Special provisions relating to certain income of non residents, Introduction to transfer pricing, APA, Double taxation Relief

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Chapter XIIA : Special Provision relating to certain income of non-resident

- Provisions applicable only to NR and only in respect of specified incomes
- Income of NR not covered by this Chapter will be taxed as per Normal Rates of tax
- These provisions are OPTIONAL
- Few Definitions (S. 115C)
  - Non-Resident
  - Foreign Exchange Asset
  - Investment Income
  - Long-term Capital Gain

Chapter XIIA : Special Provision relating to certain income of non-resident

Section 115D

- Investment income & LTCG
- No deduction allowed in respect of expenses incurred
- No Chapter VI-A deduction allowed
- Basic exemption limit not allowed to be adjusted
- In respect of LTCG: expenses on transfer will be allowed, but benefit of indexation not allowed

Chapter XIIA : Special Provision relating to certain income of non-resident

- Rate of Tax (S. 115E)
  - Investment Income – 20%
  - LTCG -10%
  - Surcharge and Education cess as applicable
  - If income of NR includes any other income, -the same will be taxed at normal rates
- Exemption on LTCG (S. 115F)
  - Net sale proceeds to be utilized within 6 months from the date of transfer
  - Purchase of another forex assets
  - NSC certificates
  - Exemption withdrawn if newly acquired asset is transferred/ converted within 3 years – LTCG taxed in the year of violation

Chapter XIIA : Special Provision relating to certain income of non-resident

Section 115G

- No need to file Return of Income
  - If no other income except investment income & LTCG
  - Tax on such income has been correctly deducted at source
- Section 115I : OPTIONAL
  - If normal provisions are found more beneficial, assessee can opt for the same – by filing ROI
  - Option can be changed on year to year basis

Chapter XIIA : Special Provision relating to certain income of non-resident

Section 115H

- On becoming Resident – by default normal provisions shall apply
- Special provision apply only till the assessee holds such forex asset, except shares of Indian Company
- ROI to be filed for availing these provisions along with an application addressed to AO

S. 44B – Sp. Provision for computing profits and gains of shipping business of non-resident

- Applicable to non-resident engaged in the business of operation of ship
- 7.5% of specified amount shall be deemed to be profits and gains of such business
- Specified amounts:
  - Amount paid/payable in respect of carriage of goods, passengers, livestock, mail or goods shipped at any ports in India
  - Amount received/ deemed to be received in India on account of carriage of goods, livestock, mail or goods shipped at any ports outside India
  - Include demurrage charges or handling charges or any other amount of similar nature

Section 44BB : Profits and gains in connection with business of exploration

- Non-resident engaged in the business of providing services or facilities in connection with or supplying plant and machinery on hire to be used in prospecting / extraction /production of mineral oils
- 10% of specified amount
  - Amount paid/payable – for prospecting, extraction, production of mineral oils in India
  - Amount received or deemed to be received - for prospecting, extraction, production of mineral oils outside India

S. 44BBA : Profits and gains of the business of operation of aircraft by non-resident

- Non-resident engaged in the business of operation of aircraft
- 5% of specified amount
  - Amount paid/ payable on account of carriage of passengers, livestock, mail or goods from any place in India
  - Amount received or deemed to be received on account of carriage of passengers, livestock, mail or goods from any place outside India

Introduction to Transfer Pricing

Introduction to transfer pricing

- Globalization is the business reality – majority of the cross boarder transaction happens between related party
- Simple illustration:

	Scenario 1		Scenario 2	
	A	B	A	B
Profit	300	100	100	300
Tax	90	15	30	45
Total Tax	105		75	

- Transfer price therefore tends to shape the tax base of the countries involved in cross-boarder transactions
- Indian TP regulation - Section 92 to 92F – Rule 10A to 10E
- S. 92 – Any income arising from an international transaction shall be computed having regard to 'arm's length price" (allowance of any expense/ interest)
- No impact – if ALP result in to reduction of income/ increasing loss

Transfer pricing - Process

- Understand the business - Identify AEs and international transactions
- Analysis of international transactions, FAR and characterisation
- Selection of Tested Party
- Selection of Most Appropriate Method
- Searching for and identifying potential comparables (economic adjustments)

International transactions

- Transactions between two or more AE
  - Transaction with Non AE – if there exist a prior agreement between such other person and AE
- Either or both of whom are non-resident
  - Purchase, sale or lease of tangible/ intangible property
  - Provision of services
  - Lending/ borrowing of money
  - Any other transactions having a bearing on profits, income, losses or assets of such enterprises
  - Arrangements for allocation/ apportionment of any cost/ expenses
  - Etc.
- Such transactions need not be formal or in writing and need not be legally enforceable

Scope of section 92

- Guarantee given by the AE
- Deferred receivable/ payable
- Issue of equity/preference shares
- Exit charge paid on conversion of a manufacturer to a toll manufacturer
- transaction of business restructuring/ reorganisation

Associated Enterprises

AE has direct / indirect participation in the Management, Control or Capital [S. 92A]

Controlled by Capital

- Holding directly/indirectly not less than 26% of shares voting power
- Loan – not less than 50% of book value of total assets
- Guarantee not less than 10% of borrowings from another
- Holding not less than 10% interest in Firm, AOP, BOI

Controlled by Management

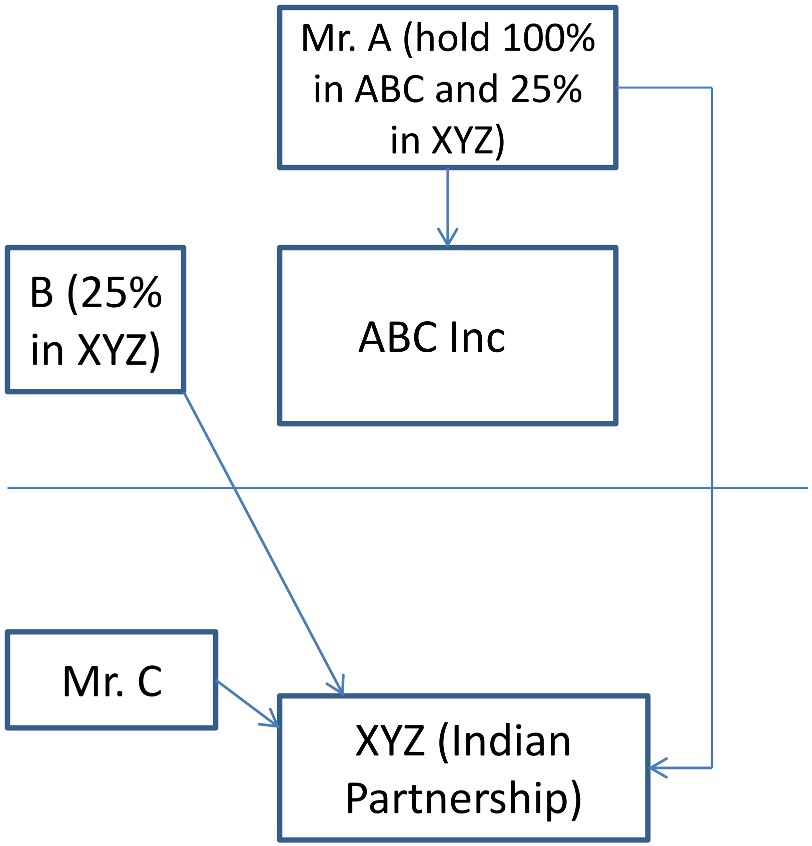
- More than half of board of directors or one or more executive directors are appointed by another enterprise
- More than half of the directors or one or more of executive directors of each enterprises are appointed by same person

Associated Enterprises ...contd.

Other Control

- The manufacturing/ processing is wholly dependent on other enterprise
- 90% or more of the raw material/ consumable are supplied by the other enterprise / prices are influenced by other enterprise
- Goods manufactured are sold to other enterprise and prices are influenced by other enterprise
- Where one enterprise is controlled by an Individual/ HUF and other enterprise is controlled by such individual or his relatives or member of such HUF or relative of such members

Associated Enterprise … Case Study



- A, B and C are the Partners in XYZ
- International transaction between ABC and XYZ
- Test whether ABC and XYZ are AE?
  - If B is not a relative of A
  - If B is relative of A
  - If B is a Company controlled by A
  - If ABC becomes Partner holding 5% interest in XYZ

Function, Assets and Risk Analysis (FAR)- Illustration

FAR	Oversea Parent	Ind. Co
FUNCTION Performed		
Manufacturing Activity		✓
Procurement of Raw Material		✓
Inventory management	✓	
Marketing	✓	
ASSETS Deployed		
Plant & Machinery		✓
Other Assets	✓	✓
Know-how	✓	
Trademark	✓	

FAR – Illustration … contd.

FAR	Oversea Parent	Ind. Co
RISK Assumed		
Market risk	✓	
Inventory risk	✓	
Credit risk	✓	✓⊙
Capacity risk	✓	
Workmanship risk		✓
Product liability risk	✓	
Tested Party ?		✓

Oversea Parent – Entrepreneur
Ind. Co – Contract Manufacturer

Indian Contract manufacturer will have limited credit risk

Tested Party

- First step for selection of most appropriate method
- Selection of tested party based on functional analysis
- The one to which TP methods can be applied in reliable manner
- Least complex entity for which reliable comparable can be found

Arm’s Length Price (ALP)

- Price in a transaction with Non-AE in uncontrolled conditions
- Computation of ALP
  – Determined using “most appropriate method”
  – If more than one price – Arithmetic means of such prices
- No adjustment – if the difference is within the tolerance band

Transfer Pricing Methods

The five major transfer pricing methods are

- Comparable uncontrolled price (CUP)
- Resale price method (RPM)
- Cost plus method (CPM)
- Profit split method (PSM)
- Profit Comparison Method (TNMM)

Recently one more method introduced

Appropriateness of method – based on:

- Functional Analysis
- Availability of reliable information
- Degree and reliability of comparability

Comparable Uncontrolled Price (CUP) Method

- One of the five method prescribed u/s. 92C(1)
- Most appropriate method – OECD TP Guideline – Para 2.3
  - "Moreover, where, taking account of the criteria for comparability, the CUP and another transfer pricing method can be applied in an equally reliable manner, the CUP method is to be preferred"
  - Also endorsed in various judicial decision

CUP – Income Tax Rules, 1962

- IT Rules are in line with OECD TP Guidelines (Chapter II, Section B)
- Rule 10B(1)(a)
  - "Comparable uncontrolled price method, by which-

  (i) the price charged or paid for property transferred or services provided in a comparable uncontrolled transaction, or a number of such transactions, is defined;

  (ii) Such price is adjusted to account for difference, if any, between the international transaction and the comparable uncontrolled transactions or between the enterprises entering into such transactions, which could materially affect the price in the open market;

  (iii) The adjusted price arrived at under sub-clause (ii) is taken to be an arm's length price in respect of the property transferred or services provided in the international transaction"
- Rule 10B(2)
  - "The comparability of an international transaction with the uncontrolled transaction shall be judged with reference to the following, namely-

  (a) The specific characteristics of the property transferred or services provided in either transaction;

  (b) The function performed, taking into account assets employed or to be employed and the risk assumed, by the respective parties to the transactions;

CUP – Income Tax Rules, 1962

- Rule 10B(2) (Continued)
  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, risk and benefits are to be divided between the respective parties to the transactions;
  d. Conditions prevailing in the markets in which the respective parties to the transactions 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"

- Rule 10B(3)
  – "An uncontrolled transaction shall be comparable to an international transactions if-
  (a) none of the difference, if any, between the transactions being compared, or between the enterprises entering into such transactions are likely to materially affect the price or cost charged or paid, or the profit arising from, such transaction in the open market; or
  (b) reasonably accurate adjustments can be made to eliminate the material effect of such differences"

Application of CUP Method

- Most direct and reliable way to apply arm's length principle - but can be used in case of strong similarity of products or services
- Difficult to find a transaction between independent enterprises that is similar to a controlled transaction with no material differences
- Para 2.16 of OECD TP Guidelines –
  - "In considering whether controlled and uncontrolled transactions are comparable, regard should be had to the effect on price of broader business function other than just product comparability"
- Other comparability factors
  - Level of market (Wholesale or Retail)
  - Volume
  - Geographical differences
  - Timing of transaction
  - Contractual terms, such as credit period, currency, after sales service, etc.
  - Intangible property associated with sale

Some of the Judicial view on comparability factor

- The relevant market condition for testing a transaction is the market where goods are sold and not the place of origin
- Purchase from newly developed third party Chinese suppliers cannot be used on the ground of risk associated with uncertain quality standard
- Due to significant volume and geographical differences between sales to AE and non-AE, CUP method was rejected
- CUP method is more appropriate where reliable data is available – purchase of API for generic drugs – custom data base
- Internal CUP would not be suitable where the quantity exported to AE is on wholesale basis while sold to third parties is on retail basis

Typical transactions where CUP is applied

- Goods traded on exchange or products whose prices are available in public domain, e.g. metals, coffee, commodities, etc.
- Financing transactions / Guarantee transactions
- Purchase and sale of listed shares
- Tangible & Intangible assets – royalties

Resale Price Method (RPM)

Rule 10B(1)(b)

i. the price at which property purchased or services obtained by the enterprise from an associated enterprise is resold or are provided to an unrelated enterprise, is identified;

ii. such resale price is reduced by the amount of a normal gross profit margin accruing to the enterprise or to an unrelated enterprise from the purchase and resale of the same or similar property or from obtaining and providing the same or similar services, in a comparable uncontrolled transaction, or a number of such transactions;

iii. the price so arrived at is further reduced by the expenses incurred by the enterprise in connection with the purchase of property or obtaining of services;

iv. the price so arrived at is adjusted to take into account the functional and other differences, including differences in accounting practices, if any, between [55]**[***the international transaction or the specified domestic transaction***]** and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect the amount of gross profit margin in the open market;

v. the adjusted price arrived at under sub-clause (*iv*) is taken to be an arm's length price in respect of the purchase of the property or obtaining of the services by the enterprise from the associated enterprise;

RPM

- Used when purchase from related party for resale to unrelated party
- Ideal for trading/distribution activity
- Used when Reseller does not add substantial value to the goods
- Used when Reseller does not apply intangible assets to add value
- Better when goods sold within short span else more adjustment like, exchange rate, inventory cost

Steps for RPM

- Identification of resale price by tested party
- Resale price reduced by normal gross profit with reference to uncontrolled transactions
- Such price reduced by expenses incurred (custom duty, etc.) in purchase of the product/ service
- This price may be adjusted to account for functional and other difference, if any
- Adjusted price arrived above taken to be ALP

Illustration of RPM

Tax payer has imported goods from AE and also from 3rd Party

		Import from AE	Import from Non-AE
Step 1	Resale price per unit	250	250
	No. of unit sold	200	100
	Resale price in Rs.	50,000	25,000
Step 2	Less: Normal Profit margin	28%	
	Purchase price		18,000
	Gross Margin	14,000	7,000 [28%]
		36,000	
Step 3	Expense if any		
Step 4	Adjustment if any (Mkt. fn.)	2,000	
Step 5	ALP of import	34,000	

RPM

Adjustment under RPM for material differences

- Inventory levels and turnover rates
- Sales, marketing and advertising programs
- The level of market, wholesale or retail
- Accounting practices
- Use of tangible/ intangible assets
- Foreign currency risk
- Contractual terms, i.e. pricing, warranty, credit, volume term

Few decisions on RPM

ITO v. L'oreal India P. Ltd. (ITA No, 5423/Mum/2009)

- There is no order of priority in selection of methods. RPM is one of the standard method and the OECD guidelines also states that in case of distribution and marketing activities (where goods are purchased from AEs and sold to unrelated parties) RPM is the most appropriate method.

Gharda Chemicals v. DCIT (ITA No. 2242/MUM/06)

- RPM could be applied only in cases where Indian entity had 'purchased' goods from its AE

St. Jude Medical India P Ltd v. DCIT (ITA No. 1626/HYD/2010)

- Only goods sold could be considered while determining ALP and unsold goods would have to be excluded. Further, under RPM, price needs to be considered after applying GP margin on sales and accounting for functional, economic and working capital differences

Cost Plus Method

Rule 10B

i. the direct and indirect costs of production incurred by the enterprise in respect of property transferred or services provided to an associated enterprise, are determined;

ii. the amount of a normal gross profit mark-up to such costs (computed according to the same accounting norms) arising from the transfer or provision of the same or similar property or services by the enterprise, or by an unrelated enterprise, in a comparable uncontrolled transaction, or a number of such transactions, is determined;

Cost Plus Method

iii. the normal gross profit mark-up referred to in sub-clause (*ii*) is adjusted to take into account the functional and other differences, if any, between *the international transaction or the specified domestic transaction* and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect such profit mark-up in the open market;
iv. the costs referred to in sub-clause (*i*) are increased by the adjusted profit mark-up arrived at under sub-clause (*iii*);
v. the sum so arrived at is taken to be an arm's length price in relation to the supply of the property or provision of services by the enterprise;

Steps for CPM

1. Ascertain the direct and indirect cost of production
2. Ascertain normal gross profit mark-up
3. Adjust the normal GP mark-up referred above to take in to account the functional and other differences
4. The cost referred in 1 above are increased by the adjusted GP mark-up referred in 3 above
5. The sum so arrived is an arm’s length price

CPM

- This method is ideally used in cases involving manufacturing, assembling or production of tangible products or provision of services that are sold / provided to AE’s
- Requires high level of comparability between the tested party and the comparable in terms of functions performed

Some of the key aspect of CPM

- Focuses on gross profit margins, which are heavily influenced by the scope, intensity of functions and accounting methods
- Difference in the cost base may require adjustment for proper comparability
- Internal v external comparable
  – Internal comparable more reliable – fewer adjustment is required to internal comparable

CPM

Illustration

- Company A – Manufacturer- sells goods to AE in UK – AE in UK is engaged in distribution of goods in UK
- Also sells directly to customers in India an other countries
- CPM can be most appropriate – internal comparable can be used – split P&L in 3 segment – AE, Exports and Domestic

Profit Split Method (PSM)

Rule 10B(1)(d)

The PSM is applied in complex situations when other available methods (such as CUP/ TNMM) are not sufficient to price the function performed

PSM is usually appropriate when:

- Transactions are very interrelated such that they cannot be evaluated on a separate basis
- Valuable, non-routine intangibles exist in transactions and profit arising to the group cannot be assigned to one of the entities of the group
- Significant differences between controlled and uncontrolled transactions are attributable to economies of horizontal/ vertical integration
- Adequate comparable are unavailable to set margins for all the entities

PSM

There are two forms of PSM

- Comparable Profit Split Method Or Contribution Method
- Residual Profit Split Method

Steps for PSM

- The combined net profits of the associated enterprises arising from the international transaction is determined
- The relative contribution made by each of the AE to the earning of such combined profit is then evaluated
  - On the basis of function performed, assets employed/ to be employed, risks assumed
  - On the basis of reliable market data which indicate how such contribution would be evaluated by unrelated enterprise performing similar function
- The combined net profit is then split amongst the enterprise in the proportion of their relative contribution
- The profit thus attributed as ALP

Steps for RPSM

The combined net profit in first instance is partially allocated to each enterprises

The residual profit is then split in proportion of relative contribution

1. Define the correct pool of global profit
2. Identify routine activities
3. Determine functional returns for routine activities
4. Determine residual profit pool
5. Determine value driver or objective keys to apportion the residual profit

PSM - Illustration

Typically PSM is used in Telecommunications/ Pharmaceuticals Industries

Illustration

- Assume that there exist a company which is responsible for broadcasting content through various channels all over the world
- This company through its subsidiaries provide television network feeds to various broadcasters around the world.
- Each subsidiary company is responsible for content development and transmission to broadcaster
- To ensure appropriate content development, each subsidiary perform R&D on multimedia related area
- These subsidiary bears risk of appropriate content, delivery and standard routine transfer pricing risk

Illustration – Contd.

Particulars	India	US	UK	Singapore	UAE
Gross Revenue (a)	x	x	x	x	x
3rd Party cost (b)	y	y	y	y	y
Net Revenue (c) = (a) – (b)	150	80	160	-15	-5
Routine Returns	85	30	145	10	5
Residual Profit	65	50	15	-25	-10
Allocation ratio	0.3	0.1	0.20	0.25	0.15
Allocation Amount	28.50	9.50	19.00	23.75	14.25
PBIT after TP Adjt.	113.50	39.50	164.00	33.75	19.25

PSM – Practical Challenges

- Third parties in general do not use profit split method to establish transfer prices
- Evaluation and measurement of the value drivers / intangibles – element of subjectivity
- Requires use of data from foreign locations
- Difficulty in calculating the combined revenue and costs for all the AEs

Transactional Net Margin Method (TNMM)

- Most frequently used method – due to lack of availability of comparable uncontrolled price and gross margin data required for CUP/ CPM/ RPM
- Broad level of product comparability and high level of functional comparability

Transactional Net Margin Method (TNMM)

- Net margin realized by the enterprise from an international transactions with AE is computed in relation to
  - Sale effected, assets employed, other relevant factor
- Net margin realized from comparable uncontrolled transactions is computed with regard to same base
- Net margin in uncontrolled transaction is adjusted to take into account, difference if any, between international transaction and uncontrolled transaction

TNMM

- Most frequently used and practical method
- Applicable for any type of transaction
- Comparison at operating margin level
- Broad level of similarity of functions, Assets and risks (FAR)
- Net margins are more tolerant to functional differences
- Selection of the right comparables and PLI are critical factors

TNMM - ILLUSTRATION

- Indian manufacturer (IP is with overseas parent) – imports some parts from AE
- Revenue from end customer = INR 100 and other operating cost = INR 15
- PLI
  - Cost base PLI cannot be used as cost is affected by TP
  - Assets based PLI cannot be used in absence of information of comparable company's asset base
  - Net profit margin seems to be most appropriate
- External benchmarking suggest net profit margin of 10%
- TP = INR 100 – INR 10 – INR 15 = INR 75

Other Methods

Rule 10AB

- The other method for determination of the arms' length price in relation to an international transaction shall be ***any method*** which takes into account the ***price*** which has been ***charged or paid, or would have been charged or paid,*** for the same or similar uncontrolled transaction, with or between non-associated enterprises, under similar circumstances, ***considering all the relevant facts.***

Some Practical Examples

- Cost sharing arrangements
- Purchase/ sale of fixed assets
- Transactions supported by valuation reports
- Third party quotation (guarantees, derivative transactions etc.)

Most Appropriate Method

Method	Typically used for Transactions
CUP/ Other Method	Loans, Royalties, Service fee, transfer of tangibles , guarantee fees
RPM	Marketing operations of finished products, where distributor does not performing significant value addition to product
CPM	Sale of finished / semi-finished goods or services
PSM	Transactions involving provision of integrated services by more than one enterprise or involving unique intangibles
TNMM	Provision of services, manufacture / distribution of finished goods and guarantee fees

Domestic Transfer Pricing

- Partially existent way before introduction of TP
  - Expenditure in respect of which payment has been made to related parties referred to in Section 40A(2)(b) can be disallowed if it is excessive having regard to the fair market value
  - Computation of tax holiday of eligible undertakings based on fair market value of goods / services, in case of transactions with other units in the same legal entity and based on ordinary profits in case of transactions with closely connected persons

- Supreme Court in the case of *Glaxo SmithKline Asia (P) Ltd.* suggested in its order that TP regulations be made applicable where fair market value needs to be assigned to transactions between domestic related parties

- S. 92(2A) – Any allowance for expenditure or interest or allocation of any cost, expenses or income in relation to SDT to be computed having regard to ALP
  - No impact – if ALP result in to reduction of income/ increasing loss

Scope of Domestic Transfer Pricing

Specified Domestic Transactions (SDT) [S. 91BA]

Section 40A(2)

- Disallowance of **expenditure** in excess of arm's length price for transactions between **related parties.**

Tax Holiday Unit

- Any Transfer of goods and services between '**eligible unit'** and 'non-eligible unit' - whether at market value?
- Transactions with entities having close connection – whether earning **ordinary profits** ?

Domestic Transfer pricing – Case Study

1. Company X has given a loan to Company Y (where X and Y are AE)
   - What is the implication of such loan is interest free
   - Will the answer change, if Company Y is enjoying tax holiday
   - What if X charges interest @ 18% where ALP of interest is 12%
2. Cost Allocation :

P&L Account	Cost allocation	Cost plus allocation
Sales	100	100
Cost of sales	65	65
Allocation of HO cost	20	22
Profit	15	13

Domestic Transfer pricing – Case Study

- Transfer of undertaking within the group company, i.e. by Co.1 to Co.2
- Whether transfer of undertaking is specified domestic transaction
- Consider two scenario – 1) where transfer happens at book value and 2) where transfer happens at FMV
- If undertaking enjoys tax holiday – whether DTP provision would be invoked?

Particular	Scenario 1	Scenario 2
Sale	100	100
Cost of sale	60	60
Adm. cost	15	15
Depreciation	6	10
Profit	19	15

Advance Pricing Agreement

Advance Pricing Agreement (APA)

Key features

- Broadly similar to APA scheme of other countries
- Agreement between tax payer and CBDT
  - To determine ALP
  - Specify the manner in which ALP has to be determined
- Can be unilateral, bilateral or multilateral
- Binding on tax payer and tax authority in respect of such transaction
- Use of any method (whether specified or not) with adjustments/ variations as necessary
- Application should be filed
  - Before undertaking a proposed transaction or
  - For continued transaction – before 1^{st} day of relevant fiscal year, i.e. 1^{st} April
- Valid for a maximum period of 5 consecutive years
- Provision for renewal

Advance Pricing Agreement (APA)

- Application can be withdrawn at any time before finalization of terms
- APA team to include experts in economics, statistics, law or any other field
- APA authority may conduct meetings with taxpayer, make field visits or call for additional information/ document
- The tax payer who entered into an APA, would be required to file an annual compliance report to DGIT for each year covered under APA
- TPO shall carryout a compliance audit for each year covered under APA

APA – Overview of process

Phase 1 – Pre-filing discussion –mandatory- no fees

Details required in forms, include

- Unilateral v bilateral/ multilateral
- International transactions in prior 3 years
- Critical assumptions
- History of any previous CA request
- History of audits and appeals, etc
- We understand that understanding reached will be communicated

Phase 2 – Formal APA application – before 1st April

Phase 3A – Post filing meeting and negotiations

Phase 3B – Competent Authority negotiations for bilateral or multilateral APA

Phase 4 – Finalizing and signing an APA

Phase 5 – Annual compliance and monitoring

Renewal of APA : Process similar to original APA, no pre-filing required

Double taxation relief

Avoidance of double taxation

- Exemption Method

Particulars	No exemption	Full exemption
Income	1,00,000	1,00,000
Less : Exemption		20,000
Taxable Income	1,00,000	80,000
Tax in country of residence	30,000	24,000
Tax in country of source	4,000	4,000
Total Tax	39,000	28,000

Avoidance of double taxation

- Credit Method

Particulars	No credit	Full exemption
Income	1,00,000	1,00,000
Tax in country of source	4,000	4,000
Tax in country of residence	30,000	30,000
Less : Foreign Tax Credit		(4,000)
Total tax payable		
Total Tax	39,000	30,000

Unilateral tax credit – No DTAA

Section 91

- Person should be resident in India
- If he proves that:
  - He had income which accrued or arose outside India in that previous year
  - That income is not one which deemed to accrue or arise in India
  - He has paid tax in any country with which there is no DTAA
- Credit = sum calculated by applying Indian rate of tax on doubly taxed income or income tax/ super tax actually paid in those country whichever is less

Underlying Tax Credit (UTC)

- Available only to a Company
- DTAA with Singapore, Mauritius, USA, Australia, etc.
- Illustration : A Foreign Company (X Ltd.) has an Indian subsidiary

Particular	Amount
Profit before tax of ICo	1,00,000
Less :Tax @ 30%	30,000
Profit after tax	70,000
Dividend distributed	30,000
70% of the equity is held by X Ltd	
Dividend to X Ltd.	21,000
UTC (21,000 * 30%)	6,300

Tax Sparing

- Resident state allows credit on deemed basis at the rate applicable in the source state even though the income is exempt
- India's treaty with Japan, Canada, Malaysia, Singapore, Kenya, etc.

Particulars	Amount – No tax sparing	Amount – Tax sparing
Profit of Indian branch	100	100
Tax paid in India	0	0
Tax in country of residence	35	35
Less : Tax Sparing relief		(30)
Tax liability in Country of Residence	35	5

THANKS