recommendations under this Action plan intends to address mismatches in tax outcomes where they arise in respect of payments made under a hybrid financial instruments or payments made to or by a hybrid entity.

Part I of Action Plan 2 provides that the primary rule recommended under this action plan is that countries deny the taxpayer's deduction for a payment to the extent that it is not included in the taxable income of the recipient in the other treaty country involved or it is also deductible in that country viz. deduction / no inclusion outcomes to be avoided. If the primary rule is not applied, then the counterparty jurisdiction can generally apply a defensive rule, requiring the deductible payment to be included in income or denying the duplicate deduction depending on the nature of the mismatch viz. double deduction outcome should not be intended.

Part II of the said Action Plan intends to ensure that hybrid instruments and entities, as well as dual resident entities, are not used to obtain unduly the benefits of tax treaties. Further, tax treaties do not prevent the application of the changes to domestic law recommended in Part I.

Action Plan 3 - Designing Effective Controlled Foreign Company ('CFC') Rules

As the name suggests, the said action plan intends to curb practices arising due to shifting of income to subsidiaries located in foreign jurisdictions. It recommends 6 building blocks for designing of effective CFC rules-

- Definition of a CFC (including the definition of control) - CFC rules generally apply to foreign companies that are controlled by shareholders in the parent jurisdiction.
- CFC exemptions and threshold requirements - The report recommends that CFC rules only apply to controlled foreign companies that are subject to effective tax rates that are meaningfully lower than those applied in the parent jurisdiction.
- Definition of CFC income - CFC rules include a definition of CFC income, and it sets out a non-exhaustive list of approaches or combination of approaches that CFC rules could use for such a definition.
- Computation of income - The report recommends that CFC rules use the rules of the parent jurisdiction to compute the CFC income to be attributed to shareholders. It also recommends that CFC losses should only be offset against the profits of the same CFC or other CFCs in the same jurisdiction.
- Attribution of income - The attribution threshold should be tied to the control threshold and that the amount of income to be attributed should be calculated by reference to the proportionate ownership or influence.
- Prevention and elimination of double taxation

Action Plan 4 – Limiting Base Erosion Involving Interest Deductions and other financial payments

The said action plan recommends the concept of fixed ratio rule, group ration rule and or targeted rules to address specific risks of entities like in public-benefit projects, banking and insurance. There are instances where multi-national companies may attempt to achieve favourable tax outcomes by adjusting the amount of debt within their group entities. To combat such practices, fixed ratio rule provides for an entity to deduct the net interest expense up to a benchmark of net interest/ EBITDA ratio. The said ratio could be in the range of 10% to 30%. While, under group ratio rule, a country may supplement the fixed ratio by a group ratio rule. This ratio rule allows an entity to deduct the net interest expense up to its group's net interest/EBITDA ratio, where this is higher than the benchmark fixed ratio. The group ratio rule is carve-out for entities which are highly leveraged for non-tax reasons. Under this action plan, there are also provisions related to

carry forward of disallowed interest expense and which could then be claimed as deduction in future years.

Many countries have adopted either of these above mentioned rules under their domestic tax rules. In India, section 94B – limitation on interest deduction related provision which deals with fixed ratio rule could be regarded as an outcome of this action plan.

Action Plan 5 – Countering harmful tax practices more effectively, taking into account transparency and substance

Action Plan 5 (Action 5) deals inter alia with income arising from intellectual property and in particular countering harmful tax practices taking into account the transparency and substance factors.

Action 5 recommends the following:

- Nexus approach' to apply
- It provides that income from intellectual property should be attributed
- to and taxed in the country in which substantial research and development activity is undertaken and should not be limited to the county of legal ownership

It appears that in line with Action 5, India introduced section 115BBF under the Income-tax Act ('Act') which deals with India's patent box regime. The said section provides for 10% tax on royalty income from patents developed and registered in India by a patentee who is an Indian resident with no deduction of expenses. Under this section, at least 75% of the expenditure should be incurred in India for any invention, in respect of which patent is granted for the company being eligible for patent box regime.

Action Plan 6 – Preventing the granting of treaty benefits in inappropriate circumstances

Action Plan 6 (Action 6) focuses on the prevention of treaty abuse, noting that treaty shopping is one of the most important sources of BEPS concerns. Action Plan 6 recommends the following:

- Commitment to ensure a minimum level of protection against treaty shopping

- Countries to include in their tax treaties an express statement that their common intention is to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance, including through treaty shopping arrangements.
- Minimum level of protection by including in the tax treaties one of the following:
    - A combined approach consisting of an Limitation of Benefit rule and a Principal Purpose Test (PPT) rule
    - A PPT rule alone
    - A Limitation of Benefit rule, supplemented by specific rules targeting conduit-financing arrangements.

As noted above, the minimum standard to protect against treaty shopping that was agreed to by countries may be met by including in treaties a PPT rule alone or a PPT rule in conjunction with an LOB rule. In general, under this provision, treaty benefits would be denied when it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining treaty benefits was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of the tax treaty.

Countries may implement the minimum standard to protect against treaty shopping by including the LOB rule supplemented by a mechanism that would address treaty-shopping strategies commonly referred to as “conduit arrangements” that would not be caught by the LOB rule. These rules would deal with such conduit arrangements by denying treaty benefits in respect of income obtained under, or as part of, a conduit arrangement.

Further, they could take the form of domestic anti-abuse rules or judicial doctrines that would achieve a similar result.

Action Plan 7 – Additional guidance on Attribution of Profits to Permanent Establishments

The main objective of Action Plan 7 is to prevent the artificial avoidance of Permanent Establishment’s (PEs), where actually there is a significant activity in the country.

Action Plan 7 focuses on updating the definition of PE in Article 5 of the OECD model tax treaty to include the following:

- Changes to the rules on deemed PEs created by dependent agents, addressing commissionaire and other undisclosed agent arrangements;
- Changes to the exceptions from creating a fixed place of business PE for specific activities (such as maintenance of stocks of goods for storage, display, delivery or processing, purchasing or the collection of information) so that these will apply only where the activity in question is preparatory or auxiliary in relation to the business as a whole; and
- An anti-fragmentation rule that removes exceptions (including those for preparatory or auxiliary activities) in circumstances where activities in a country are carried out by different group companies, where the activities are part of a "cohesive business operation" and not, in the aggregate, preparatory or auxiliary.

Earlier, foreign enterprises used the Commissionaire arrangement for non-creation of a PE by stating that the contracts concluded by the person acting as a Commissionaire are not binding on them. It was therefore possible for the foreign enterprise to avoid the PE exposure by changing the terms of contracts without material changes in the functions performed in a State etc. Similar strategies were also prevalent in case of agents acting on behalf of the foreign enterprise, wherein contracts were substantially negotiated in a country were not formally concluded in the same country because they were finalized or authorized abroad or these agents used to contend that they were independent agent even though they were closely related to the foreign enterprise on behalf of which they were acting.

BEPS action plan 7 intends to tackle such arrangements.

Amendments to section 9 under the India domestic law could also be regarded as influenced by the above provisions of Action plan 7.

With significant changes in the way the businesses are conducted, the activities which were previously considered to be merely preparatory or auxiliary activities now form part of core business activities of the foreign enterprise. To effectively tackle such situations and tax the income arising therefrom, modifications were suggested to ensure that each of the exceptions included under Article 5(4) should be restricted to activities of a 'preparatory or auxiliary' character, as per Action plan 7.

Multi-national enterprises used to avoid PE status by artificially fragmenting the activities and thereby later to argue that each part is merely engaged in preparatory and auxiliary activities which form part of the exception provided under Article 5(4). The Anti-fragmentation provisions suggested under Action plan 7 is the outcome of this BEPS concern.

Other Action Plans are as briefly discussed below-

Action Plan 8 – Transfer pricing and intangibles – Covered under the transfer pricing related provisions

Action Plan 9 of the OECD BEPS Action Plan is designed to develop rules to prevent base erosion and profit shifting through the transfer of risks among or the allocation of excessive capital to group members.

Action Plan 10 – Transfer pricing and other high-risk transactions is intended to develop rules to prevent abusive transactions which would not or would rarely occur between the unrelated parties.

Action Plan 11 – Measuring and monitoring BEPS – The said action plan recommends that OECD to work with Governments to report and analyse more corporate tax statistics and to present them in an internationally consistent way. One such initiative could be considered as 'Country-by-Country' reporting of data which will help government and researchers to effectively measure and monitor BEPS and also the actions taken to address BEPS.

Action Plan 12 – Mandatory disclosure rules – Transparency is one of the three pillars of the BEPS project. Various measures developed under the BEPS project will result in substantial availability of data which will lead to enhanced co-operation and collaboration between tax administrations and which will further aid in effective tackling of BEPS concerns.

Action Plan 13 – CbC reporting provisions are covered under the Transfer pricing provisions discussed in the previous section.

Action Plan 14 – More effective dispute resolution mechanisms – The said action plan highlights the commitment of countries to implement a minimum standard to ensure that they resolve treaty-related disputes in a timely, effective and efficient manner. The compilation under the said action plan contains four documents, namely (i) the Terms of Reference; (ii) the Assessment Methodology; (iii) the Mutual Agreement Procedure (MAP) Statistics Reporting Framework; and (iv) the Guidance on Specific

Information and Documentation required to be submitted with a Request for MAP Assistance.

Action Plan 15 – A mandate for the development of a Multi-Lateral Instrument on tax treaty measures to tackle BEPS – Covered as a separate Chapter.

Chapter 18
Multi-lateral Instrument

The Base Erosion and Profit Shifting project (BEPS) is an ambitious project undertaken by the Organization for Economic Co-operation and Development (OECD) to combat issues such as double non-taxation of income, treaty shopping. To deal with these issues, OECD in October 2015 released reports on 15 action plans.

BEPS Action Plan 15 is for developing a multilateral instrument (MLI) to modify bilateral tax treaties. MLI does not need the individual countries to renegotiate each bilateral treaty. The convention provides minimum standards in respect of prevention of treaty abuse and dispute resolution. MLI also includes recommendatory measures in respect of hybrid mismatch agreements and artificial avoidance of permanent establishment (PE) status.

MLI will likely change the face of more than 2,000 tax treaties. On 7 June 2017, over 70 jurisdictions (including India) participated in the signing of the MLI. The speed of implementation of MLI propelled BEPS into action.

The MLI modifies tax treaties that are "Covered Tax Agreements". A Covered Tax Agreement is an agreement for the avoidance of double taxation that is in force between Parties to the MLI and for which both Parties have made a notification that they wish to modify the agreement using the MLI.

MLI, unlike protocol, does not directly modify a tax treaty but runs parallel to the tax treaties. MLI and tax treaties are to be read together. Where both the treaty partners ratify, accept or approve the given MLI provision, it results in adoption of that provision in the tax treaty. In the absence of such matching terms, the pre-MLI provisions in treaties may continue.

MLI will be operative between the jurisdictions only when the MLI is signed and the Instrument of ratification, acceptance or approval is deposited with the OECD. Thereafter, the effective date may be notified.

As on 22 March 2018, more than 70 jurisdictions have signed MLI. India is amongst the signatories to MLI and has provided a provisional list of 93 jurisdictions to which it intends to apply the MLI provisions and also its reservations/ options on the applicability of MLI to its treaties.

The Indian Government on 12th June 2019 announced its ratification of the Multilateral Instrument to Implement Tax Treaty Related Measures to Prevent

BEPS (the MLI). The impact of the MLI on India's Covered Tax Agreements (CTAs) are significant and requires careful consideration for existing and proposed transactions and structures. As of 17th July 2019, the MLI has been signed by 89 countries, of which 28 countries have already submitted a ratified copy with the OECD.

On 25th June 2019, India deposited its instrument of ratification with the nominated authority under the multilateral instrument, with its final MLI position to implement tax treaty related measures to prevent base erosion and profit shifting. Pursuant to the above, the MLI for India shall enter into force on 1st October 2019, and shall be applicable on various DTAAs of India from 1st April, 2020.

Many of India's important treaty partners have signed the MLI and submitted the ratified instrument with the OECD Depositary. These include the United Kingdom, Australia, Finland, France, Singapore, Netherlands, Luxembourg, Japan, Ireland and United Arab Emirates. Key countries that have so far not signed the MLIs include the United States, Brazil, Thailand and Oman.

Some of India's major trading and investment partners such as Germany, China and Mauritius have signed MLI but have not notified. India in their provisional list for applicability of MLI. Thus, despite India including them in its provisional list, MLI may not apply to these treaties.

As on 22 March, 2018, Austria, Isle of Man, Poland, Jersey and Slovenia have deposited their instruments of ratification with OECD wherein MLI provisions will be effective from 1 July, 2018.

Some of the important MLI provisions and India's positions on the same are as provided below-

- **Article 2 – Interpretation of Terms**

  Covers notification of tax treaties covered by MLI convention. India has notified 93 tax treaties. Tax treaties not notified by India: China and Marshall Islands, but included its treaty with Hongkong.

- **Article 3 – Transparent entities**

  Income derived by an entity that is treated as wholly or partly fiscally transparent under the tax law of either treaty partners shall be considered to be income of the Resident country but only to the extent that the Resident country treats this as income for taxation purposes.

India has reserved its right for non-applicability of Article 3. Thus, Article 3 may not apply to India's tax treaties.

Mostly, India's tax treaties does not have specific provisions dealing with fiscally transparent entities. India-US and India-UK tax treaties which contain a specific provision are broadly aligned to MLI.

- **Article 4 - Dual resident entities**

  The said provisions provide that where a person (other than individual) is resident of both the treaty countries, competent authorities shall tie-break and determine the residential status through mutual agreement having regard to the place of effective management (POEM), the place of incorporation and/or any other relevant factors.

  India has not made any reservations on applicability of Article 4. Thus, many of India's tax treaties tie-break the dual residency issues applying only the POEM test.

  Some of the countries viz. Canada, Cyprus, France, Luxembourg and Singapore etc. have not notified Article 4. These treaties may not be modified by Article 4.

  India-Japan tax treaty is already aligned to Article 4 of MLI.

- **Article 5: Application of Methods for Elimination of Double Taxation**

  The said Article provides three options for non-taxation or for less than single taxation. First option under this provision deals with taxation of income in the resident country which is otherwise exempt in both the countries. The second option also provides similar tax treatment in respect of hybrid instruments. While the third option deals with credit method.

  India has chosen to apply Option C (i.e., credit method – based on Article 23B of the OCED Model Convention); the said option to apply to all its CTAs for its own residents

- **Article 7: Prevention of treaty abuse**

  This article provides for three approaches to prevent treaty abuse:

  1. Only the Principal Purpose Test (PPT);
  2. PPT plus either Detailed or Simplified Limitation of Benefit test (LOB); or

3. Detailed LOB plus anti-conduit arrangements

India has earlier opted for PPT plus simplified LOB provision. Now, India has accepted to apply PPT as an interim measure and intends where possible to adopt LOB provision, in addition or replacement of PPT, through bilateral negotiations along with simplified LOB.

Many countries such as Cyprus, Luxembourg, France, Japan, Netherlands, Singapore, UK etc. have adopted only PPT.

- **Article 12 - Artificial avoidance of PE status through commissionaire arrangements and similar strategies**

Article 12 of MLI intends to amend agency PE-related provisions in tax treaties through the following:

- Countering effect of commissionaire arrangements;
- Creation of agency PE where an agent habitually plays a principal role in concluding contracts with routine approval of the principal;
- No independent agent status if the agent acts exclusively on behalf of a closely-related enterprise.

India has not made any reservation on Article 12. Article 12 may modify India's tax treaties subject to matching.

Canada, Cyprus, Luxembourg, Singapore, UK etc. have not notified Article 12. These tax treaties may not be modified by Article 12.

- **Article 13 – Artificial avoidance of PE status through specific treaty exemption**

Article 13 provides that PE exemption under treaty Article 5(4) will be available only if (option A) - the overall activities of the fixed place of business are preparatory or auxiliary in nature; or (option B) - if specific exemption for the activity is provided.

This Article also deals with anti-fragmentation rules, which provides that exemption from PE will not be available if:

- A closely-related enterprise already has a PE in the source jurisdiction
- Overall activities conducted by the closely-related enterprises are not of preparatory or auxiliary nature

India has chosen option A to deal with the avoidance of PE through specific activity exemption. India has chosen to adopt the anti-fragmentation rule.

Article 13 may modify India's tax treaties subject to matching.

Canada, Cyprus, Finland, etc. have not notified Article 13. These tax treaties with India may not be modified by Article 13.

- **Article 14- Splitting-up of contract**

  Article 14 provides for aggregation of time spent on connected projects carried out by closely-related enterprises in the determination of PE. The aggregation provision should not apply for projects with less than 30 days.

  India has not made any reservation on Article 14. Article 14 may modify India's tax treaties subject to matching.

  Canada, Cyprus, Japan, Luxembourg, Singapore, UK etc. have reserved the right not to apply Article 14. These tax treaties with India may not be modified by Article 14.

- **Article 17- Corresponding Adjustments**

  Article 17 addresses unintended double taxation arising on account of transfer pricing (TP) adjustments. It allows the tax resident of one country to claim corresponding relief of taxes paid by its associated enterprises in another country due to TP adjustments. It also provides for settlement of TP disputes through mutual agreement procedure or bilateral advance pricing arrangement (APA) negotiations.

  India reserves the right of non-applicability of Article 17 where its treaties already contain a provision described in Article 17. Article 17 may modify India's tax treaties subject to matching.

  India's tax treaties with Singapore and Japan contain similar provisions.

  Belgium, France, Sweden etc. have opted for Article 17.

- **Article 35- Entry Into Effect**

  Deals with the effect of provisions of the MLI.

  India reserved the right for an optional provision under the MLI, pursuant to which, date of entry into effect for India's CTAs shall be determined from '30 days from latter of the dates on which OECD

receives notification from India and its treaty partner about completion of its respective internal procedures'. Now, India has removed such reservation.

For India, the MLI shall enter into force on the first day of the month after the expiry of three months from the date of deposit of ratified instrument of the MLI with OECD i.e. on 1st October 2019.

India has retained its option to substitute 'taxable period' for 'calendar year' to arrive date of entry into effect. Further India has retain its stand for not opting Part VI of the Convention [which deals with Mandatory Binding Arbitration].

Accordingly, effective date of entry into effect will be as under:

- *For withholding taxes* - 1st day of next taxable period that begins on or after the latest of the dates on which this Convention enters into force for each of the contracting jurisdictions to the CTA.
- *For other taxes* - Taxable period that begins on or after expiry of six calendar months from the latest of the dates on which this Convention enters into force for each of the contracting jurisdictions to the CTA.

MLI could be regarded one of the important action plans under the BEPS project to create a healthy tax environment. This might go a long way in bringing tax parity amongst developing and developed economies subject to the adoption of matching provisions. Measures like PPT, LOB and various anti-abuse provisions covered under the MLI may give impetus to countries to curb tax avoidance and treaty shopping.

Recovery of tax in respect of non-resident from his assets [Section 173]

Without prejudice to the provisions of section 161(1) or of section 167, where the person entitled to the income referred to in section 9(1)(i) is a non-resident, the tax chargeable thereon, whether in his name or in the name of his agent who is liable as a representative assessee, may be recovered by deduction under any of the provisions of Chapter XVII-B and any arrears of tax may be recovered also in accordance with the provisions of this Act from any assets of the non-resident which are, or may at any time come, within India.

Chapter 19
Stop the Press

The Finance Bill, 2021 was introduced in Lok Sabha on 01.02.2021. Some of the important proposals pertaining to International Taxation are:

A. Proposals in Brief

1. Addressing mismatch in taxation of income from notified overseas retirement fund [Section 89A]

Proposed section 89A seeks to provide relief from double taxation due to mismatch of taxation on income from withdrawal of retirement benefit account maintained by a specified person in a notified country on account of the amount being taxable in the notified State on receipt basis while being taxable in India on accrual basis *(hereinafter referred to as "Specified Account")*. The details of the application of the provision are to be prescribed by the Central Government.

This amendment is proposed to take effect from 1st April, 2022 and will accordingly apply to assessment year 2022-23 and subsequent assessment years.

2. Rationalisation of the provision concerning withholding on payment made to Foreign Institutional Investors (FIIs) [Section 196D]

It is proposed to insert a proviso to 196D(1) to provide that in case of a payee to whom an agreement referred to in 90(1) or 90A(1) applies and such payee has furnished the tax residency certificate referred to in section 90(4) or section 90A(4) of the Act, then the tax shall be deducted at the rate of 20% or rate or rates of income-tax provided in such agreement for such income, whichever is lower.

This amendment is proposed to take effect from 1st April, 2021

3. Constitution of the Board for Advance Ruling

The Authority for Advance Rulings (AAR) is proposed to be substituted by the Board for Advance Ruling. The Board to consist of two members, each being officer not below the rank of Chief Commissioner of Income Tax, which will ensure continued functioning. This and other proposed changes are stated to impart greater efficiency, transparency and accountability.

These amendments are proposed to take effect from 1st April, 2021.

4. Proposed Rationalization of provisions of Equalization Levy

Proviso is proposed to be inserted in Section 163 *(Extent, commencement and application)* to clarify that consideration received or receivable for specified services and for e-commerce supply or services shall not include consideration taxable as royalty or fees for technical services in India under the Income-tax Act read with the agreement notified by the Central Government under section 90 or section 90A of the Income-tax Act.

- Explanation in Section 164(cb*) (Definitions) (Certain Activities to constitute e-commerce supply or service) is* proposed to be inserted to define activities, such as acceptance of offer for sale, placing/acceptance of the purchase order, payment of consideration and supply of goods or provision of services , partly or wholly, taking place online to be considered as "online sale of goods" and "online provision of services".
- *Section 165A (Charge of Equalization Levy)(Meaning of Consideration received or receivable inserted) is proposed to be amended by inserting sub-section (3) to provide that consideration received or receivable from ecommerce supply or services shall include:*
    - *(i) consideration for sale of goods irrespective of whether the e-commerce operator owns the goods;*
    - *(ii) consideration for provision of services irrespective of whether service is provided or facilitated by the e-commerce operator*

These amendments are proposed to take effect retrospectively from 1st April, 2020.

5. Section 10(50) is proposed to be amended to give effect to the above mentioned amendments.

These amendments are proposed to take effect from Assessment year 2021-22 and subsequent assessment years.

6. Proposed insertion of definition of "Liable to tax" (Section 10(29A))

It has been proposed to define Liable to tax in relation to a person, means that there is a liability of tax on such person under any law for the time being in force in any country, and shall include a case where subsequent to imposition of tax liability, an exemption has been provided.

These amendments are proposed to take effect from Assessment year 2021-22 and subsequent assessment years.

7. Proposed insertion of new section 206AB

TDS/TCS on non-filer at higher rates not applicable to non-resident who does not have permanent establishment in India.

B. Detailed Provisions

1. Addressing mismatch in taxation of income from notified overseas retirement fund [Section 89A]

- It is proposed to insert a new section 89A to the Act to provide that the income of a specified person from specified account shall be taxed in the manner and in the year as prescribed by the Central Government. It is also proposed to define the following expressions:
- Specified person: a person resident in India who opened a specified account in a notified country while being non-resident in India and resident in that country.
- Specified account: an account maintained in a notified country which is maintained for retirement benefits and the income from such account is not taxable on accrual basis and is

taxed by such country at the time of withdrawal or redemption.

- Notified country: a country notified by the Central Government for the purposes of this section in the Official Gazette.

This amendment is proposed to take effect from 1st April, 2022 and will accordingly apply to assessment year 2022-23 and subsequent assessment years

2. Rationalisation of the provision concerning withholding on payment made to Foreign Institutional Investors (FIIs) [Section 196D]

The existing provisions of section 196D of the Income Tax Act provides for deduction of tax on income of Foreign Institutional Investors(FIIs) from securities as referred to in clause (a) of sub-section (1) of section 115AD of the Act (other than interest referred in section 194LD of the Act) at the rate of 20 per cent. It is proposed to insert a proviso to subsection (1) of section 196D of the Act to provide that in case of a payee to whom an agreement referred to in sub-section (1) of section 90 or sub-section (1) of section 90A applies and such payee has furnished the tax residency certificate referred to in sub-section (4) of section 90 or sub-section (4) of section 90A of the Act, then the tax shall be deducted at the rate of twenty percent or rate or rates of income-tax provided in such agreement for such income, whichever is lower.

This amendment is proposed to take effect from 1st April, 2021.

3. Exemption of income u/s 10(50) will apply for e-commerce supply or services made or provided or facilitated on or after 1st April 2020 instead of 1st April 2021.

Following explanations proposed to be added:-

a. Section 10(50) not to be applicable to Royalty or FTS taxable under the Income-tax Act read with the agreement notified by the Central Government under section 90 or section 90A of the Income-tax Act.

b. e-commerce supply or services to have same meaning as defined u/s 164(cb) of Chapter VIII of the Finance Act,2016.

4. Constitution of the Board for Advance Ruling

AAR consists of a Chairman and various Vice-Chairman, revenue members and law members. There are three benches of the Authority. A bench cannot function if the post of Chairman or Vice-Chairman is vacant. As per past experience, the posts of Chairman and Vice-Chairman have remained vacant for a long time due to non-availability of eligible persons. This has seriously hampered the working of AAR and a large number of applications are pending since last many years. Hence, it is proposed to constitute a Board of Advance Ruling and to make the following amendments in the existing provisions of AAR:-

- The Authority for Advance Rulings shall cease to operate with effect from such date, as may be notified by the Central Government in the Official Gazette.
- It is proposed that the Central Government shall constitute one or more Board for Advance Rulings for giving advance rulings under the said Chapter on and after the notified date. Every such Board shall consist of two members, each being an officer not below the rank of Chief Commissioner.
- Section 245N is proposed to be amended to incorporate the definitions of the Board of Advance Rulings, notified date, Member of the Board of Advance Rulings and change in the definition of Authority to include the Board for

Advance Rulings.

- Section 245-O is proposed to be amended to provide that the Authority constituted under the said section shall cease to operate on or after the notified date.
- Section 245-OB shall be inserted to provide for the constitution of the Board of Advance Rulings.
- Section 245P, 245R and 245T are proposed to be amended to provide provisions of the said section shall have effect as if for the words “Authority”, the words “Board for Advance Rulings” had been substituted and provisions of Section 245R shall apply mutatis mutandi to the Board for Advance Rulings as they apply to the Authority

- Section 245Q (which deals with filing of application) is proposed to be amended to provide that the pending application with the Authority shall be transferred to the Board for Advance Rulings along with all records, documents or material, by whatever name called and shall be deemed to be records before the Board for all purposes.
- Section 245U is proposed to be amended to provide that on or from the notified date, the powers of the "Authority" under the said section shall be exercised by the "Board for Advance Rulings" and the provisions of the said section shall apply mutatis mutandi to the Board for Advance Rulings as they apply to the Authority.
- Section 245V and 245S is proposed to be amended to provide that nothing contained in the said section shall apply on and after the notified date
- A new section 245W is proposed to be inserted to provide for appeal to High Court against the order passed or ruling pronounced by the Board for Advance Ruling. This appeal can be filed by the applicant as well as by the Department.
- References to Customs Act, 1962, Central Excise Act, 1944 and Finance Act, 1994 in the definition of applicant in section 245N and in section 245Q relating to application for advance ruling is proposed to be omitted.

These amendments are proposed to take effect from 1st April, 2021