

Case Studies

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Case Study No. 1

USA Inc. is the company engaged in manufacture and sale of customized software products. Mauritius Inc. is a wholly owned subsidiary of USA Inc. Mauritius Inc. acts as an agent/distributor for USA Inc. throughout the world. Mauritius Inc has appointed India Inc. a group company as an agent in India in respect of its agency business for USA Inc. India Inc. solicits orders for onward transmission to Mauritius Inc. Mauritius Inc. has the authority to accept orders on behalf of US Inc. but not India Inc.

The method of transacting the sale of software is two fold:-

- a) In the first scenario USA Inc. transfers the goods on a principal to principal transaction to Mauritius Inc. which in turn sells at a cost plus mark up to India Inc. which again in turn will sell the product to an Indian concern. The entire transfers in this process will take place only after the order is booked and also the software (in a customized form) is developed by US Inc.

Consider:

- a)
 - a) Will the profits arising from the transfer of the customized software between USA Inc. to Mauritius Inc. be chargeable to tax in India?
 - b) Can India Inc. be treated as a permanent establishment of USA Inc.
 - c) If transfer pricing conditions are not satisfied would it make a difference to the conclusion arrived at in questions 1 & 2?
- b) The second method of dealing is that USA Inc. develops customized and off the shelf software in US and directly transfers the same to the Indian party without the intervention of either Mauritius Inc. or India Inc. after orders are solicited by India Inc.

Consider :

- a) Whether profits accruing to USA Inc. would be chargeable to tax under Article 7 or Article 12.
- b) Consider in this scenario whether India Inc. could be treated as a permanent establishment of USA Inc. by virtue of the shareholding structure through Mauritius, or US Inc. having a business connection as contemplated by section 9 of the Act.
- c) If the answer to (b) is in the affirmative then what would be the factors determining the amount of profits chargeable to tax in India?

- d) Does it make a difference if in either of the two scenarios there is commonality of directors in the respective countries.
- e) Mr. X, Director of USA Inc. who is a whole time employee director of USA Inc. has visited India a total of 21 days in the whole year, each visit not extending beyond 2 days at a time. His visits are primarily social calls to laise with and entertain prospective customers and out of the 21, 10 days he was on a brief holiday in Goa. Mr. Director receives US \$ 1,00,000/- per month as salary and US \$ 2000 as Directors Sitting Fees (no Board meeting of USA Inc. has taken place in India). Discuss the taxability of these two amounts in India? Should Mr. X file a Return in India.

Case study No. 2

UAE 1 Limited is a company incorporated in the United Arab Emirates and is the managing agent of its 100% subsidiary UAE 2 Limited. For managing UAE 2 Limited it receives a management fee of 10% of UAE 2 Limited's profits.

UAE 2 Limited is engaged in the business of management consultancy and is located in the Dubai Free Trade Zone and under the law is granted an exemption from payment of taxes for the next 50 years.

UAE 2 Limited gives management consultancy services to clients throughout the world. It has three projects in India for advising three different Indian corporate entities, two of the projects last for 6 months each and one lasts for 10 months.

Questions:

1. Can UAE 2 Limited be entitled to the DTA with UAE?
2. If yes, in respect of its consultancy work in India which is rendered through employees based in India, does it have a PE under article 5(2)(i) of the DTA?
3. Can UAE 1 Limited be taxable in India on its managing agent's income? Can the PE of UAE 2 Limited, be also deemed to be a PE of UAE 1 Limited in view of the interrelations between the companies?
4. UAE 2 Limited's AO proposes to invoke the provisions of section 44C while computing the income of the PE of UAE 2 Limited on :-
 - a) direct expenses incurred in UAE such as travel etc. in respect of the Indian business and allocated to India;
 - b) indirect head office expenses incurred in UAE. How would you prevent the officer from invoking section 44C
5. Under article 26(2) of the DTA relating to non discrimination UAE 2 Limited wants to argue that the rate of tax chargeable on its PE should be the same as applicable to Indian companies, despite the retrospective amendment to section 90. Consider in the light of the recent decision of *ABN Amro Bank vs. CIT 96 TTJ (Cal.) (TM) 1041* and also *JCIT vs Sakura Bank Ltd. 99 TTJ 689 Bom.*

Case Study No. 3: Turnkey Power Project – implications under section 44BBB

A group of two companies viz. N Ltd. of Norway and I Ltd. of India won a bid for one turnkey power project in India. Both the companies are signatories to the agreement signed with the Authority. There is an umbrella co-ordination agreement between two companies specifying their respective role and responsibility, as also, specifying the methodology of working. Indemnities and guarantees have been provided by both the companies to the Authority on joint and several basis. The agreement carries break up of the price relevant to different components such as equipment supply, civil construction, designing, etc.

For commercial reasons, the parties decided that the work in the segment of civil construction, erection, commissioning may be entrusted to a company registered in UAE comprised of N Ltd. and I Ltd. as its shareholders. The company at UAE is an existing joint venture company of the parties undertaking similar turnkey projects in UAE. UAE company is equipped with office and engineers who will oversee all policy decisions with regard to the power project. UAECO will have a regular project office in India.

The implementation of civil construction, erection, commissioning segment is likely to endure for 36 months.

I Ltd. [which is an experienced construction company] is likely to play the role of an important sub contractor for UAECO in India. Design work relevant to civil construction, erection, commissioning will be got done by UAECO through its office in Norway. To recapitulate, agreement with the Authority specifies this amount separately.

CEO of N Ltd. has since contacted half a dozen consultants in India and has collected more than a dozen versions from the consultants on taxability of UAECO in connection with its role in India. He is still seized of all his questions intact and is keen on collective wisdom of IFA participants. His questions are:

- a) Is the project of UAECO a qualifying project within the meaning of section 44BBB of the Act? For application of section 44BBB, does it matter that the entirety of work forming part of Turnkey project is not to be handled and performed by UAECO?
- b) Can applicability of section 44BBB be denied on the ground that one of the shareholders of UAECO is an Indian company and/or that I Ltd. is to work as a major sub-contractor?
- c) Can applicability of section 44BBB be denied if the A.O. were to dispute binding validity of double tax avoidance agreement which India has signed with UAE?
- d) Will the amount received by UAECO for embedded designs be processed under section 44BBB?

- e) Can A.O. determine tax liability at a figure higher than one warranted under section 44BBB if income reflected in profit and loss account of project office is higher than 10% of the consideration ?
- f) Can UAECO opt for section 44BBB on selective basis in some of the years forming part of the project? Can it opt for selection on a project to project basis?
- g) Will UAECO be subject to MAT liability under section 115JB of the Act?
- h) If the A.O. alleges any default in the matter of tax deduction by the project office, can there, in view of section 40(a), be an attempt at enhancing income base beyond the level specified in section 44BBB?
- i) Will there be any liability to deduct tax at source in respect of sub contract payments made to I Ltd.?

Case Study No. 4 : Taxation of Specialist Equipment

The facts

Boring Solutions Ltd., resident of France, designs and manufactures tunnelling and mining equipments. Tunnelling machine “XX3” has recently been developed by Boring Solutions at substantial cost (\$10 M) to cope with difficult tunneling work. After perfecting the design of XX3, a number of machines were built at cost of \$ 1 M each. To protect the design of XX3, extensive patents were taken out by Boring Solutions Ltd. For commercial reasons, the company does not sell or lease the machine to third parties.

Boring Solutions has agreed to undertake a contract in India for an Indian Company Deep Pockets Ltd., under which a team of operators will bore a series of tunnels at construction site in India. Under the contract, Boring Solutions will be paid \$ 7,000 per day of operation (covers use of one XX3, crew and all operational cost) and mobilization fee of \$80,000 to cover cost of bringing the equipment and operators to India and returning them to France. The equipment and personnel are to be on site for 9 months. During this period, equipment is likely to be operated for 200 days.

Costs in respect of the project are estimated to be as follows:

| | |
|---------------------------------------|------------|
| ➤ Wages of operators [in India] | \$ 400,000 |
| ➤ Operational costs, parts, fuel etc. | \$ 300,000 |
| ➤ Mobilization of crew and equipment | \$ 50,000 |
| ➤ Accommodation and food (in India) | \$ 30,000 |
| ➤ Administrative costs in France | \$ 10,000 |

The machine has an expected operational life of 600 days. But, after 300 days of operation it will need to be dismantled, overhauled and reassembled at cost of about \$ 500,000.

The following is comparative projected profit calculation of the project in India as per the project CFO, as per the accountant at France and as per tax advisor in India.

(Figures \$ '000)

| Particulars | As per Project CFO at France | As per Accountant | As per the tax advisor |
|---------------------------------|---|------------------------------|-----------------------------------|
| Gross receipts | 1400 | 1400 | 1400 |
| Mobilisation fees | — | — | 80 |
| Total receipts (A) | 1400 | 1400 | 1480 |
| Expenses: | | | |
| Wages | 400 | 400 | 400 |
| Operational Costs | 300 | 300 | 300 |
| Accommodation and food | 30 | 30 | 30 |
| Administrative costs | 10 | 10 | 10 |
| Maintenance reserve | ¹ 330 | — | — |
| Research & Development [Ad-hoc] | 200 | — | — |
| Lease of Machinery | — | ² 600 | — |
| Mobilisation costs | — | — | 50 |
| Depreciation @ 15% (9mths)) | — | — | 112 |
| Total Cost (B) | 1270 | 1340 | 902 |
| Net Profit (A- B) | 130 | 60 | 578 |

Issues for Discussion

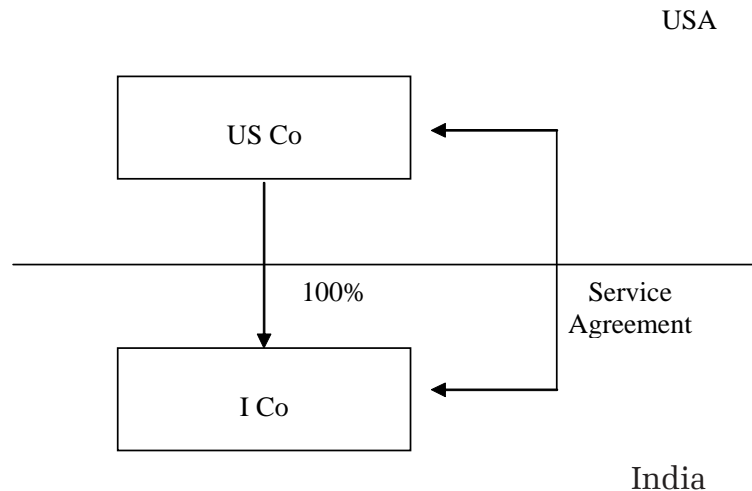
1. How would you calculate profits of the project in - India in particular, what are your thoughts on:
 - a. Treatment of use by the permanent establishment of XX3 machine.
 - b. Deductibility of the following :
 - i. Depreciation.
 - ii. maintenance reserve.
 - iii. lease fee.
 - c. If it is agreed that the use of XX3 machine is a notional lease by head office to PE, would India be prevented from imposing withholding tax on notional lease?
 - d. Treatment of profit on mobilization. Can it be taxed in India?
2. What would be your view if Boring Solutions is resident of non treaty country ?

¹ Calculated : 200 days / 300 days * refurbishment cost of \$500,000.

² The accountant at France believes that the equipment is effectively leased to PE.

Case Study No. 5

Facts



- US Co, is a company incorporated in, and tax resident of USA, and is part of a global multinational group, which is engaged in the business of preparing designs, software and undertakes research & development (R & D) for automobile industry.
- I Co, a company incorporated in India, is a wholly owned subsidiary of US Co, which is set up to prepare designs, undertake R & D, prepare software and supply the same to US Co, which may after due study, utilize the same. Prior to setting up of I Co, these activities were undertaken by US Co itself.
- I Co enjoys benefits of tax holiday under section 10A of the Act.
- Under the agreement with I Co for above services, US Co has also agreed to send its employees to India for stewardship and other similar activities (without any consideration), such as briefing I Co on the standard of services expected, acquainting the staff of I Co on various aspects of the functions by conducting briefing sessions for effective transitioning of various functions and providing basic guidance so that services provided meet the overall global value benchmarks of the multinational group. The stewardship activities include monitoring the overall activities at I Co.
- US Co also sends some employees on deputation to I Co at the latter's request to work under the control of I Co and substantially perform functions within the capacity of I Co's staff. Such deputees :-
 - o Work under the direct control of I Co
 - o Report to I Co

- Further the risk and rewards of work done by such deputees lie with I Co. However, the deputees remained on the payroll of the US Co and the actual cost (without profit element) of these deputees was reimbursed by I Co to US Co.
- As per the agreement between US Co and I Co
 - o I Co was entitled to use the brand name and logo of US Co
 - o All deliverables of I Co was to be the exclusive property of US Co
 - o Activities of I Co was subject to audit and investigation by US Co
 - o There was provision of unlimited access to the business premises of I Co for such investigation
- I Co does not carry significant market risk with respect to its transactions with US Co and it does not have any interaction with the clients of US Co.
- In consideration for services rendered by I Co, US Co pays I Co costs (direct and indirect) plus an agreed mark up on costs.
- I Co is remunerated by US Co for its services at arm's length price.

Issues

- Whether I Co constitutes a PE of US Co?
 - o Whether I Co constitutes a Fixed Place PE of US Co?
 - o Whether I Co constitutes a Service PE of US Co?
 - o Whether I Co constitutes an Agency PE of US Co?
- If I Co constitutes a PE, since transactions between US Co and I Co are at arm's length, can further profits be taxable in India in the hands of the US Co?

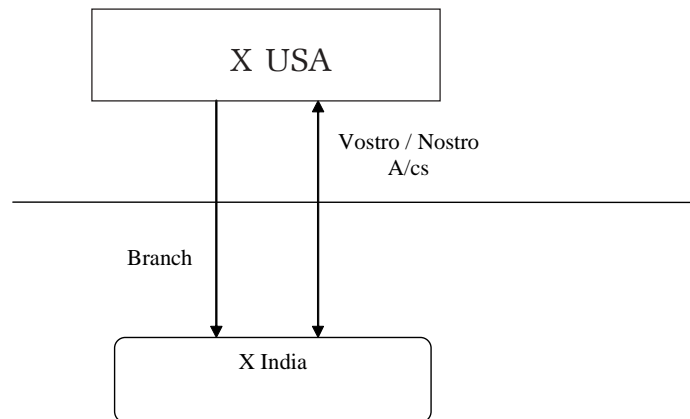
Key reference material

- Article 5 of India US Treaty
- Morgan Stanley and Co. AAR No. 661 of 2005, In re 201 CTR 67 (AAR)
- AAR No. 542 of 2001, In re 274 ITR 501 (AAR)
- OECD Commentary 2005 on Article 5
- OECD Discussion Draft on Attribution of Profits to PE - 2004
- CBDT Circular 23 of 1969, dated July 23, 1969
- CBDT Circular 5 of 2004, dated September 28, 2004

Case Study No. 6

USA

Facts



- X Bank LLC. ('X USA'), is a non-resident company, incorporated in the USA, and qualifies as a tax resident of USA under the provisions of the Agreement for Avoidance of Double Taxation between India and US ('India US treaty').
- X USA is carrying on banking activities in India, through its branch X Bank, India Branch ('X India') registered as per the RBI regulations. Hence, X USA has a permanent establishment ('PE') in India in the form of X India.
- X India pays interest to X USA, on X USA's Vostro balances with X India.
- Similarly, X India earns interest income on its Nostro account with X USA.
- X India has been filing its return of income claiming benefits under the India US treaty, in which:-
 - o the interest received by X India from X USA is offered to tax, and
 - o the interest paid by X India to X USA has been claimed as a deductible expenditure.
- X India does not withhold any taxes from interest payments to X USA.

Issues

1. Whether interest payable by X India to X USA is an allowable deduction in the hands of X India?
2. Whether interest received by X India from X USA is taxable in the hands of X India?

Key reference material

- Article 7 of India US Treaty
- Article 7 of India Netherlands Treaty
- Article 11 of India US treaty
- *ABN Amro Bank NV vs. ADIT 97 ITD 89 (Cal) (SB)*
- CBDT Circular 740 dated April 17, 1996

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