Centre for Tax Laws (CTL)

Directorate of Distance Education

NALSAR University of Law, Hyderabad

In collaboration with

TAXMANN

Course Material

M.A. (INTERNATIONAL TAXATION)

1.1.4. RESIDENCE FOR TREATY PURPOSES

Prepared by

CA Prerna Peshori

FCA, LL.B., LL.M.(Int. Tax., Vienna), DIIT, M.Com.

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Residence for Treaty Purposes

Residence

1. Introduction

Revenue is assessed by most of the countries by imposing taxes on two key components of the economy i.e., income and consumption. As traditionally followed in most of the countries, determination of conditions for levy of consumption-based taxes is relatively simple as compared to determination of levy of taxes on Income.

Consumption-based taxes are levied on consumption of goods and services and are imposed at the time of incurring the expenditure on the transaction. However, tax levied on income is generally due on the net income (gross income net of expenses for material, labour, capital, etc.,) earned by the taxpayer over the tax period. Given this significant difference in nature of levy (i.e., the taxable event not being a transaction in form of exchange of goods), determination of place of levy or right to levy taxes on income is a debatable issue.

Over the period of time, economies have developed two principles for determination of taxability of income in a particular jurisdiction, one is the **residence-based taxation**, where income is taxed by virtue of a person's domicile in a particular country, and the other being the concept of **source-based taxation** where a person is taxed in the country from where the income is sourced.

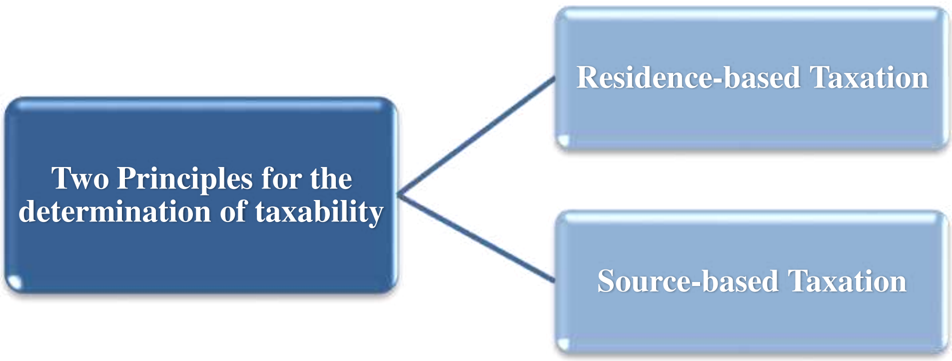

Fig. Principles for Determination of Taxability

2. Residence-based Taxation versus Source-based Taxation

In the early 1920s, the League of Nations took upon itself the task of studying the issue of global double taxation. The foremost objective of that study was to study the possibility of formulating general principles which would become the basis of an international tax framework and which would be capable of preventing double taxation. The outcome of the study conducted by the League of Nations was the concept of "economic allegiance" that became the basis to design framework for international tax. Economic allegiance is based on factors aimed at measuring the existence and extent of the economic relationships between a particular state and the income or person to be taxed.

The study also identified four factors comprising economic allegiance, namely

(i) origin of wealth or income,
(ii) situs of wealth or income,
(iii) enforcement of the rights to wealth or income, and
(iv) place of residence or domicile of the person entitled to dispose of the wealth or income.

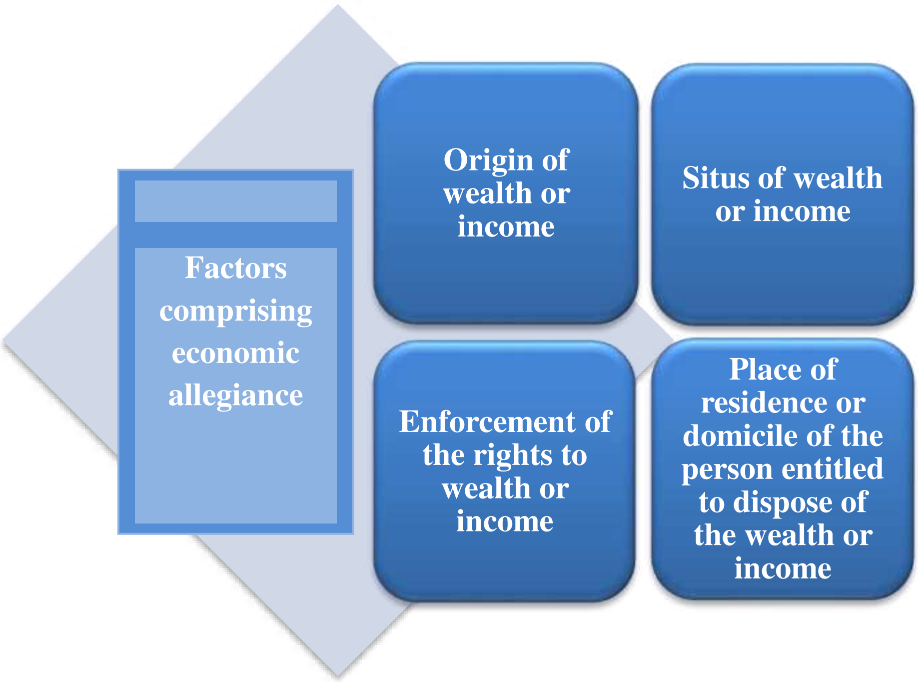

Fig. Principles for Determination of Taxability

Among those factors, the study also concluded that more importance should be given to the origin of the wealth [i.e., source] and the residence or domicile of the owner who consumes the wealth [i.e., residence]. In other words, the League of Nations advocated that tax jurisdiction should generally be allocated between the state of source and the state of residence depending on the nature of the income to be taxed. This was one of the earliest principles of international taxation and continues to be valid till date.

3. Residence Rule under Domestic Tax Law

The tax incidence and imposition of tax is dependent upon the concept of residential status of a person. Therefore, the identification and classification of the residential status of a person is one of the first steps in order to proceed with the assessing of income of a person. The rules for determination of the residential status of a person are laid down in section 6 of Income-tax Act, 1961. The taxpayers are classified into three broad categories on the basis of their residential status viz.

(i) Resident and ordinarily resident (ROR)
(ii) Resident but not ordinarily resident (RNOR)
(iii) Non-resident

3.1. Residential Status of an Individual

The provisions of residential status of an individual are covered under Section 6(1) of the Income Tax Act, 1961, which are as mentioned below.

3.1.1 Residential Status of an Individual on the basis of Number of Days of Stay in India

As per **section 6(1) of Income-tax Act, 1961**, an individual is said to be resident in India in any of the previous year if he satisfies any one of the below-mentioned conditions:

(i) He has been in India during the previous year for a total period of 182 days or more; or
(ii) He has been in India during the 4 years immediately preceding the previous year for total period of 365 days or more and has been in India for at least 60 days in that previous year.

If the individual satisfies any one of the above conditions, he will be considered as resident in India. If the individual does not satisfy both the conditions, he is considered to be non-resident.

Exception to above section:

(i) Indian citizen, who leaves India during the relevant previous year as a member of the crew of an Indian ship or for the purposes of employment outside India, or
(ii) Indian citizen or a person of Indian origin, who, being outside India comes on a visit to India during relevant previous year.

3.1.2. Deemed Resident [Section 6(1A)]

(i) An individual, being an Indian citizen, having total income, other than the income from foreign sources [i.e., income which accrues or arises outside India (except income from a business controlled from or profession set up in India) and which is not deemed to accrue or arise in India], exceeding **15 lakhs** during the previous year would be deemed to be resident in India in that previous year, if he is not liable to pay tax in any other country or territory by reason of his domicile or residence or any other criteria of similar nature.

(ii) Further, it is clarified that in case an individual is said to be resident in India in the previous year under section 6(1), the provision of deemed resident would **not** be applicable.

3.1.3. Resident and Ordinarily Resident/ Resident and not Ordinarily Resident

Only individuals and HUF can be resident but not ordinarily resident in India. All other classes of assesses are either a resident or non-resident. A not-ordinarily resident person is one who satisfies any one of the conditions mentioned in section 6(6) of Income-tax Act, 1961.

(i) If such individual has been non-resident in India in any 9 out of the 10 previous years preceding the relevant previous year, or

(ii) If such individual has, during the 7 previous years preceding the relevant previous year, been in India for a period of 729 days or less.

(iii) If such individual is an Indian citizen or person of Indian origin (who, being outside India, comes on a visit to India in any previous year) having total income, other than the income from foreign sources [i.e., income which accrues or arises outside India (except income from a business controlled from or profession set up in India) and which is not deemed to accrue or arise in India], exceeding 15 lakhs during the previous year, who has been in India for 120 days or more but less than 182 days during that previous year, or

(iv) If such individual is an Indian citizen who is deemed to be resident in India under section 6(1A)

3.2. Residential Status of HUF, Firm, AOPs/BOI, Artificial Juridical Person, Local Authorities, etc.

In case of assessees like HUF, Firm, AOPs/BOI, Artificial Juridical Person, Local Authorities, etc., the residential status is determined on the basis of the concept of Control and Management. These assessees would be considered as resident in India if the control and management of their affairs is situated wholly or partly in India. If the control and management is situated wholly outside India, they would become non-resident.

Control and management of HUF	Karta or its manager
Control and management of Firms/BOIs	Partners or its members

An HUF can be resident and ordinarily resident if it satisfies the additional conditions as applicable in case of individuals.

Additional Conditions:

(i) Karta of Resident HUF should be resident in at least 2 previous years out of 10 previous years immediately preceding relevant previous year; and

(ii) Stay of Karta during 7 previous year immediately preceding relevant previous year should be 730 days or more.

Note: All assessees other than HUF and individual can be resident or non-resident but cannot be resident and ordinarily resident or resident and not ordinarily resident.

The High Court of Delhi in *CIT* v. *Suresh Nanda* affirmed the ruling in *Suresh Nanda* v. *Assistant Commissioner of Income-tax, Central Circle-13, New Delhi* that where the assessee was forced to stay in India against his will due to impounding of passport, the period of forced stay cannot be counted for determining the residential status.

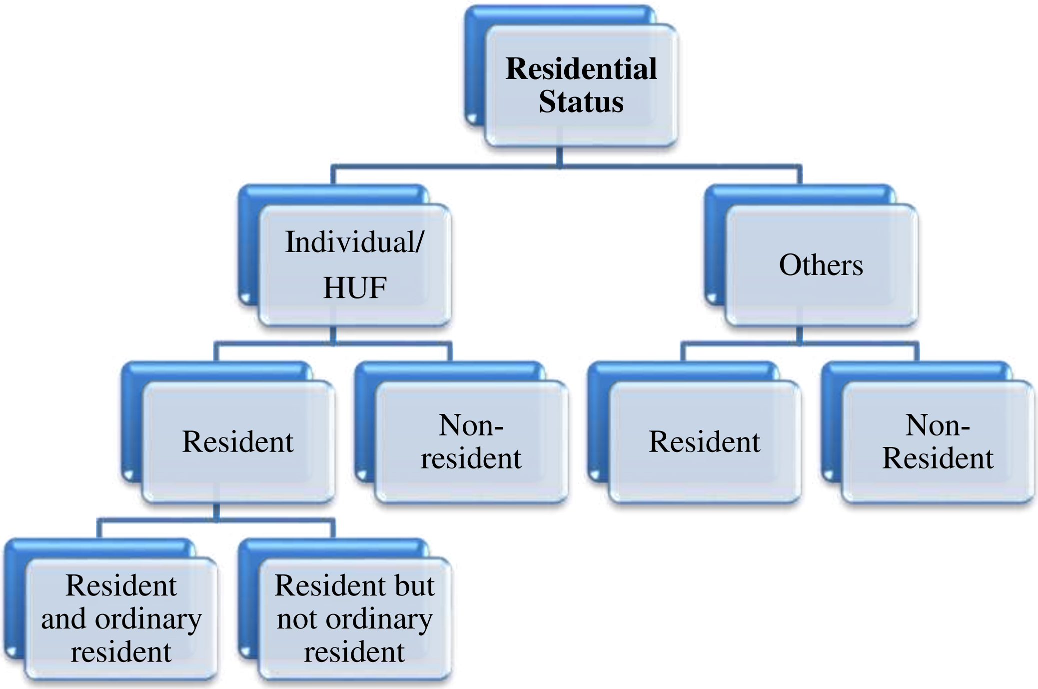

Fig. Residential Status of Persons

3.3. Residential Status of a Company

As per **section 6(3)** of Income-tax Act, 1961, a company would be considered resident in India in any previous year, if-

(i) it is an **Indian company**; **or**

(ii) its **place of effective management**, in that year, is in India.

An **"Indian Company"** means the company registered under the Companies Act, 1956 or under the Companies Act, 2013

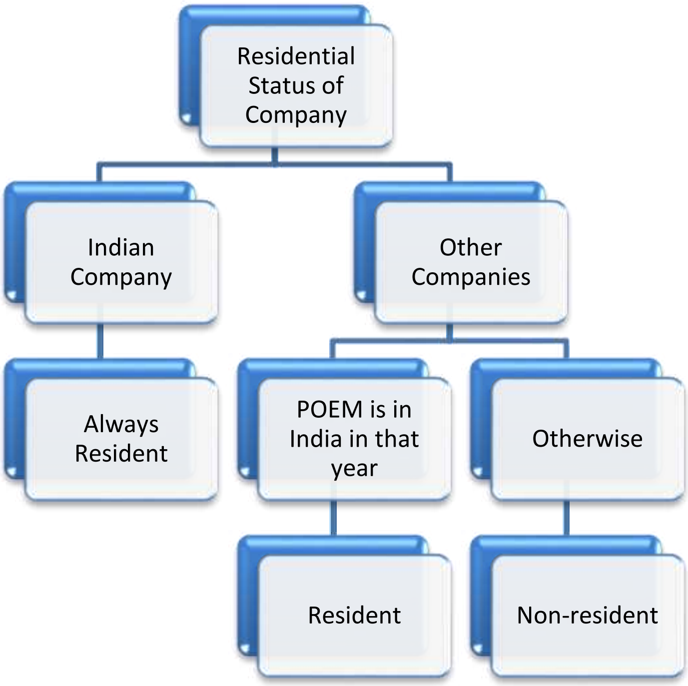

Fig. Residential Status of Companies

Place of Effective Management (POEM) seeks to extend the residence rule to foreign companies. POEM is defined in ***explanation to section 6(3)*** as a **place from where key management and commercial decisions, that are necessary for the conduct of the business of an entity as a whole, are in substance made.** Therefore, the concept of POEM seeks to make a foreign company which is effectively controlled (i.e., place where the key decisions are taken) from India, a resident of India.

However, the definition of the term POEM is not very clear; and therefore the Central Board of Direct Taxes ('CBDT') has issued a circular for the applicability of POEM.

The test of POEM in **Circular No. 6/2017** is based on whether the entity is earning only passive income and its operations are so structured that it is present or active in a country without paying applicable taxes. Thus, a company having key managerial people stationed in India with substantial asset base in India and selling goods through a subsidiary may yet claim that it has no Permanent Establishment (PE) in India and being incorporated outside India, it could end up paying very little tax. The concept of POEM thus examines whether the company is in fact a tax resident of a foreign state with substantial operations outside India or whether the incorporation or having different places of business is only a device to evade tax by being a non-resident.

Concept of Substance over form

The determination of the POEM will primarily be depending upon the facts and circumstances of a given case. The POEM concept is one of substance over form. An entity may have more than one place of management, but it can have only one place of effective management at any point of time. Since "residence" is to be determined for each year, POEM will also be required to be determined on year to year basis.

Guiding Principles for Determination of Place of Effective Management ('POEM') of a Company, other than an Indian company – [Circular No. 6/2017, dated 24.01.2017 & Circular No. 8/2017, dated 23-02-2017]:

The POEM of a company is said to be outside India if both the conditions are satisfied:

(i) The company has active business outside India; **and**
(ii) The majority board meetings are held outside India.

A company shall be said to be engaged in 'active business outside India'

- if passive income is not more than 50% of its total income, and
- less than 50% of its total asset are situated in India; and
- less than 50% of total number of employees are situated in India or are resident in India; and
- the payroll expenses incurred on such employees is less than 50% of its total payroll expenditure.

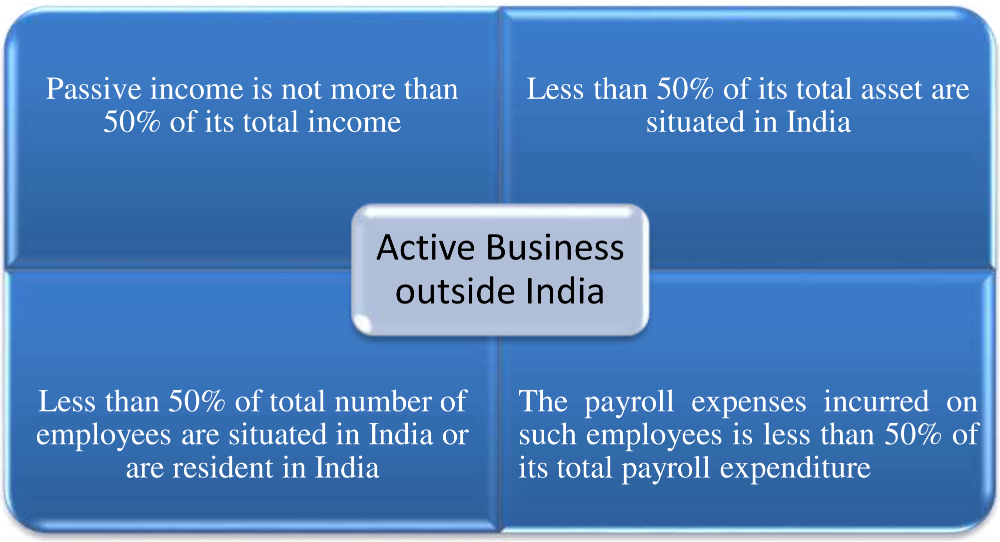

Fig. Determination of Active Business Outside India

Meaning of Important Terms for Understanding the Concept of Active Business Outside India:

1) Income:

(i) As computed for tax purpose in accordance with the laws of the country of incorporation; or

(ii) As per books of account, where the laws of the country of incorporation does not require such a computation.

2) Passive income:

It is the aggregate of:

(i) income from the transactions where both the purchase and sale of goods is from or to its associated enterprises; and

(ii) income by way of royalty, dividend, capital gains, interest, or rental income.

However, any income by way of interest shall not be considered to be passive income in case of a company which is engaged in the business of banking or is a public financial institution, and its activities are regulated as such under the applicable laws of the country of incorporation. Hence, above mentioned income would not be a part of the passive income.

3) Value of assets:

(i) In case of an individually depreciable asset, value of assets would be the average of its value for tax purposes in the country of incorporation of the company at the beginning and at end of the previous year; **and**

(ii) In case of pool of fixed asset treated as a block for depreciation, the value of assets would be the average of its value for tax purposes in the country of incorporation of the company at the beginning and at end of the year; **and**

(iii) In case of any other asset, the value of asset would be value as per books of account.

4) Number of employees:

It is the average of the number of employees as at the beginning and at the end of the year which includes person, who though not employed directly by the company, perform tasks similar to those performed by the employees.

5) Payroll:

It includes the cost of salaries, wages, bonus, and all other employee compensation including related pension and social costs borne by the employer.

It is to be noted that for the purpose of calculation of active business outside India, the average of the data of the previous year and two years prior to that shall be considered. However if the company has been in existence for a shorter period, then data of such period shall be considered. In case the accounting year for tax purposes, in accordance with laws of country of incorporation of the company, is different from the previous year, then, data of the accounting year that ends during the relevant previous year and two accounting years preceding it shall be considered.

3.3.1. Power of Management and Control

According to the concept of POEM, a company that satisfies the active business test would be considered as non-resident if the majority of the board meetings are held outside India. There might be circumstances where the board is not exercising the power of management and control and such powers are exercised by the holding company or such other person resident in India, then POEM shall be considered to be in India.

CBDT **Circular No. 25/2017, dated 23.10.2017** clarifies that as long as the Regional Headquarter 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 payroll functions, accounting, 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; it would not constitute a case of Board of Directors (BOD) of companies standing aside and such activities of Regional Headquarter in India alone will not be a basis for establishment of POEM for such subsidiaries or group companies. It is further mentioned in the above Circular that the provisions of General Anti-Avoidance Rule provided in Chapter X-A of the Income-tax Act, 1961 may get provoked in such cases where the above clarification is found to be used for abusive or aggressive tax planning.

In case of companies that are not engaged in active business outside India, a framework provides a two-stage procedure for determination of POEM in case of companies not engaged in active business in India:

Stage I: Identifying the person(s) who actually makes the key management and commercial decisions for the conduct of the company as a whole.

Stage II: Determine the place from where the decisions are being made. Therefore, the place from where decisions are being made is more important than the place where the decisions are implemented.

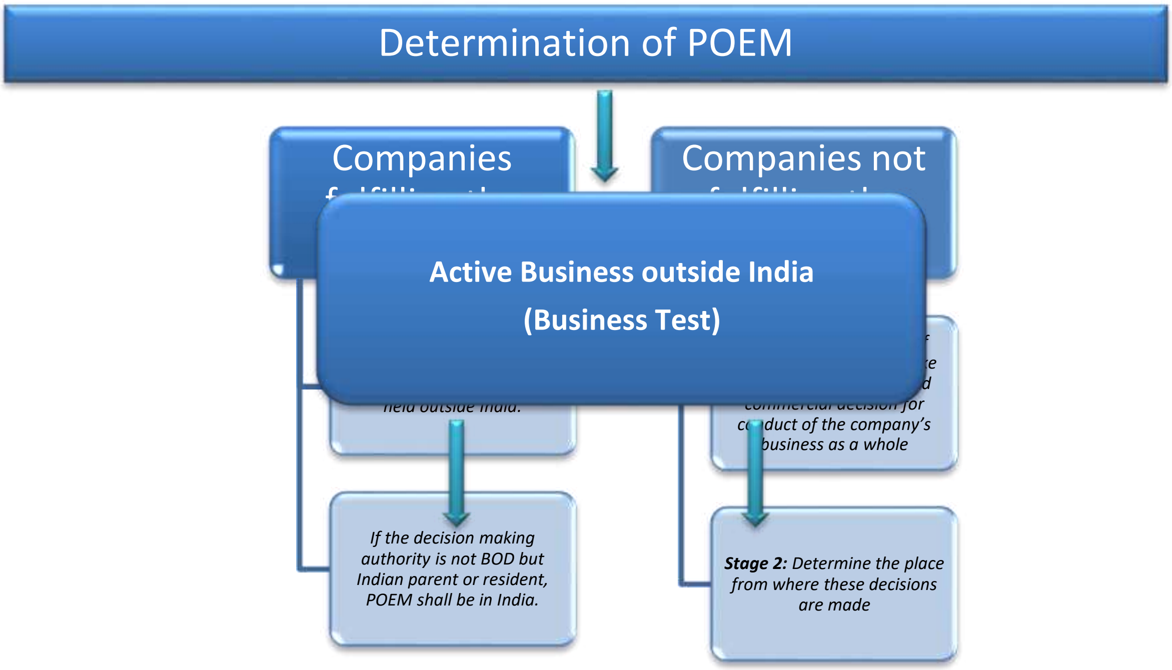

Fig. Determination of POEM

3.3.2. Other Guiding Principles Considered While Determining POEM of Company

The other gudiing principles taken into account while determining the POEM of a company include the following:

(i) The Location of Head Office: The location of head office will be a very important aspect in the determining the company's place of effective management as it often reflects the place where key decisions are made. Below-mentioned points need to be considered while determining the location of the head office of the company:

If the company's senior management and their support staff are based on same location and that location is held out to the public as the company's principal place of business or headquarters, then that location is the place where head office is located.

If the company's senior management operate, from time to time, at offices located in the various countries, then the company's head office would be the location where these senior managers, -

a) are primarily based; or
b) normally return to after traveling to other locations; or
c) meet when formulating or deciding key strategies and policies for the company as a whole.

In situations where the senior management is decentralised in such a way that it is not possible to determine the company's head office with a reasonable certainty, the location of a company's head office would not be of much relevance in determining that company's place of effective management.

(ii) Location where the Board of Directors Meets and Makes Decisions: The location may also be the place of effective management of a company provided, if the Board –

a) exercises and retains its authority to govern the company; and
b) makes all the key management and commercial decisions necessary for its conduct as a whole.

It may be noted that mere holding of board meetings at a place would not be enough for determination of POEM being located at that place; if the key decisions by the directors are being taken from a place other than the place from where the formal meetings are held, then such other place would be more relevant for POEM.

However if the Board has delegated its authority to make the key management and commercial decisions for the company to the senior management or any other person including a shareholder, promoter, strategic or legal or financial advisor etc. and the only role of the board is routinely ratifying the decisions that have been made, then the company's place of effective management will ordinarily be the place where these senior managers or the other person make those decisions.

"Senior Management" in respect of a company means the person or persons who are generally responsible for developing and formulating key strategies and policies for the company and for ensuring or overseeing the execution and implementation of those strategies on a regular and on-going basis. While designation may be different, these persons may include:

- Managing Director or Chief Executive Officer;
- Financial Director or Chief Financial Officer;
- Chief Operating Officer; and
- The heads of various divisions or departments.

(iii) Decision made through Circular Resolution or Round Robin Voting: In case of circular resolution or round robin voting, the factors like, the type the frequency with which it is used, the type of decisions made and where the parties involved in those decisions are located etc. are to be taken into consideration. It is also based on past practices and general conduct.

(iv) The Location of Executive Committee if the Powers are Delegated by the Board: There can be situation where company's board may delegate some or all of its authority to one or more committees such as an executive committee consisting of key members of senior management. In such cases, the location where the members of the executive committee are located and where that committee develops and formulates the key strategies and policies will be said to be the company's place of effective management.

(v) Application of Modern Technology: The application of modern technology impacts the place of effective management in many ways. Nowadays, it is not necessary for a person taking decision 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 being made. In such situations, the place where the directors or the persons taking the decisions or majority of them usually reside may also be an important factor in the determination of place of effective management.

(vi) Decisions made by Shareholders are Not Significant in Determination of POEM: The decisions taken by shareholder on matters which are provided under the company laws and such matters are expressly reserved for the shareholders are not relevant for determination of a company's place of effective management. Such matters may include sale of all or substantially all of the company's assets, the dissolution, liquidation or deregistration of the company, the modification of the rights attaching to various classes of shares or the issue of a new class of shares etc. These decisions actually affect the existence of the company or the rights of the shareholders rather than the conduct of the company's business and are therefore, generally not relevant for the determination of a company's place of effective management.

However, the shareholder's power to take decisions can sometimes lead to ineffective management. It may happen through a formal arrangement by way of shareholder agreement etc. or may also happen by way of actual conduct. For example, if the shareholders limit the authority of board and senior managers of a company and remove the company's real authority to make decision, such actions of the shareholders can result into misuse of its power and such undue influence may result ineffective management being exercised by the shareholders.

Therefore, whether the shareholders' power to exercise authority is within the definition of effective management is one of the questions which is to be determined on the basis of facts whether such power or authority exercised is within the ambit of law.

(vii) The Routine Operational Decisions are Not Relevant for Determination of POEM: Day-to-day routine operational decisions undertaken by junior and middle management are not relevant for the purpose of determining the POEM. The operational decisions are related to day-to-day business operations and activities of a company whereas the key management and commercial decision are more focused on strategic and policy decision. For example, a decision to amalgamate or demerge the company would be an example of key commercial decisions affecting the company's business as a whole. The decisions made by the production manager who is appointed by senior management to run the facility, concerning repairs and maintenance, the implementation of company-wide quality controls and human resources policies, would be an example of routine operational decisions. In certain situations, a person responsible for operational decision is also responsible for the key management and commercial decision. In such cases, it will be necessary to differentiate between the two types of decisions and thereafter evaluate the location where the key management and commercial decisions are taken.

If the above factors do not lead to clear identification of POEM, then the final guidelines provide the following secondary factors which may be contemplated:

a) Place where main and substantial activities of the company is carried out; **or**
b) Place where the accounting records of the company are kept.

It may be noted that the determination of POEM is to be based on all relevant facts related to the management and control of the company, and is not to be determined on the basis of isolated facts that do not establish effective management, as illustrated by the following examples:

a) Where local management of a foreign company is situated in India in respect of activities carried out in India, in such cases it would not conclusive evidence that the conditions for establishing POEM in India have been satisfied.
b) Where one or more directors of a foreign company reside in India will not lead to conclusive evidence that the conditions for establishing POEM in India have

been satisfied.

c) The existence of Permanent Establishment of a foreign entity in India would not be conclusive evidence that the conditions for establishing POEM in India have been satisfied.

d) Where a foreign company is owned by an Indian company will not be conclusive evidence that the conditions for establishing POEM in India have been satisfied.

e) The existence of support functions that are preparatory and auxiliary in character will not be conclusive evidence that the conditions for establishing POEM in India have been satisfied.

It is reiterated that the above principles for determining the POEM are for guidance only. No single principle will be decisive in itself. The above principles are not to be seen with reference to any particular moment in time rather activities performed over a period of time, during the previous year, need to be considered.

The CBDT clarifies that the Assessing Officer shall, before initiating any proceedings for holding a company incorporated outside India being resident in India on the basis of its POEM should seek prior approval of the Principal Commissioner or the Commissioner, as the case may be.

Further, in case the AO wants to hold a company incorporated outside India, as being resident in India on the basis of its POEM, then any such finding shall be given by the AO after seeking prior approval of the collegium of three members consisting of the Principal Commissioners or the Commissioners, as the case may be, to be constituted by the Principal Chief Commissioner of the region concerned, in this regard. The collegium so constituted shall provide an opportunity of being heard to the company before issuing any directions in the matter.

Illustration 1: An Indian multinational group has a local holding company X Co. in country A. X Co. also has 100% downstream subsidiaries Y Co. and Z Co. in country A and M Co. in country B. X Co. has income only by way of dividend and interest from investments made in its subsidiaries. The Place of Effective Management of X Co. is in India and is exercised by ultimate parent company of the group. The subsidiaries Y, Z and M are engaged in active business outside India. The meetings of Board of Director of Y Co., Z Co. and M Co. are held in country A and B respectively.
Solution: 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 has to be examined separately. As indicated in the facts, since Y Co., Z Co., and M Co. are

independently engaged in active business outside India and majority of Board meetings of these companies are also held outside India, the POEM of X Co., Y Co., and M Co. shall be presumed to be outside India.

Illustration 2: Company X Co. is a sourcing entity, for an Indian multinational group, incorporated in country A and is 100% subsidiary of Indian company (Y Co.). The warehouses and stock in them are the only assets of the company and are located in country A. All the employees of the company are also in country A. The average income-wise breakup of the company's total income for three years is,

(i) 40% of income is from transaction where purchases are made from parties which are non- associated enterprises and sold to associated enterprises.

(ii) 20% of income is from transaction where purchases are made from associated enterprises and sold to associated enterprises.

(iii) 10% of income is from transaction where purchases are made from associated enterprises and sold to non-associated enterprises. and

(iv) 20% of the income is by way of interest.

Solution: In this case, passive income is 40% of the total income of the company. The passive income consists of, -

(i) 20% income from the transaction where both purchase and sale is from/to associated enterprises; **and**

(ii) 20% income from interest.

X Co. satisfies the first requirement of the test of active business outside India. Since no assets or employees of X Co. are in India, the other requirements of the test are also satisfied. Therefore, company is engaged in active business outside India.

Illustration 3: The other facts remain same as that in Illustration 1 with a change that X Co. has a total of 52 employees. 47 employees, managing the warehouse, storekeeping, and accounts of the company, are located in country A. The Managing Director (MD), Chief Executive Officer (CEO) and sales head are resident in India. The total annual payroll expenditure on these 52 employees is of ` 6 crore. The annual payroll expenditure in respect of MD, CEO and sales head is of ` 3.5 crore.

Solution: As seen in Illustration 1, the first limb of active business test is satisfied by A Co. as only 40% of its total income is passive in nature. Also more than 50% of the employees are situated outside India. All the assets are situated outside India. However, the payroll expenditure in respect of the MD, the CEO and the sales head being employee's resident in India exceeds 50% of the total payroll expenditure. Therefore, X Co. is not engaged in active business outside India.

Illustration 4: The basic facts are same as in Illustration 1. Further facts involve that all the directors of the X Co. are Indian residents. During the relevant previous year, 5 meetings of the Board of Directors were held; of which two were held in India and 3 outside India with two in country A and one in country B.

Solution: X Co. is engaged in active business outside India as the facts indicated in Illustration 1 establish. As majority of board meetings have been held outside India, the POEM of X Co. shall be presumed to be outside India.

Illustration 5: The facts are same as in Illustration 3 but it is established by the Assessing Officer that although X Co.'s senior management team signs all the contracts, for all the contracts above ` 20 lakhs, X Co. must submit its recommendation to Y Co. and Y Co. makes the final decision whether or not the contract may be accepted. It is also seen that during the previous year more than 99% of the contracts are above ` 20 lakhs and over past years also, the same trend in respect of value contribution of contracts above ` 20 lakhs is seen.

Solution: The above facts suggest that the effective management of X Co. may be in the hands of parent company i.e. Y Co. Therefore, POEM of X Co. may not be presumed to be outside India even though X Co. is engaged in active business outside India and majority of board meetings are held outside India.

The <u>CBDT vide Circular no. 8/2017 dated 23.02.2017</u> clarifies that POEM guidelines shall not apply to a company having turnover or gross receipts of ` 50 crores or less in a financial year.

Transition mechanism for a company incorporated outside India and has not been assessed to tax earlier (Chapter XII-BC – Section 115JH)

The transition mechanism for a company that is incorporated outside India and is assessed to Indian tax for the first time due to application of the concept of the POEM has been provided in Chapter XII-BC – Section 115JH.

Section 115JH of the Act provides that the Central Government may at any time notify exception, modification and adaptation subject to which, provisions of the Act relating to 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 in a case where a foreign company is said to be resident in India due to its POEM being in India for the first time and the said company has never been resident in India before.

It has been further given that these transitional provisions would also cover any subsequent previous year up to the date of determination of POEM in the assessment proceedings.

The Central Government has notified that the exceptions, modifications and adaptations for application of provisions of the Act with regard to 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 in respect of the foreign company which is said to be resident in India in any previous year on account of application of the provisions of Place of Effective Management (POEM), and said foreign company is not previously assessed in India is provided as under:

Particulars	Provisions
Determining the opening WDV	If the foreign company **is assessed** to tax in the foreign jurisdiction, the written down value (WDV) of the depreciable asset with regard to tax record in the foreign country on the 1st day of the previous year shall be adopted as the opening WDV for the relevant previous year. **Where WDV is not available as per tax records,** the WDV shall be calculated assuming that the assets were installed, utilised and the depreciation was actually allowed as per the provisions of the laws applicable to the company in the foreign jurisdiction. The WDV so arrived at as on the 1st day of the previous year shall be adopted to be the opening WDV for the said previous year.
	If the said foreign company **is not assessed** to tax in the foreign jurisdiction where it is based, then WDV of the depreciable asset as appearing in the books of accounts maintained in accordance with the laws of that foreign jurisdiction shall be adopted.

The period of profit and loss A/c and balance sheet where the accounting period of such company does not end on 31st March	The foreign company shall be required to prepare profit & loss account and balance sheet for the period starting from the date on which the accounting year immediately following said accounting year begins, to 31st March of the year immediately preceding the period beginning with 1st April and ending on 31st March during which the foreign company has turned resident. The foreign company shall also be required to prepare profit & loss account and balance sheet for succeeding periods of twelve months, beginning from 1st April and ending on 31st March, till the year the said foreign company remains resident in India on account of its POEM. **Example**: If the company follows calendar year and becomes resident in P.Y. 2021-22 for the first time due to the application of the concept of POEM, then it is required to prepare profit and loss statement from 1st January, 2021 to 31st March 2021 and also for period from 1st April, 2021 to 31st March, 2022. For the purpose of carry forward of loss, in cases where the accounting year does not end on 31st March and the period starting from the date on which immediately following year begins to 31st March of the year, immediately preceding the period beginning with 1st April and ending on 31st March during which the **foreign company** has turned resident, is,- (a) less than six months, it shall be included in that accounting year; (b) equal to or more than six months, that period shall be treated as a separate accounting year. Thus, if the accounting year of the foreign company is calendar year, the accounting year immediately preceding the accounting year in which the foreign company is held to be resident in India on the basis of its POEM, shall be increased by three months, i.e., 1st January to 31st March and if the accounting year of the foreign company is from 1st July to 30th June, the accounting year immediately

	preceding the accounting year in which the foreign company is held to be resident in India on the basis of its POEM, shall be of 9 months from 1st July to 31st March.
Brought forward loss and unabsorbed depreciation	If the foreign company **is assessed** to tax in the foreign jurisdiction, it's brought forward loss or unabsorbed depreciation as per the tax record shall be determined year to year basis on the 1st day of the previous year in which it is said to be resident in India. They shall be deemed as losses or unabsorbed depreciation brought forward on the 1st day and shall be allowed to be set off and carried forward in accordance with the provisions of the Act.
	Where the foreign company is **not assessed** to tax in the foreign jurisdiction, it's brought forward loss or unabsorbed depreciation as per the books of accounts prepared in accordance with the laws of that country shall be determined year to year basis on the 1st day of the previous year in which it is said to be resident in India. They shall be deemed as losses or unabsorbed depreciation brought forward on the 1st day and shall be allowed to be set off and carried forward in accordance with the provisions of the Act.
Foreign tax credit [Applicability of section 90 and 91]	The foreign company shall be entitled to the relief or deduction of taxes paid in accordance with the provisions laid out in section 90 or section 91 of the Act. Where the income on which foreign tax has been paid or deducted, is offered to tax in more than one year, credit of foreign tax shall be allowed across those years in the same proportion in which the income is offered to tax or assessed to tax in India in respect of the income to which it relates and shall be in accordance with the provisions of rule 128 of the Income- tax Rules, 1962.
TDS provisions [Chapter XVII-B]	Where more than one provision of Chapter XVII-B of the Act is applicable to the foreign company as resident as well as foreign company, the provisions which applies to the foreign company shall apply. Compliance to those provisions of Chapter XVII-B of the Act as are applicable to the foreign company prior to it becoming Indian resident shall be deemed sufficient

	compliance to the provisions of the said Chapter. The provisions of section 195(2) relating to application to Assessing Officer to determine the appropriate proportion of sum chargeable to tax shall be applicable in such manner so as to include payment to the foreign company.
Applicability of the notification where foreign company becomes resident in the subsequent previous year also	Where the foreign company is said to be resident of India during a previous year, immediately succeeding a previous year during which it is said to be resident in India; the exceptions, modifications and adaptations shall apply to the said previous year subject to the condition that the WDV, the brought forward loss and the unabsorbed depreciation to be adopted on the 1st day of the previous year shall be those which have been arrived at on the last day of the preceding previous year in accordance with the provisions of this notification.
Non-applicability of the notification	The above exceptions, modifications and adaptations shall not apply in respect of such income of the foreign company which otherwise would have been chargeable to tax in India, even if the foreign company had not become Indian resident.
No effect on other transactions	Any transaction of the foreign company with any other person or entity under this Act shall not be altered only on the ground that the foreign company has become Indian resident.
Applicability of tax rate on foreign company	In case of conflict between the provision applicable to the foreign company as resident and the provision applicable to it as foreign company, the later shall prevail. Therefore, the rate of tax in case of foreign company i.e., 40% shall remain the same, i.e., rate of income-tax applicable to the foreign company even though residency status of the foreign company changes from non-resident to resident on the basis of POEM.
Applicability of other provisions relating to foreign company	Subject to the above exceptions, modifications and adaptions specifically provided vide this notification, the foreign company shall continue to be treated as a foreign company even if it is said to be resident in India and all the provisions of the Act shall apply accordingly.

	Consequently, the provisions specifically applicable to— (i) a foreign company, shall continue to apply to it; (ii) non-resident persons, shall not apply to it; and the provisions specifically applicable to resident, shall apply to it.
Applicability of notification	This notification shall be deemed to have come into force from 1st April 2017.

POEM and Control and Management of the Affairs : A Comparative

In order to understand the difference between the concept of POEM and Control and Management of Affairs, the following some of the relevant case studies can be referred to:

Narottam & Pereira v. CIT [1953] 23 ITR 454 (BOM.)
Issue Involved: Whether controlling and directive power established in India with presence of directors in India is sufficient to establish residence even though controlling managers operated abroad. **Case Scenario:** The company is a subsidiary company of the Scindia Steam Navigation Co. Ltd. and its business is stevedoring in Ceylon. It is registered in Bombay and its registered office is also in Bombay. The meetings of the board of directors are held in Bombay and also the meetings of the shareholders. As per the prevailing law, for a company should be resident, it is necessary that the control and management of its affairs should be situated wholly in the taxable territories or its income earned in the taxable territories should exceed its income without the taxable territories in that year**.** Also, Company appointed two managers in Ceylon to carry out business transactions **Judgement Involved:** There is distinction between doing business and the control and management of business. Business and the whole of it may be done outside India and yet the control and management of that business may be wholly within India. The control and management contemplated by this sub-section is not the carrying on of day to day business by servants, employees or agents. The real test to be applied is, where is the controlling and directing power, or rather, where does the controlling and directing power function or to put it in a different language there is always a seat of power or the head and brain, and what has got to be ascertained is, where is this seat of power, or the head and brain. It is that authority to which the servants, employees and agents are subject, it is that authority which controls and manages them, which is the central authority, and it is at the

place where the central authority functions that the company resides. The two managers do all the business of the company in Ceylon and in doing that business naturally a large amount of discretion is given to them and a considerable amount of authority. But the mere doing of business does not constitute these managers the controlling and directing power. Their power-of-attorney can be cancelled at any moment, they must carry out any orders given to them from Bombay, they must submit to Bombay an explanation of what they have been doing, and throughout the time that they are working in Ceylon a vigilant eye is kept over their work from the directors' board room in Bombay. It is not the *de jure* control and management but the *de facto* control and management. Control and management signifies, in the present context, the controlling and directive power, the head and brain as it is sometimes called, and situated implies the functioning of such power at a particular place with some degree of permanence, while wholly would seem to recognize the possibility of the seat of such power being divided between two distinct and separated places. The second principle is that the mere activity by the company in a place does not create residence. The third is that the central management and control of a company may be divided, and it may keep house and do business in more than one place.

Conclusion: In case of dual residence, there may be two centers of management. But the important principle which applies to the present case is the one that has been first set out and which emphasizes the fact that what we have to consider in order to determine the residence of a company is as to where its head and brain is, and the head and brain of the company will be where its controlling and directive power functions. Therefore, controlling and directive power must be established in India with a degree of permanence, and that the presence of directors in India is sufficient to establish residence even though controlling managers operated abroad.

Radha Rani Holdings (P) Ltd. vs. Additional Director of Income Tax
Issue Involved: Where one of the two directors of a company is present in India, whether the test of control and management being "wholly situated" in India would be satisfied if board meetings were conducted outside India. **Case Scenario:** The assessee-company incorporated under the Laws of Republic of Singapore filed its return of income in the status of a non-resident company. The Assessing Officer noticed that the paid up capital of the company consisted of 100 shares; out of which one Geeta Soni, who was a resident of India, was holding 99 shares and the other director Juliana Kassim, who was a resident of Singapore, was holding only one share. It was alleged that the assessee-company was merely a paper company to route the money through abroad. The Assessing Officer held that the control and management of

the assessee-company was wholly in India and hence he held the company to be resident in India within the meaning of section 6(3)(*ii*) of the Income-tax Act as well as under the DTAA between India and Singapore **Judgement Involved:** In the days of technological advancements, conducting meetings by telephonic conversations or video conferencing process is very much prevalent in the world and, therefore, the actual presence of a person at the exact place of meeting or conference may not be necessary. The board resolution may also be by way of "circular suggestion". Not only day-to-day affairs, but even control and management of company during year had been conducted at Singapore and further tax residency certificate had been issued by Singapore taxation authorities in favour of assessee, which established residential status of assessee at Singapore. Provisions of section 6(3)(ii) relating to 'control and management' of company being situated wholly in India, were not satisfied in instant case. Assessee was a 'non-resident' in India during year under consideration. **Conclusion:** Even if one of two directors of a company is present in India, the test of control and management being "wholly situated" in India would not be satisfied, since board meetings were conducted outside India.

Universal Cargo Carriers Inc. and Ors v. CIT [1994]205ITR215(Cal)
Issue Involved: Can a company said to be resident outside India if its affairs are managed by a company incorporated outside India? **Case Scenario:** The assessee-company was a non-resident shipping company incorporated in the Republic of Panama. It had no business apart from shipping business. In 1976; they entered into a management agreement with a Greek company, namely, Messrs. Hellenic Lines Ltd. According to the agreement, the entire affairs of the assessee-companies were to be managed by the said Hellenic Lines Ltd., as their general manager and agents. The company intended to take the benefit of the DTAA between India and Greece. It claimed that it is a Greek resident. As per India-Greece DTAA, a company shall be regarded as resident in Greece if: (i) it is incorporated in Greece or (ii) its business is wholly managed and controlled in Greece As per Income Tax Act, 1961 a company is said to be resident in India in any previous year if

(i) it is an Indian company or

(ii) during that year 'the control and management of **its affairs**' is situated only in India

The Income Tax Officer was of the opinion that Messrs. Hellenic Lines Ltd., had only been appointed as general managers and agents of the assessee-companies to control and manage the affairs, operate the vessels, collect the moneys and make disbursements, etc. For that purpose, Messrs. Hellenic Lines Ltd. was to receive only a fixed percentage (1 to 1.25) on the total freights collected. These arrangements did not mean that the de-facto control and management of the assessees' business had been actually given to Messrs. Hellenic Lines Ltd. Therefore, the assessees could not be treated as resident in Greece within the meaning of Article 11(1)(f) of the Agreement for Avoidance of Double Taxation between India and Greece.

Judgement Involved: The Commissioner of Income Tax (Appeals) held in favour of the company and opined that, by virtue of the agreement between the assessees and Messrs. Hellenic Lines Ltd. the control of the entire business of the assessee's company had been given to the Greek company. Hellenic Lines, Ltd., has been given power to appoint and dismiss the staff of the assessee company, to control the entire shipping business of the assessee-company; to collect and disburse moneys on behalf of the assessee-company; to appoint an agent and sub-agent at its discretion; to enter into all negotiations and contacts on behalf of the assessee-company.

The Tribunal was of the view that the entire management and control of the assessees' business could not be said to have been vested in Messrs. Hellenic Lines Ltd. wholly. Moreover, there was no allegation or proof that the assessee-company was subject to Greek taxes except for the small amount of commission earned by Messrs. Hellenic Lines Ltd. Since the assessee was incorporated within the Republic of Panama, they might be liable to taxes imposed by the said Republic but there was nothing to show that they would be liable to Greek taxes on the incomes earned by them in India.

The High Court referred some clauses in the agreement which included Clause 1 of the agreement that clearly says the assessee has appointed Hellenic, the Greece Co., as its general manager and agent to control and manage "wholly" the entire affairs of "Universal", the assessee-company. The assessee-company has no staff of its own and all facilities including officers, staff, agents and sub-agents and the provisions of all administrative services necessary for the organisation or management in accordance with accepted commercial practice of the entirety of the assessee's affairs shall be provided by Hellenic, the Greece Co., as stipulated in clause 2(a). The very preamble of the agreement clearly stipulates that the assessee-company wishes to arrange for the management and control wholly of the entirety of its business by Hellenic Lines Ltd., and, with that end in view, it wishes to appoint Hellenic, the Greek company, as its general manager and agent.

Conclusion: Admittedly, the de-facto control and management of the assessee-company was actually vested in Hellenic Lines Ltd., the Greek company, and such control and management over the business of the assessee-company was actually exercised by the said Greek company.

De Beers Consolidated Mines, Limited v Howe (Surveyor of Taxes) [1906] A.C. 455 House of Lords
Issue Involved: Whethere the place where directors frequently meet would be considered as the Place of Effective Management or the place from where the decisions are being made. **Case Scenario:** De Beers is a company incorporated in the Cape of Good Hope. It is a non-UK company. The head office is formally at Kimberley, and the general meetings have always been held there. Also the profits have been made out of diamonds raised in South Africa. Some of the directors and life governors live in South Africa and the directors meetings are held at Kimberley as well as in London. Where was the company resident for tax purposes? **Judgement Involved:** The court considered not just the frequency and composition of directors meetings, but the nature of the decisions taken in each location. The directors meetings in London are the meetings where the real control is always exercised. All the important business decisions were taken in London except the mining operations. London has always controlled the negotiation of the contracts with the diamond syndicates, has determined policy in the disposal of diamonds and other assets, the working and development of mines, the application of profits, and the appointment of directors. **Conclusion:** The decisive factor for determining the company's residence would be where the important decisions are taken. Hence, the company was considered to be resident in London.

4. Source Rule under Domestic Tax Laws

Income-tax Act, 1961 taxes the income which has a source in India and in case of resident, any receipt even if the source is outside India, would be taxable. **Section 4 of**

the Income-tax Act, 1961 is the charging section and **Section 5 of the Income-tax Act, 1961** deals with the scope of total income.

The income which is subject to tax is divided into three broad categories. As per **Section 5 of the Income-tax Act, 1961**, the total income of a person who is a **resident** in any of the previous year includes all income from whatever source derived and will be taxable if it:

(i) is received or is deemed to be received in India in such year by or on behalf of such person.
(ii) accrues or arises or is deemed to accrue or arise to him in India during such year.
(iii) accrues or arises to him outside India during such year.

In the case of a person not ordinarily resident in India within the meaning of **sub-section (6) of Section 6**, the income which accrues or arises to him outside India shall not be included unless it is derived from a business controlled in or a profession set up in India.

In the case of a **non-resident**, the following incomes are taxable:

(i) Income which is received or is deemed to be received in India in such year by or on behalf of such person, or
(ii) Income accrues or arises or is deemed to accrue or arise to him in India during such year.

Nature of Income	Resident and ordinarily resident	Resident and not ordinarily resident	Non-resident
Income received or deemed to be received in India	Taxable	Taxable	Taxable
Income accrues/arises or deemed to accrue or arise in India	Taxable	Taxable	Taxable
Income (other than above) derived from business or profession wholly controlled in India	Taxable	Taxable	Non-taxable
Any other income	Taxable	Non-taxable	Non-taxable

Note: Any income already taxed on accrual basis consequently remitted to India, is not chargeable to tax at the time of remittance irrespective of the Residential Status.

4.1. Income deemed to accrue or arise in India

Section 9 of Income-tax Act, 1961 talks about the categories of income deemed to accrue or arise in India. This is an important concept because it serves as a foundation for taxation of income of a person. This section provides for taxation on both, residents as well as non-residents.

Section 9 originally brings a **"source income"** rule of taxation, ranging from income from a business connection to royalty paid by the government as accruing or deeming to accrue from India for the purposes of taxation. Due to its nature of taxing non-resident corporations as well, this section has been criticised as ultra vires to the Constitution of India on the grounds of being outside the legislative competence of the legislature as well as violation to the fundamental rights.

4.1.1. Income deemed to accrue or arise in India through Business Connection [Section 9(1)(i)]

The term business connection has been explained in Explanation 2 to section 9(1)(i) which include any business activity carried out through a person, acting on behalf of the non-resident.

'Business connection' shall include any business activity carried out through a person acting on behalf of the non-resident ***[Explanation 2 to section 9(1)(i)]***

For a **business connection** to be established, the person acting on behalf of the non-resident:

a) must have an authority, which is habitually exercised in India, 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 such 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 that non-resident, or

b) Where he 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) Who habitually secures orders in India, mainly or wholly for the non-resident. Further, there might be situations when the person acting on behalf of the non-resident secure order for other non-residents. In such situation, business connection for other non- residents would be established if:
   (i) such other non-resident controls the non-resident or
   (ii) such other non-resident is controlled by the non-resident or
   (iii) such other non-resident is subject to same control as that of non-resident.

However, such business connection shall not include any business activity carried out through a broker, general commission agent or any other agent having independent status, if they are acting in ordinary course of business.

Where a business is carried on in India through a person referred to in (a), (b) or (c) above, only so much of income as is attributable to the operations carried out in India shall be deemed to accrue or arise in India ***[Explanation 3 to Section 9(1)(i)].***

In the case of a non-resident, the following shall not, however, be treated as business connection in India ***[Explanation 1 to section 9(1)(i)]***:

(i) Where all the operations are not carried out in India *[Explanation 1(a) to section 9(1)(i)]*: In the case of a business of which all the operations are not carried out in India, the income of such business shall be deemed to accrue or arise in India shall be only for such part of income as is reasonably attributable to the operations carried out in India. Therefore, it provides that such part of income which cannot be reasonably attributed to the operations in India shall not be deemed to accrue or arise in India.

(ii) Purchase of goods in India for export *[Explanation 1(b) to section 9(1)(i)]:* 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.

(iii) Collection of news and views in India for transmission out of India *[Explanation 1(c) to section 9(1)(i)]:* 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.

(iv) **Shooting of cinematograph films in India** ***[Explanation 1(d) to section 9(1)(i)]:*** In the case of a non-resident, no income shall be deemed to accrue or arise in India through or from operations which are confined to the shooting of any cinematograph film in India, if such non-resident is :

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.

(v) **Activities confined to display of rough diamonds in SNZs** ***[Explanation 1(e) to section 9(1)(i)]:*** In case of a foreign company engaged in the business of mining of diamonds, no income shall be deemed to accrue or arise in India to it through or from the activities which are confined to display of uncut and unsorted diamonds in any special zone notified by the Central Government in the Official Gazette in this behalf.

4.1.2. Income from Property, Asset or Source of Income in India

Any income which arises from any property in India (movable, immovable, tangible and intangible property) would be deemed to accrue or arise in India. For example, hire charges or rent paid outside India for the use of the machinery or buildings situated in India, deposits with an Indian company for which interest is received outside India etc.

4.1.3. Income through Transfer of Capital Assets Situated in India

Capital gains arising through or from the transfer of a capital asset situated in India would be deemed to accrue or arise in India in all cases irrespective of the fact whether

a) The capital asset is movable or immovable, tangible or intangible;
b) The place of registration of the document of transfer etc., is in India or outside; and
c) The place of payment of the consideration for the transfer is within India or outside.

The expression "through" shall mean and include and shall be deemed to have always meant and included "by means of", "in consequence of" or "by reason of" ***[Explanation 4 to section 9(1)(i)].***

It is hereby clarified 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 ***[Explanation 5 to section 9(1)(i)].***

However, ***Explanation 5 to section 9(1)(i)*** shall not apply to an asset or capital asset, which is held by a non-resident by way of investment, directly or indirectly in:

a) An asset or capital asset, which is held by a non-resident by way of investment, directly or indirectly, in Category-I or Category-II foreign portfolio investor under the Securities and Exchange Board of India

b) A Foreign Institutional Investor as referred to in clause (a) of the Explanation to Sec. 115AD for assessment year commencing on or after 01.04.2012 but before 01.04.2015.

Explanation 6 to section 9(1)(i) states that the share or interest in a company or entity registered or incorporated outside India, 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 Indian assets, -

(i) exceeds the amount of 10 crore; and
(ii) represents at least 50% of the value of all the assets owned by the company or entity, as the case may be;

Note: Definitions of the various terms used are provided in the table below:

Terms	Definition
Value of an asset	The fair market value as on the specified date, of such asset without reduction of liabilities, if any, in respect of the asset, determined in prescribed manner.
Specified date	Specified date means: (i) the date on which the accounting period of the company or, as the case may be, the entity ends preceding the date of transfer of a share or an interest. (ii) the date of transfer shall be the specified date of valuation, in a case where the book value of the assets of the company or entity on the date of transfer exceeds by at least 15%, the book value of the assets as on the last

	balance sheet date preceding the date of transfer.
Accounting period	Each period of 12 months ending with 31st March. **Different date of year-end:** Where a company or an entity, referred to in ***Explanation 5***, regularly adopts a period of 12 months ending on a day other than 31st March for the purpose of— (i) complying with the provisions of the tax laws of the territory, of which it is a resident, for tax purposes; or (ii) reporting to persons holding the share or interest, Then the period of twelve months ending with the other day shall be the accounting period of the company or, as the case may be, the entity.
First Accounting Period	It 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	The later accounting period shall be the successive periods of twelve months
Accounting period of an entity which ceases to exist	If the company or the entity ceases to exist before the end of accounting period, as aforesaid, then, the accounting period shall end immediately before the company or, as the case may be, the entity, ceases to exist.

Explanation 7 to section 9(1)(i) No income shall be deemed to accrue or arise to a non-resident from transfer, outside India, of any share of, or interest in, a company or an entity, registered or incorporated outside India, referred to in the ***Explanation 5***;

(i) If such company directly owns the assets situated in India and the transferor (whether individually or along with its associated enterprises), at any time in the twelve months preceding the date of transfer,

a) neither holds the right of management or control in relation to foreign company or entity;
b) nor the voting power or share capital or interest exceeding 5% of the total voting power or total share capital or total interest, as the case may be, of the foreign company or entity; or

(ii) If such company indirectly owns the assets situated in India and the transferor (whether individually or along with its associated enterprises), at any time in the twelve months preceding the date of transfer,

a) neither holds the right of management or control in relation to foreign company or entity;
b) nor holds any right in, or in relation to, such foreign company or entity which would entitle him to the right of management or control in the company or entity that directly owns the assets situated in India;
c) nor holds such percentage of voting power or share capital or interest in foreign company or entity which results in holding of (either individually or along with associated enterprises) a voting power or share capital or interest exceeding 5% of the total voting power or total share capital or total interest, as the case may be, of the company or entity that directly owns the assets situated in India;

However in case where all the assets owned, directly or indirectly, by a company or an entity reffered to in Explanation 5, and not located in India, the income of non-resident transferor, from transfer outside India of a share of, or interest in, such company or entity, deemed to accrue or arise in India under this clause, shall be only such part of the income as is reasonably attributable to assets lacated in India and determined in such manner as may be prescribed.

"Associated enterprise", in relation to another enterprise, means an enterprise:

- that participates, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise; or
- in respect of which one or more persons who participate, directly or indirectly, or through one or more intermediaries, in its management or control or capital, are the same persons who participate, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise.

4.2. Income from Salaries Earned in India [Section 9(1)(ii)]

Income, which falls under the head "Salaries", deemed to accrue or arise in India, if it is earned in India. Salary payable for service rendered in India would be treated as earned in India.

Further, any income under the head "Salaries" payable for 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.

4.3. Income from Salaries Payable by the Government for Services Rendered Outside India [Section 9(1)(iii)]

Income from 'Salaries' which is payable by the Government to a citizen of India for services rendered outside India would be deemed to accrue or arise in India.

However, allowances and perquisites paid or allowed outside India by the Government to an Indian citizen for services rendered outside India is exempt, by virtue of section 10(7).

4.4. Dividend paid by an Indian company outside India [Section 9(1)(iv)]

Dividend paid by an Indian company outside India is deemed to be accrues or arise in India and would be taxable in India in the hands of non-resident shareholders.

It is clarified that the dividends declared and paid 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 income accruing or arising in India by the virtue of the provision of ***Explanation 5 to section 9(1)(i)***

4.5. Interest payable outside India [Section 9(1)(v)]

Under section 9(1)(v), an interest is deemed to accrue or arise in India if it is payable by –

(i) the Government;
(ii) a person resident in India;
(iii) .a non-resident, when it is payable in respect of any debt incurred or moneys borrowed and used, for the purpose of a business or profession carried on in India by him.

Explanation Section 9(1)(v) states that in case of a non-resident, being a person engaged in the business of banking, any interest payable by the permanent establishment (PE) in India of such non-resident to the head office or any PE 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 PE in India and the PE in India shall be deemed to be a person separate and independent of the non-resident person of which it is a PE and the provisions of the Act relating to computation of total income, determination of tax and collection and recovery shall apply accordingly.

"Permanent Establishment" includes a fixed place of business through which the business of the enterprise is wholly or partly carried on.

4.6. Royalty [Section 9(1)(vi)]

Royalty will be deemed to accrue or arise in India when it is payable by -

(i) the Government;

(ii) a person who is a resident in India except where it is payable for the transfer of any right or the use of any property or information or for the utilisation of services for the purposes of a business or profession carried on by such person outside India or for the purposes of making or earning any income from any source outside India, or

(iii) a non-resident only when the royalty is payable in respect of any right, property or information used or services utilised for purposes of a business or profession carried on by such person in India or for the purposes of making or earning any income from any source in India.

4.6.1. Important Concepts Relating to Royalty

Lump sum royalty payments made by a resident for the transfer of all or any rights (including the granting of a license) in respect of computer software supplied by a non-resident manufacturer along with computer hardware under any scheme approved by the government under the policy on computer software export, software development and training, 1986 shall not be deemed to accrue or arise in India.

"Computer software" means any computer programme recorded on any disc, tape, perforated media or other information storage device and includes any such programme or any customised electronic data.

The term **'royalty'** means consideration (including any lump sum consideration but excluding any consideration which would be the income of the recipient chargeable under the head 'capital gains') for:

(i) the transfer of all or any rights (including the 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 similar 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) the transfer of all or any rights (including the granting of 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.
(vii) the rendering of any service in connection with the activities listed above.

Royalty includes and has always included consideration in respect of any right, property or information, whether or not,

(i) the possession or control of such right, property or information is with the payer;
(ii) such right, property or information is used directly by the payer;
(iii) the location of such right, property or information is in India [Explanation 5].

4.7. Fees for Technical Services [Section 9(1)(vii)]

Any fees for technical services will be deemed to accrue or arise in India if they are payable by -

(i) the Government.
(ii) a person who is resident in India except where the fees is payable in respect of technical services utilised in a business or profession carried on by such person outside India or for the purpose of making or earning any income from any source outside India.
(iii) a person who is a non-resident, only where the fees are payable in respect of services utilised in a business or profession carried on by the non-resident in India or where such services are utilised for the purpose of making or earning any income from any source in India.

Fees for technical services mean any consideration (including any lumpsum consideration) for the rendering of any managerial, technical or consultancy services (including providing the services of technical or other personnel). However, it 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'.

4.8. Any Sum of Money paid by a Resident Indian to a Non-Corporate Non-Resident or Foreign Company [Section 9(1)(viii)]

Income arising outside India, being any sum of money paid without consideration, by a Indian resident person to a non-corporate non-resident or foreign company would be deemed to accrue or arise in India if the same is chargeable to tax under section 56(2)(x) i.e., if the aggregate of such sum received by a non-corporate non-resident or foreign company exceeds ` 50,000.

It may be noted that this deeming provision applies only to sum of money paid outside India to a non-corporate non-resident or foreign company, and not in respect of property, movable or immovable, transferred outside India without consideration or for inadequate consideration to a non- corporate non-resident or foreign company.

5. Certain Activities Not to Constitute Business Connection in India - Business Connection of Eligible Investment Fund through Presence of Eligible Fund Manager [Section 9A]

As the presence of a fund manager in India could entail business connection/ permanent establishment/ tax residence risks for offshore funds in India, the Finance Act, 2015 had introduced a new section 9A in the Income-tax Act, 1961 in order to encourage fund management of offshore funds from India. This was done to ensure that more fund management is done in India without adverse tax implications, as it provided a safe harbour regime for onshore management of offshore funds thereby neutralising the impact of constitution of business connection/ permanent establishment/ tax residence for the offshore funds in India.

However, in order to qualify as an 'Eligible Investment Fund' (EIF) and an 'Eligible Fund Manager' (EFM) for the purposes of availing the safe harbour, the fund and the fund manager are required to comply with the conditions laid down under section 9A of the Act and the rules made thereunder.

5.1 Fund Management Activity through an Eligible Fund Manager Not to Constitute Business Connection

In the case of an eligible investment fund, the fund management activity carried out through an eligible fund manager acting on behalf of such fund shall not constitute business connection in India of the said fund, subject to fulfilment of certain conditions.

Note: Merely location of fund manager in India shall not affect residential status of an eligible investment fund i.e. an eligible investment fund shall not be said to be resident in India merely because the eligible fund manager undertaking fund management activities on its behalf, is located in India.

5.2 Conditions to be fulfilled by an Eligible Investment Fund

The eligible investment fund means a fund established or incorporated or registered outside India, which collects funds from its members for investing it for their benefit. Further, it should fulfill the following conditions:

(i) the fund should not be a person resident in India;

(ii) the fund should be a resident of a country or a specified territory with which an agreement referred to in section 90(1) or section 90A(1) has been entered into or should be established or incorporated or registered, outside India in a country or a specified territory notified by the Central Government in this behalf;

(iii) the aggregate participation or investment in the fund, directly or indirectly, by 0persons being resident in India should not exceed 5% of the corpus of the fund;

(iv) the fund and its activities should be subject to applicable investor protection regulations in the country or specified territory where it is established or incorporated or is a resident;

(v) the fund should have a minimum of 25 members who are, directly or indirectly, not connected persons;

(vi) any member of the fund along with connected persons shall not have any participation interest, directly or indirectly, in the fund exceeding 10%;

(vii) the aggregate participation interest, directly or indirectly, of ten or less members along with their connected persons in the fund, shall be less than 50%;

(viii) the investment by the fund in any entity shall not exceed 20% of the corpus of the fund;

(ix) no investment shall be made by the fund in its associate entity;

(x) the monthly average of the corpus of the fund shall not be less than ` 100 crore. If the fund has been established or incorporated in the previous year, the corpus of fund should not be less than ` 100 crore at the end of a period of twelve months from the last day of the month of its establishment or incorporation;

(xi) However, this condition shall not be applicable to a fund which has been wound up in the previous year.

(xii) the fund shall not carry on or control and manage, directly or indirectly, any business in India;

(xiii) the fund should neither be engaged in any activity which constitutes a business connection in India nor should have any person acting on its behalf whose activities constitute a business connection in India other than the activities undertaken by the eligible fund manager on its behalf.

(xiv) the remuneration paid by the fund to an eligible fund manager in respect of fund management activity undertaken on its behalf should not be less than the amount calculated in the prescribed manner.

5.3. Certain Conditions Not to Apply to Investment Fund Set Up by the Government or the Central Bank of a Foreign State or a Sovereign Fund or Other Notified Fund [Proviso to Section 9A(3)]

The following conditions would, however, not be applicable in case of an investment fund set up by the Government or the Central Bank of a foreign State or a sovereign fund or such other fund notified by the Central Government [i.e., an investment fund set up by a Category-I or Category-II Foreign Portfolio Investor registered under the SEBI (Foreign Portfolio Investors) Regulations, 2014, made under the SEBI Act, 1992 and an investment fund set up by a Category-I foreign portfolio investor registered under the SEBI (Foreign Portfolio Investors) Regulations, 2019, made under the SEBI Act, 1992]:

(i) the fund should have a minimum of 25 members who are, directly or indirectly, not connected persons;
(ii) any member of the fund along with connected persons shall not have any participation interest, directly or indirectly, in the fund exceeding 10%;
(iii) the aggregate participation interest, directly or indirectly, of ten or less members along with their connected persons in the fund, shall be less than 50%.

5.4. Eligible Fund Manager [Section 9A(4)]

The eligible fund manager, in respect of an eligible investment fund, means any person who is engaged in the activity of fund management and fulfills the following conditions:

(i) the person should not be an employee of the eligible investment fund or a connected person of the fund;
(ii) the person should be registered as a fund manager or investment advisor in accordance with the specified regulations.
(iii) the person should be acting in the ordinary course of his business as a fund manager;
(iv) the person along with his connected persons shall not be entitled, directly or indirectly, to more than 20% of the profits accruing or arising to the eligible investment fund from the transactions carried out by the fund through such fund manager.

5.5. Furnishing of Statement in Prescribed Form [Section 9A(5)]

Every eligible investment fund shall, in respect of its activities in a financial year, furnish within 90 days from the end of the financial year, a statement in the prescribed form to the prescribed income-tax authority. The statement should contain information relating to –

(i) the fulfillment of the above conditions; and

(ii) such other relevant information or document which may be prescribed.

If any eligible investment fund fails to furnish such statement or information or document within 90 days from the end of the financial year, the income-tax authority prescribed under the said sub-section may direct that such fund shall pay, by way of penalty, a sum of 5,00,000 ***[Section 271FAB].***

5.6. Non-applicability of Special Taxation Regime under section 9A [Section 9A(6)]

This special taxation regime would not have any impact on taxability of any income of the eligible investment fund which would have been chargeable to tax irrespective of whether the activity of the eligible fund manager constituted business connection in India of such fund or not.

Further, the said regime shall not have any effect on the scope of total income or determination of total income in the case of the eligible fund manager.

CBDT to prescribe guidelines for the manner of application of the provisions of this section.

6. Determination of Residence under DTAA: Tie Breaker Rule and Dual Residency

Tie-breaker rules are included in tax-treaties to help in determining as to which country has the right to tax an individual as the country of residence in case the individual qualifies as a resident under the domestic laws of both countries.

6.1. Person Resident in More Than One Country

There are many situations in which an individual can be considered as a resident under the domestic income tax laws of multiple countries, especially in the year of immigration/emigration. This is also a common phenomenon for individuals who habitually reside in more than one country and for those who reside in one country and work in another country.

Some exceptional cases of dual-residence occur because the domestic laws of countries define "resident" (for tax purposes) in different manner. For example, tax residency in the Netherlands depends on the particular facts and circumstances of the individual, such as the availability of a permanent home, where his/her family resides and other such personal and economic connections. On the other hand, many other countries, including India, US, UK and Spain, determine tax residency based on the number of days an individual is physically present there (in the current year and sometimes in the current and previous tax years). It is also very common that countries use more than one concept for determining tax residence. A good example is the US who continues to tax its nationals even if they have moved to another country and are not or hardly present in the US anymore. Hence, it is easy to see how someone could qualify as a resident in both these countries in the same tax-year because of the use of differences in concepts.

Further, tax years may overlap – since some countries follow the calendar (January to December) and others follow the financial year (April to March) as the tax year which also leads to situation of dual residency if countries do not apply concepts of split year residency.

6.2. Tie Breaker Rule

a) In case of Individuals:

Most countries tax "residents" on their worldwide income (while allowing for exemptions/credits for taxes paid on income sourced in other countries). So, qualifying as a resident in two countries could mean that you are taxable in both countries on your entire income. In such cases, tie-breaker rules may come to your rescue.

Tie-breaker rules, as the name suggests, helps to determine which of two countries should tax an individual as his/her country of residence, in case there is a "tie" on the matter between two countries. The country of residence (determined according to the tie-breaker rules) taxes the individual on worldwide income while allowing for exemptions of income or credits for taxes paid on income sourced in the other country and the other country taxes the individual only on income sourced in that country. Hence, double taxation of the same income is avoided.

Tie-breaker rules (found in tax-treaties) are based on facts and circumstances, rather than number of days. They provide a step-by-step approach for analysing an individual's particular circumstances and thereby determining which of two countries is to be seen as the country of residence. The

a) The first criterion is access to a **permanent home**. If the individual has a permanent home in only of the two countries, that country would be said to be the country of residence.
b) If the individual has a permanent home in both countries, then we have to determine in which of the two countries his/her "**centre of vital interest**" lie by considering factors such as work and family. This comes very close to the domestic concept of residence applied by the Netherlands.
c) If the country of residence cannot be determined based on these material factors, the next step is to look at which of the two countries he/she **habitually resides** in.

d) If the individual can be said to habitually reside in both countries, then the tax residency will be determined according to his/her **nationality**.
e) However, if he/she is a national of both or neither of the two countries, the dual residency cannot be solved by the tie-breaker rules. In such case, it is left up to the **tax authorities** of both the countries to mutually decide that which of the two countries should be allowed to tax the individual as the country of residence.

b) In case of Persons other than Individuals:

As per paragraph 3 of OECD and UN Model, where a person other than individual is resident in both the countries, the tax authorities shall endeavour to determine by mutual agreement as to which country should tax such person, having regard to its place of effective management, the place where it is incorporated or otherwise and any other relevant factors. In absence of any such agreement, such person shall not be entitled to any relief or exemption from tax provided by this Convention except to the extent and such manner as may be agreed upon by the tax authorities of the respective countries. Until 2017, the sole tie-breaker rule for resolving double taxation was the concept of effective place of management. In 2017, the Committee of Fiscal Affairs recommended a change to case-by-case approach considering the number of tax avoidance cases involving dual residency. The step by step approach also known as Mutual Agreement Procedure is provided under Article 25.

6.3. Application of Tie Breaker Rule

It is important to note that tie-breaker rules do not automatically in all the situations of dual residence. These rules are found in tax-treaties. Thus, in order to be able to make use of these rules, a tax treaty should be applicable to the individual. This means that there should be a tax treaty between the two countries in question and that the individual should qualify as a resident under the domestic laws of both countries.

6.4. If Tax Treaty is Not Applicable

When there is the obvious possibility of an individual being taxed on his/her worldwide income in both countries while being allowed limited exemptions/credits with respect to taxes paid in the other country.

Though the global network of tax treaties is quite extensive but there might be a situation where no treaty exists might be more common and closer to home than one would expect. For example, there is no tax treaty (on income and capital) between the Netherlands and Cyprus, or between Denmark and France/Spain.

Sometimes a tax treaty may exist but it may not be applicable. That could be because of difference in the tax residency concept. An example is someone immigrates from the Netherland in August to a country that uses a 183 days test for counting days in the calendar year, which will not be surpassed. In the period between August and December 31 there is no tax residency established, then such person is for this period is called a “tax nomad”. Double taxation may arise since no tax treaty protection applies. Often people do not realise this.

Besides, determining tax residency is only the starting point for taxation. There may be more complications based on where the income is sourced; for instance if the income is sourced in a third country other than the two where the individual can be considered a tax-resident.

So, it is clear that tax residency or non-residency are utmost important for the determination of someone’s income tax position in the first place. Only after that has been established, the tax position can be further analysed.

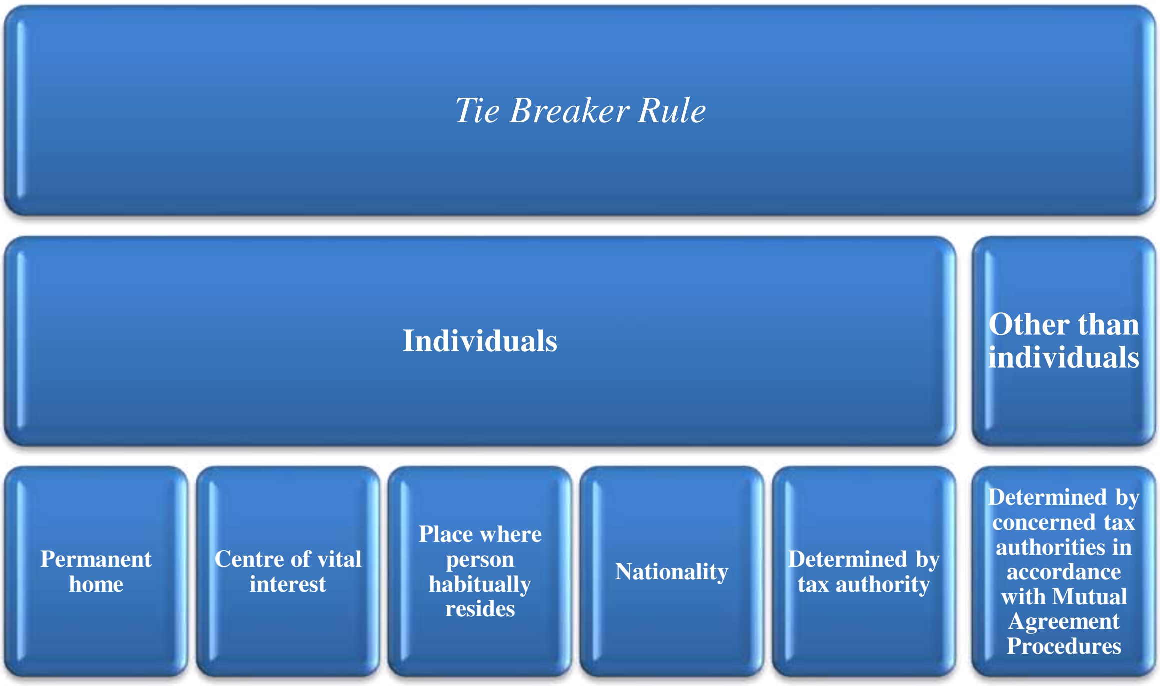

Fig. Tie Breaker Rule

7. Mutual Agreement Procedure (MAP)

Mutual Agreement Procedure (MAP) is a process of discussion between the competent authorities in which they seek to explore the possibilities of a solution to the relevant problem that can be accepted by all concerned.

Thus, MAP can be said to be an alternate tax dispute resolution mechanism which is available to the taxpayers under the DTAAs to resolve disputes giving rise to double taxation or taxation not in accordance with DTAAs. It can help in relieving double taxation either fully or partially.

7.1. Step-by-step Approach to MAP

The mutual agreement procedure is a well-established means through which tax administrations consult to resolve disputes regarding the application of double tax conventions. Article 25 sets out three different areas where mutual agreement procedures are generally used.

The first area includes instances of "taxation not in accordance with the provisions of the Convention" and is covered in paragraphs 1 and 2 of the Article. Procedures in this area are typically initiated by the taxpayer.

The other two areas, which do not necessarily involve the taxpayer, are dealt with in paragraph 3 and involve questions of "interpretation or application of the Convention" and "the elimination of double taxation in cases not otherwise provided for in the Convention".

Paragraph 10 of the Commentary on Article 25 makes clear that Article 25 is intended to be used by competent authorities in resolving not only problems of juridical double taxation but also those of economic double taxation arising from transfer pricing adjustments made pursuant to paragraph 1 of Article 9 (Article 9 – Associated enterprises).

Two alternatives - Alternative A and Alternative B, are provided by the UN Model Convention for the article on Mutual Agreement Procedure which was introduced in 2011. Under the OECD Model, the taxpayer may make a request to either Contracting State while UN Model (Alternative A) provides for the taxpayer going to Residence State or the country of his nationality. Alternative B of UN Model Article 25 provides reference to an arbitration process as a part of Mutual Agreement procedure. The decision arrived through the arbitration process is binding on a person unless a person directly affected by the decision does not accept it.

Para	OECD Model Tax Convention	UN Model Convention
		Alternative A
1	Where a person considers that the actions of one or both of the Contracting States result or will result for him in taxation not in accordance with the provisions of this Convention, he may, irrespective of the remedies provided by the domestic law of those States, present his case to the competent authority of the Contracting State of which he is a resident or, if his case comes under **paragraph 1 of Article 24**, to that of the Contracting State of which he is a national. The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the Convention.	
2	The competent authority shall endeavour, if the objection appears to it to be justified and if it is not itself able to arrive at a satisfactory solution, to resolve the case by mutual agreement with the competent authority of the other Contracting State, with a view to the avoidance of taxation which is not in accordance with the Convention. Any agreement reached shall be implemented notwithstanding any time limits in the domestic law of the Contracting States.	
3	The competent authorities of the Contracting States shall endeavour to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the Convention. They may also consult together for the elimination of double taxation in cases not provided for in the Convention.	
4	The competent authorities of the Contracting States may communicate with each other directly, including through a joint commission consisting of themselves or their representatives, for the purpose of reaching an agreement in the sense of the preceding paragraphs.	The competent authorities of the Contracting States may communicate with each other directly, including through a joint commission consisting of themselves or their representatives, for the purpose of reaching an agreement in the sense of the preceding paragraphs. **The competent authorities, through consultations, may develop appropriate bilateral procedures, conditions, methods and techniques for the implementation of the mutual agreement procedures provided for in this article.**

<table>
<tr><td></td><td colspan="2">Note: Article 25(4) of the UN MC consists of two sentences, the first of which reproduces the first sentence of the Article 25(4) of the OECD MC while the second sentence in UN MC, which is not contained in the OECD MC, relates to development of procedures and other matters relating to smooth implementation of MAP.</td></tr>
<tr><td></td><td colspan="2">Alternative B</td></tr>
<tr><td>5</td><td>Where,
(a) under paragraph 1, a person has presented a case to the competent authority of a Contracting State on the basis that the actions of one or both of the Contracting States have resulted for that person in taxation not in accordance with the provisions of this Convention, and

(b) the competent authorities are unable to reach an agreement to resolve that case pursuant to paragraph 2 within two years from the date when all the information required by the competent authorities in order to address the case has been provided to both competent authorities,

Any unresolved issues arising from the case shall be submitted to arbitration if the person so requests in writing. These unresolved issues shall not, however, be submitted to arbitration if a decision on these issues has already been rendered by a court or administrative tribunal of either State. Unless a person directly affected by the case does not accept the mutual agreement that</td><td>Where,
(a) under paragraph 1, a person has presented a case to the competent authority of a Contracting State on the basis that the actions of one or both of the Contracting States have resulted for that person in taxation not in accordance with the provisions of this Convention, and

(b) the competent authorities are unable to reach an agreement to resolve that case pursuant to paragraph 2 within three years from the presentation of the case to the competent authority of the other Contracting State,

Any unresolved issues arising from the case shall be submitted to arbitration if either competent authority so requests. The person who has presented the case shall be notified of the request. These unresolved issues shall not, however, be submitted to arbitration if a decision on these issues has already been rendered by a court or administrative tribunal of either State. The arbitration decision shall be binding on both States and shall be implemented notwithstanding any time limits in the domestic laws of these</td></tr>
</table>

<table>
<tr><td></td><td>implements the arbitration decision, that decision shall be binding on both Contracting States and shall be implemented notwithstanding any time limits in the domestic laws of these States. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this paragraph.</td><td>States unless both competent authorities agree on a different solution within six months after the decision has been communicated to them or unless a person directly affected by the case does not accept the mutual agreement that implements the arbitration decision. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this paragraph.</td></tr>
<tr><td></td><td colspan="2">Note: Article 25B of the Un Model reproduces Article 25 of the OECD Model with the addition of the aforementioned second sentence in paragraph (4) and also includes arbitration as provided in Article 25(5) of the OECD Model with the following differences:

(i) Article 25B (5) of the UN Model provides that arbitration may be initiated if the competent authorities are unable to reach an agreement on a case within three years from the presentation. However, Article 25(5) of the OECD Model provides a time limit of 2 years.
(ii) While the OECD MC provides that arbitration must be requested by the person who initiated the case, paragraph 5 of Alternative B provides that arbitration must be requested by the competent authority of one of the Contracting States
(iii) While the OECD MC provides that the two-year period begins when all the information required by the competent authorities in order to address the MAP case has been provided, paragraph 5 of alternative B of UN MC provides that the three-year period begins with the presentation of the MAP case to the competent authority of the State that did not initially relate it.
(iv) Unlike the corresponding provision of the OECD MC, allows the competent authorities to depart from the arbitration decision if they agree on a different solution within six months after the decision has been communicated to them.</td></tr>
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7.2. Categories of Disputes Covered under MAP

The categories of disputes covered under MAP include:

(i) Arise where a person who is resident of a country considers that action of one or both the countries results or will result in taxation not in accordance of with the provision of DTAA.

(ii) Issues relating to interpretation or application of the treaty General in nature and can be initiated suo moto by

(iii) Provides for elimination of double taxation for cases not provided in DTAA.

7.3. Need for MAP

The need for MAP can be highlighted below:

(i) Double Taxation Avoidance Agreements ('tax treaties') are available for capturing and curtailing juridical double taxation.

(ii) Tax treaties generally do not cover instances of economic double taxation.

(iii) MAP provides relief in cases of economic double taxation.

(iv) MAP also provides relief in cases where automatic relief, such as tax credits, tax exemption, etc. are not available

7.4 Process Involved in Application of MAP

The steps involved in the MAP application process are:

Step 1: Brief facts and background of the case must be summarised

Step 2: Contentions of Indian Revenue must be summarised in the application

Step 3: The net tax and interest impact only by virtue of transfer pricing adjustment is computed

Step 4: Take note of transactions only relating to one country (in one application), e.g. USA, UK, etc.

Step 5: All documents including tax returns, TP study, notices, submissions, orders, etc. must be furnished.

Step 6: Relevant judicial precedence and their applicability to taxpayer's case must be demonstrated.

7.5. Outcome of MAP Process

The process of MAP can lead to following outcomes:

(i) The Assessing Officer gives effect of the decision of the MAP, after receiving instructions from the CCIT / DGIT (within 90 days of receiving instructions)

(ii) If taxpayer is aggrieved by decision of the Competent Authority, he may reject the decision and go ahead with the remedies under the domestic law.

(iii) If remedies are not granted by the domestic law, the taxpayer may apply to the Competent Authorities again for subsequent years.

(iv) Decision of a Competent Authority is generally case specific and not a precedent for the taxpayer for subsequent years or other taxpayers on same issues.

7.6. Drawbacks of MAP Process

The drawbacks of the MAP process include the following:

(i) Time limits under domestic law may make corresponding adjustments unavailable if those limits are not waived in the relevant tax treaty.

(ii) Mutual agreement procedures may take too long to complete.

(iii) Taxpayer participation may be limited.

(iv) Published procedures may not be readily available to instruct taxpayers on how the procedure may be used; and

(v) There may be no procedures to suspend the collection of tax deficiencies or the accrual of interest pending resolution of the mutual agreement procedure.

Test Your Knowledge

QUESTIONS	
1.	Mr. Ram is born and brought up in U.K. and is a citizen of that country. His parents and maternal grandparents were also born and brought up in U.K., but his paternal grandparents were born in Lahore, Pakistan before the year 1940. He visits India every year from 1st May to 31st July. What is his residential status under the Income-tax Act, 1961 for A.Y. 2021-22, assuming that his total income from Indian sources is 25 lakhs?
2.	Manipal Ltd. is having its registered office in London. It is engaged in the business of manufacturing of Yarn and is one of the well-known exporters of the Yarn in UK. The company has employed talented sales managers in India and has set up a marketing office in India which handles sales and marketing activities of the company. Also, majority of the directors are placed in India and they take all the important decisions relevant to the company from India. Determine the place of effective management for Manipal Ltd. as per Income Tax Act, 1961.
3.	State with reason whether the following transaction attract income tax in India, in the hands of recipients u/s 9 of the Income Tax Act, 1961. (i) A firm of solicitors in Mumbai engaged a barrister in UK for arguing a case before Supreme Court of India. A payment of 5000 pounds was made as per terms of professional engagement. (ii) Amount paid by Government of India for use of patent developed by Mr. Y,

	who is a non-resident. **(iii)**Gina Engineering, a non-resident foreign company entered into a collaboration agreement on 25.06.2020, with an Indian Company, in consideration of providing technical know-how during previous year 2020-21.
4.	ABC Inc., a Country A company whose place of effective management (POEM) is also in Country A, entered into an agreement with Monu Ltd., India, for the execution of electrical work in India. Separate payments, termed as "Engineering Fee", were made towards drawings and designs by Monu Ltd. to the Country A Company, which does not have any permanent establishment (PE) in India for doing the business and operates only from Country A. Is the "Engineering Fee" paid outside India to ABC Inc., Country A Company, in the P.Y. 2020-21 chargeable to tax in its hands in India? Examine.
5.	Megha Inc, a Country M company, whose POEM is outside India, entered into a collaboration agreement on 22.08.2020 with Yamaha Ltd., an Indian Company. The Country M Company was issued debentures by Yamaha Ltd. for ` 80 lakhs on 1.09.2020 bearing interest @ 12% p.a. in consideration for providing the technical know-how to Yamaha Ltd. in relation to its business in India. Yamaha Ltd. also remitted the interest on debentures to Megha Inc. which was due for the relevant period ended on 31.03.2021. Examine the taxability of fees for technical services and interest income accruing to Megha Inc. for P.Y.2020-21 on debentures issued by Yamaha Ltd., which was received by Megha Inc. in Country M.
6.	State with reasons whether the following transactions are subject to tax as deemed Income. (i) ABC Ltd. is a broadcaster of News Channel in India. It has made payments to a Malaysian company having no PE in India for downlinking Television Channels into India and International footprint through a channel. (ii) Mr B, a foreign citizen and a diamond merchant from US has earned income of ` 10 crores from display of uncut and unassorted diamonds in the Mumbai Diamond Bourse, a notified special zone in Mumbai.
7.	Examine the following statement in context to the provisions of Income-tax Act, 1961: Liaison office maintained in India to explore the opportunity of business in India does not constitute business connection.

8.	X Ltd., a company incorporated in USA has entered into an agreement with Y Ltd. an Indian company for rendering technical services to the latter for setting up a fertiliser plant in Orissa. As per the agreement, X Ltd. rendered both off-shore and on-shore services to Y Ltd. at a fees of ` 50 lakhs and ` 1 crores respectively. X Ltd. is of the view that it is not liable to tax in India in respect of fee of ` 50 lakhs as it is for rendering services outside India. Discuss the correctness of the view of X Ltd.

SOLUTIONS	
1.	Since Mr. Ram is a person of Indian origin, who, being outside India, comes on a visit to India, he would be treated as a resident for A.Y. 2021-22 as per section 6(1) if his stay in India is for 182 days in the P.Y. 2020-21 or his stay in India is for 120 days in the P.Y. 2020-21 and 365 days in the four immediately preceding previous years, since his total income (other than income from foreign sources) exceeds 15 lakhs during that year. However, in this case, since his stay in India in the P.Y. 2020-21 is only for 92 days, he does not satisfy either of the conditions. Hence, he is non-resident in India for A.Y. 2021-22. ***Note*** *- Section 6(1A) deeming such an individual having total income, other than income from foreign sources, exceeding 15 lakhs during the P.Y.2020-21 to be a resident, if he is not liable to tax in any other country by reason of his domicile or residence or other criteria of similar nature, is not applicable to Mr. Ram since he is not an Indian citizen.*
2.	As per the provisions of Income Tax Act, 1961 the place where company's board regularly meet and makes decision is more important than the place where the registered office of the company is situated. In the given case, Manipal Ltd. is having a registered office in London, the majority of the directors reside in India. Further all the important decisions are taken by the directors residing in India. Therefore, it is clear that though Manipal Ltd. has a registered office in London, its place of effective management will be considered in India as majority of board members reside in India and all the major decisions are taken in India.

3.	i) As per section 9(1)(i), all the income accruing or arising, whether directly or indirectly, through or from any business connection in India is deemed to accrue or arise in India. In the given case, there exists a professional connection between the film solicitors in Mumbai and the barristers in UK. Further the expression "business" includes not only trade and manufacture but also "profession". Thus, such professional connection would amount to business connection in India under section 9(1)(i). Hence, the amount of 5000 pounds paid to the barrister in UK would be deemed to accrue or arise in India under section 9(1)(i). ii) As per section 9(1)(vi), income by way of royalty is deemed to accrue or arise in India if it is paid by Government. "Royalty" has been defined to include even consideration for the use of patent. Thus, the amount paid by government of India for use of patent developed by Mr. Y, a non-resident, is deemed to accrue or arise in India and hence, will be taxable in India. iii) Debentures issued by Indian Company as a consideration for providing technical know-how is in the nature of fees for technical services and hence, as per section 9(1)(vii). It will be deemed to accrue or arise in India. Thus, it will be liable to tax in India.
4.	Separate payments made towards drawings and designs (described as "engineering fee") are in the nature of fees for technical services. Fees for technical services payable by a resident (Monu Ltd., an Indian company, in this case) would be deemed to accrue or arise in India under section 9(1)(vii) in the hands of the non-resident recipient (ABC Inc., the Country A company) This is so, since the fees is not in respect of services utilised for a business or profession outside India or for the purpose of making or earning income from any source outside India. In this case, Monu Ltd., an Indian company, has paid fees for technical services to ABC Inc., the Country A company for a business in India, and therefore, the same is deemed to accrue or arise in India as per section 9(1). Further, as per *Explanation* to section 9, where income is deemed to accrue or arise in India under section 9(1)(vii), such income shall be included in the total income of the non-resident Country A company, regardless of whether it has a residence or place of business or business connection in India, and even if such services are rendered from outside India. Accordingly, in this case, payments towards drawings and designs would taxable in India in the hands of ABC Inc., the Country A company.

5.	` 80 lakhs, being the value of debentures issued by an Indian company, Yamaha Ltd., in consideration of providing technical know-how, is in the nature of fee for technical services, deemed to accrue or arise in India to Megha Inc., a foreign company, under section 9(1)(vii). Hence, it is taxable in India. Further, as per section 9(1)(v), income by way of interest payable by a person who is a resident in India is deemed to accrue or arise in India except if the debt incurred is used for its business purposes outside India or for making or earning any income from any source outside India. Therefore, in this case, interest income from debentures of Yamaha Ltd., an Indian company, is deemed to accrue or arise in India in the hands of Megha Inc. by virtue of section 9(1)(v), since the debt incurred is not used for a business outside India or for earning income from a source outside India. Hence, interest @ 12% for 7 months on ` 80 lakhs amounting to ` 5.60 lakhs shall be taxable in the hands of Megha Inc. in India in the A.Y. 2021-22.
6.	i) As per Explanation 2 to section 9(1)(vi), royalty means the consideration for transfer of all or any rights in respect of any copyright, literacy, artistic, scientific work including films or video tapes for use in connection with ratio broadcasting but does not include consideration for sale, distribution or exhibition of cinematographic films. In case of ABC Ltd, a broadcaster of News Channel in India has made payments to a Malaysian company having no PE in India for downlinking television channels and international footprints through a channel does not amount to royalty as defined under Explanation 2 to section 9(1)(vi). Therefore, the payment received by Malaysian company shall not be taxable in India. ii) As per Explanation 1(e) to section 9(1)(i), in case of a foreign company engaged in the business of mining of diamonds, no income shall ne deemed to accrue or arise in India to it through or from the activities which are confined to the display of uncut and unassorted diamond in any special zone notified by the Centeral Government in the Official Gazette. In this case, Mr. B, who is a foreign citizen and diamond merchant from US has earned income of ` 10 crores from the display of uncut and assorted diamonds in the Mumbai Diamond Bourse, a notified special zone in Mumbai. Since Mr. B is a foreign citizen and not a foreign company, Explanation 1(e) to section 9(1)(i) shall not be applicable and the income earned by him shall be

	deemed to accrue or arise in India.
7.	If a Liaison Office is maintained solely for the purpose of carrying out activities which are preparatory or auxiliary in character, and such activities are approved by Reserve Bank of India, then, no such business connection is established. In the given case, the Liaison Office is maintained for the purpose of exploring the opportunity of business in India, which is in the nature of auxiliary or preparatory activity and it is assumed that such activities are approved by the Reserve Bank of India. Since, it does not undertake commercial, trading or industrial activity, directly or indirectly, the Liaison Office does not constitute a business connection in India.
8.	The explanation below section 9(2) clarifies that income by way of, inter alia, fees for technical services from services utilised in India would be deemed to accrue or arise in India under section 9(1)(vii) in case of non-resident and be included in his total income, whether or not such services were rendered in India. In this case, the technical services rendered by the foreign company, X Ltd., were for setting-up fertiliser plant in Orissa. Therefore, the services were utilised in India. Consequently, as per section 9(2), the fees of ` 1.5 crores for technical services rendered by X Ltd. (both off-shore and on-shore) to Y Ltd. is deemed to accrue or arise in India and includible in the total income of X Ltd. Therefore, the view of X Ltd. that it is not liable to tax in India in respect of fee of ` 50 lakhs (as it is for rendering service outside India) is not correct.