

# Capital Trainers

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### PAPER – 7: DIRECT TAX LAWS & INTERNATIONAL TAXATION

Question No.1 is compulsory.

Answer any **four** questions from the remaining **five** questions.

Working notes should form part of the respective answers

All questions relate to Assessment Year 2018-19, unless stated otherwise in the question.

#### Question 1

- (a) SDK Ltd. is engaged in the manufacture of textile since 01-04-2010. Its Statement of Profit and Loss for the previous year ended 31<sup>st</sup> March, 2018 shows a profit of ₹ 600 lakhs after debiting or crediting the following items:
- (i) Depreciation charged on the basis of useful life of assets as per Companies Act is ₹ 40 Lakhs.
  - (ii) Industrial power tariff concession of ₹ 3.5 Lakhs, received from State Government was credited to P & L Account.
  - (iii) The company had provided ₹ 25 Lakhs being sum fairly estimated as payable with reasonable certainty, to workers on agreement to be entered with the workers union towards periodical wage revision once in every three years.
  - (iv) Dividend received from a foreign company ₹ 10 Lakhs.
  - (v) Loss ₹ 25 Lakhs, due to destruction of a machine worth ₹ 30 Lakhs by fire due to short circuit and ₹ 5 Lakh received as scrap value. The insurance company did not admit the claim of the company on charge of gross negligence.
  - (vi) Provision for gratuity based on actuarial valuation was ₹ 400 Lakhs. Actual gratuity paid debited to gratuity provision account was ₹ 275 lakhs.
  - (vii) The company has purchased 500 tons of industrial paper as packing material at a price of ₹ 30,000 per ton from M/s. Shivbramha, a firm in which majority of the directors of SDK Ltd. are partners. The firm's normal selling price of the same material in market is ₹ 28,000 per ton.
  - (viii) Advertisement charges ₹ 1.5 Lakhs, paid by cheque for advertisement published in the souvenir of a political party registered with the Election Commission of India.
  - (ix) Long term capital gain ₹ 4.5 Lakhs on sale of equity shares on which Securities Transaction Tax (STT) was paid at the time of acquisition and sale.

#### Additional Information:

- (i) Normal depreciation as per Income-tax Rules is ₹ 65 Lakhs.

The Suggested Answers for Paper 7:- Direct Tax Laws and International Taxation are based on the provisions of direct tax laws as amended by the Finance Act, 2017, which is relevant for May, 2018 examination. The relevant assessment year is A.Y.2018-19.

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- (ii) The sales tax ₹ 11 Lakhs collected from its customers was paid by the company on the due dates. On an appeal, the High Court directed the sales tax department to refund ₹ 4 Lakhs to the company. The company in turn refunded ₹ 3 lakhs to the customers from whom it was collected and the balance ₹ 1 lakh is still lying under the head "Current Liabilities".

Compute the total income of SDK Ltd. for the A.Y. 2018-19 by analyzing and applying the relevant provisions of income-tax law. Briefly explain the reasons for treatment of each item. Ignore the provisions relating to Minimum Alternate Tax. **(14 Marks)**

- (b) X Ltd., a resident Indian Company, on 01-04-2017 has borrowed ₹ 100 crores from M/s. A Inc, a Company incorporated in US, at an interest rate of 9% p.a. The said loan is repayable over a period of 10 years. Further, loan is guaranteed by M/s B Inc incorporated in US. M/s. K Inc, a non-resident, holds shares carrying 30% of voting power both in M/s X Ltd. and M/s B. Inc. M/s K Inc has also deposited ₹ 100 crores with M/s A Inc.

**Other information**

Net profit of M/s. X Ltd. was ₹ 10 crores after debiting the above interest, depreciation of ₹ 5 crores and income-tax of ₹ 3.40 crores. Calculate the amount of interest to be disallowed under the head "Profits and gains of business or profession" in the computation of M/s X Ltd.

Substantiate your answer with reasons.

**(6 Marks)**

**Answer**

- (a) **Computation of Total Income of SDK Ltd. for the A.Y. 2018-19**

	Particulars	Amount (₹ )	
I	<b>Profits and gains of business and profession</b>		
	Net profit as per the statement of profit and loss		6,00,00,000
	<b>Add: Items debited but to be considered separately or items of expenditure to be disallowed</b>		
	(i) <b>Depreciation as per Companies Act</b>	40,00,000	
	(iii) <b>Provision for wages payable to workers</b>	-	
	[Since the provision is based on a fair estimate of wages payable with reasonable certainty, the provision is allowable as deduction. ICDS X requires a reliable estimate of the amount of obligation and 'reasonable certainty' for recognition of a provision, which is present in this case.		

	As the provision of ₹ 25 lakhs has been debited to statement of profit and loss, no adjustment is required while computing business income]		
(v)	<b>Loss due to destruction of machinery by fire</b> [Loss of ₹ 25 lakhs due to destruction of machinery caused by fire is not deductible since it is capital in nature. Since the loss has been debited to statement of profit and loss, the same is required to added back while computing business income]	25,00,000	
(vi)	<b>Provision for gratuity</b> [Provision of ₹ 400 lakhs for gratuity based on actuarial valuation is not allowable as deduction. However, actual gratuity of ₹ 275 lakhs paid is allowable as deduction. Hence, the difference has to be added back to income [₹ 400 lakhs (-) ₹ 275 lakhs]	1,25,00,000	
(vii)	<b>Purchase of paper at a price higher than the fair market value</b> [Since the purchase is from a related party, a firm in which majority of the directors of the company are partners, at a price higher than the fair market value, the difference between the purchase price (₹ 30,000 per ton) and the fair market value (₹ 28,000 per ton) multiplied by the quantity purchased (500 tons, i.e., [₹ 2,000 x 500) has to be added back]	10,00,000	
(viii)	<b>Advertisement in souvenir of a political party</b> [Advertisement charges paid in respect of souvenir published by a political party is not allowable as deduction from business profits of the company. Since, the expenditure has been debited to statement of profit and loss, the same has to be added back while computing business income]	1,50,000	
		<hr/>	<u>2,01,50,000</u>

			<b>8,01,50,000</b>
	<b>Add: Income taxable but not credited to statement of profit and loss</b>		
	Al(ii) <b>Sales tax not refunded to customers out of sales tax refund</b> [The amount of sales tax refunded to the company by the Government is a revenue receipt chargeable to tax. Out of the refunded amount of ₹ 4 lakhs, the amount of ₹ 3 lakh stands refunded to customers would not be chargeable to tax. <sup>1</sup> . The balance amount of ₹ 1,00,000 lying with the company would be chargeable to tax]		1,00,000
			<b>8,02,50,000</b>
	<b>Less: Items credited to statement of profit and loss, but not includible in business income/ permissible expenditure and allowances</b>		
	(ii) <b>Industrial power tariff concession received from State Government</b> [Any assistance in the form of, <i>inter alia</i> , concession received from the Central or State Government would be treated as income. Since the same has been credited to statement of profit and loss, no adjustment is required]	-	
	(iv) <b>Dividend received from foreign company</b> [Dividend received from foreign company is taxable under "Income from other sources". Since the said same has been credited to the statement of profit and loss, it has to be deducted while computing business income]	10,00,000	
	(v) <b>Scrap value of machinery</b> [Scrap value of machinery, being capital in nature, has to be reduced from WDV of machinery. Since the same has been credited to the statement of profit and loss, it has to be deducted while computing business income]	5,00,000	

<sup>1</sup>CIT v. Thirumalaiswamy Naidu & Sons (1998) 230 ITR 534 (SC)

	(ix) <b>Long term capital gains of sale of equity shares</b> [The taxability or otherwise of long term capital gain on sale of equity shares has to be considered while computing income under the head "Capital Gains". Since such capital gains has been credited to statement of profit and loss, the same has to be reduced to arrive at the business income.]	4,50,000	
	Al(i) <b>Depreciation as per Income-tax Rules, 1961 [See Note below]</b>	<u>65,00,000</u>	<u>84,50,000</u>
	<b>Profits and gains from business and profession</b>		<b>7,18,00,000</b>
<b>II</b>	<b>Income from Other Sources</b>		
	<b>Dividend received from foreign company</b> [Dividend received from a foreign company is chargeable to tax under the head "Income from other sources"]		10,00,000
<b>III</b>	<b>Capital Gains</b>		
	<b>Long term capital gain on sale of equity shares</b> [Long term capital gains on sale of equity shares on which STT is paid at the time of acquisition and sale is exempt under section 10(38).]		-
	<b>Gross Total Income</b>		<b>7,28,00,000</b>
	<b>Less: Deduction under Chapter VI-A</b> Under section 80GGB [Contribution by a company to a registered political party is allowable as deduction, since payment is made otherwise than by cash. Expenditure incurred by an Indian company on advertisement in souvenir published by such political party tantamounts to contribution to such political party.]		<u>1,50,000</u>
	<b>Total Income</b>		<b>7,26,50,000</b>

**Note –** As per section 43(6)(c), for computation of written down value (WDV) of a block of asset at the end of the year, the amount of scrap value received has to be reduced from the value of block of assets at the beginning of the previous year and cost of assets purchased during the year. Depreciation is calculated on the value so arrived of the block

of asset as on 31.3.2018. In the question, adjustment (v) states that scrap value of ₹ 5 lakh is received in respect of destroyed machinery and same is credited in the statement of profit and loss. In the additional information, since, depreciation as per Income-tax Rules, 1962 is given, no further adjustment for scrap value is done, presuming that the same has already been reduced and depreciation has been calculated on the value so arrived at of the block as on 31.3.2018.

However, since scrap value has been credited to the statement of profit and loss, it is possible to take a view that the amount of scrap value is not reduced while computing the value of the assets. In such a case, depreciation allowable would be ₹ 64,25,000 [i.e., ₹ 65,00,000 – ₹ 75,000, being 15% of ₹ 5,00,000]. The business income and total income would be ₹ 7,18,75,000 and ₹ 7,27,25,000, respectively.

- (b) If an Indian company, being the borrower, incurs any expenditure by way of interest in respect of any debt issued by its non-resident associated enterprise (AE) and such interest exceeds ₹ 1 crore, then, the interest paid or payable by such Indian company in excess of 30% of its earnings before interest, taxes, depreciation and amortization (EBITDA) or interest paid or payable to associated enterprise, whichever is lower, shall not be allowed as deduction as per section 94B.

Further, where the debt is issued by a lender which is not associated but an associated enterprise either provides an implicit or explicit guarantee to such lender or deposits a corresponding and matching amount of funds with the lender, such debt shall be deemed to have been issued by an associated enterprise and limitation of interest deduction would be applicable.

In the present case, since M/s K Inc holds 30% of voting power i.e., more than 26% of voting power in both X Ltd and M/s B Inc, X Ltd. and M/s B Inc are deemed to be associated enterprises.

Since loan of ₹ 100 crores taken by X Ltd., an Indian company from M/s A Inc, is guaranteed by M/s B Inc, an associated enterprise of X Ltd., such debt shall be deemed to have been issued by an associated enterprise and interest payable to M/s A. Inc shall be considered for the purpose of limitation of interest deduction under section 94B.

**Computation of interest to be disallowed as per section 94B in the computation of income under the head profits and gains of business or profession of M/s.X Ltd.**

Particulars	₹
Net profit	10,00,00,000
Add: Interest already debited (₹ 100 crores x 9%)	9,00,00,000
Depreciation	5,00,00,000
Income tax	<u>3,40,00,000</u>
<b>EBITDA</b>	<b><u>27,40,00,000</u></b>

Interest paid or payable by X Ltd.	9,00,00,000
Interest paid or payable in excess of the lower of the following would be disallowed	
- 30% of EBITDA	₹ 8,22,00,000
- Interest paid or payable to non-resident AE	₹ 9,00,00,000
	<u>8,22,00,000</u>
Interest to be disallowed as deduction	<u>78,00,000</u>

**Note** – Since K Inc., an associated enterprise of X Ltd., has deposited a matching amount of ₹ 100 crores with A Inc., the interest payable by X Ltd. to A Inc. on loan of ₹ 100 crores borrowed from A Inc. would be subject to limitation of interest deduction on the basis of this line of reasoning also.

### Question 2

- (a) M/s. Gomati P Ltd., a closely held company, is in the business of growing rubber. The profit & loss account for the year ended 31-03-2018 of the company shows a net profit ₹ 37.65 crores after debiting depreciation of ₹ 30 crores.

The company has provided the following additional information:

- (i) The company has deposited ₹ 30 crores in a special account with NABARD on 29-04-2018.
- (ii) The company has brought forward losses of ₹ 6 crores pertaining to Assessment Year 2015-16. Mr. A who continuously held 60% of shares carrying voting power since incorporation of the company, had sold his entire holding to Mr. B on 01-08-2017.
- (iii) The company had an accumulated balance of ₹ 200 crores in the special account with NABARD as on 01-04-2017. It has withdrawn ₹ 40 crores and utilized the same for the following purposes:
  - Purchase of a new sprinkling machine for use in its operation ₹ 10 crores,
  - Purchase of office appliances for corporate office at Chennai ₹ 10 crores.
  - Purchase of computers and accessories ₹ 5 crores.
  - Construction of a godown at a cost of ₹ 1 crore near the rubber estate to store raw rubber.
  - Repairs to machinery ₹ 35 lakhs.
- (iv) On 31-03-2018, the company has sold machinery which was purchased on 10-05-2009 for ₹ 10 crores. The purchase of the said machinery was in accordance with the scheme of deposit.
- (v) Depreciation allowable as per Tax Audit Report is ₹ 28 crores.

Compute Taxable and Exempt income of M/s. Gomati (P) Ltd.

**(8 Marks)**

- (b) The Gross Total Income of Mr. Bharadwaj who is a resident of Varanasi for the year ended 31-03-2018 is ₹ 15 lakhs.

Further

- (i) He has contributed ₹ 2 lakh towards Clean Ganga Fund set up by the Central Government
- (ii) He has incurred medical expenditure of ₹ 50,000 towards surgery for his grandmother who is 85 years of age. (No Premium is paid to keep in force an insurance on her health)
- (iii) He has donated ₹ 2 lakhs in cheque and ₹ 50,000 in cash to a political party during its annual conference of which he is a member.
- (iv) Repayment of housing loan instalment ₹ 1 lakh during the financial year to his employer XYZ Private Limited.

Discuss the allowable deduction to Mr. Bharadwaj from the above information. (6 Marks)

- (c) Amrutha is a resident Individual. She has income from the following sources:

- (i) Taxable income from a sole-proprietary concern in Kochi ₹ 50 lakhs.
- (ii) Share of profit from a partnership firm in Chennai ₹ 30 lakhs.
- (iii) Agricultural Income from rubber estate in Country A which has no DTAA with India, USD 70000. Withholding Tax on the above income USD 10500 (Assume 1 USD = Rs 64).
- (iv) Brought forward Business Loss in Country A was USD 10000 which is not permitted to be set off against other income as per the laws of that country.

Compute taxable income and tax payable by Amrutha for the A.Y. 2018-19. (6 Marks)

**Answer**

- (a) **Computation of Taxable and Exempt Income of M/s Gomati (P) Ltd. for the A.Y. 2018-19**

Particulars	₹
Net profit as per Profit and Loss Account	37,65,00,000
<b>Add: Excess depreciation as per books of account</b>	<b>₹</b>
Depreciation as per books of account	30,00,00,000
Less: Depreciation allowable as per the Income-tax Act, 1961	<u>28,00,00,000</u>
	<u>2,00,00,000</u>
<b>Net profit before allowing deduction under section 33AB</b>	<b>39,65,00,000</b>
Less: Deduction under section 33AB would be the lower of:	
- <b>Amount deposited in Rubber Development Account</b> on or before 30.9.2018 [i.e., ₹ 30,00,00,000]	
- <b>40% of profits of such business</b> [i.e., ₹ 15,86,00,000, being 40% of ₹ 39,65,00,000]	
	<u>15,86,00,000</u>

<b>Net profit after allowing deduction under section 33AB</b>	<b>23,79,00,000</b>
<b>Add:</b> Amount withdrawn from special account with NABARD, which is deemed as profits and gains of business or profession	
(i) <b>Purchase of a new sprinkling machine for use in its operation for ₹ 10 crores</b> , would <b>not</b> be deemed as profits and gains of business or profession, since the said amount is utilised as per the specified scheme.	Nil
(ii) <b>Purchase of office appliances for corporate office at Chennai for ₹ 10 crores</b> , out of the amount withdrawn from the deposit account, would be deemed as profits and gains of business or profession, since the said utilisation is not permissible.	10,00,00,000
(iii) <b>₹ 5 crores utilised for purchase of computers and accessories is permissible</b> . Thus, such amount would <b>not</b> be deemed as profits and gains of business or profession.	Nil
(iv) <b>₹ 1 crore utilised for construction of a godown near rubber estate to store raw rubber</b> , would <b>not</b> be deemed as profits and gains of business or profession, since the said amount is utilised as per the specified scheme.	Nil
(v) <b>₹ 35 lakhs utilised for repairs to machinery</b> would not be deemed as profits and gains of business or profession, since the said amount is utilised as per the specified scheme. <i>Note - However, no deduction would be allowed in respect of such expenditure mentioned in (i), (iii), (iv) and (v) during the P.Y. 2017-18, since amount is spent out of the amount deposited in special account with NABARD, which has already been allowed as deduction in an earlier assessment year.</i>	Nil
(vi) The <b>remaining amount of ₹ 13.65 crores {₹ 40 crores less ₹ 26.35 crores}</b> [utilised above in (i) to (v)], which is <b>not</b> utilised during the previous year in which such amount is withdrawn, would be deemed as profits and gains of business or profession.	13,65,00,000
<b>Add:</b> Sale of machinery acquired out of the amount withdrawn from special account in accordance with the scheme of deposit. The cost of such machinery would be deemed as profits and gains of business or profession, since such machinery is sold before the expiry of eight years from the end of the previous year of its acquisition. <b>[See Note at the end of the solution]</b>	<u>10,00,00,000</u>

<b>Total Composite business profits</b>	<b>57,44,00,000</b>
Less: 65% of ₹ 57,44,00,000, being agricultural income exempt	<u>37,33,60,000</u>
<b>Business income</b>	<b>20,10,40,000</b>
Less: Brought forward business loss of ₹ 6 crores pertaining to A.Y.2015-16 not allowed to be set-off against the business profits of the P.Y. 2017-18, since as on 31.3.2018, the shares of M/s Gomati P Ltd carrying 60% (i.e., not less than 51%) of the voting power is held by Mr. B and not by Mr. A, being the person who held such shares as on 31.03.2015, being the last day of previous year 2014-15, in which such loss was incurred.	-
<b>Business income chargeable to tax</b>	<b><u>20,10,40,000</u></b>

**Note** – As per section 33AB(5), the cost of the asset acquired would be deemed as profits of the year in which it is sold, only if the sale takes place **before** the expiry of eight years from the end of the previous year in which it was acquired. In this case the asset was acquired in the P.Y.2009-10. The eight year period from the end of P.Y.2009-10 would expire on 31.3.2018. As per the plain reading of section 33AB(5), if the sale takes place before 31.3.2018, the cost of asset would be deemed as profits of the previous year of sale. However, in this case, the sale took place exactly on 31.3.2018 and not before 31.3.2018. Therefore, it is possible to take a view that the deeming provision would not apply in this case. If this alternate view is taken, total composite business profits would be ₹ 47,44,00,000. Agricultural income would be ₹ 30,83,60,000 and business income chargeable to tax would be ₹ 16,60,40,000.

**(b) Allowable deduction to Mr. Bhardwaj from Gross Total Income**

- (i) **Contribution towards Clean Ganga Fund set up by the Central Government:**  
Whole of the contribution i.e., ₹ 2 lakh towards Clean Ganga Fund, set up by the Central Government, is allowable as deduction under section 80G to Mr. Bharadwaj, since he is a resident of India.
- (ii) **Medical Expenditure of ₹ 50,000 towards surgery of his grandmother:**  
Deduction is allowable under section 80D, in respect of medical expenditure incurred by an assessee for himself or any member of the family or parents, if any of such person(s) is of the age of 80 years or more and no payment has been made to keep in force an insurance on the health of such person(s).

In the present case, no deduction is allowable to Mr. Bharadwaj, since he incurred medical expenditure towards surgery of his grandmother, who does **not** fall within the definition of "family" under section 80D. Apart from family, deduction is only allowable in respect of premium paid for parents, and not grandparents.

(iii) **Donation to political party:** Deduction under section 80GGC is allowable to Mr. Bharadwaj in respect of donation of ₹ 2 lakhs made by cheque to a political party<sup>2</sup>.

However, no deduction is allowed to him in respect of donation of ₹ 50,000, since such payment is made in cash.

(iv) **Repayment of housing loan:** As per section 80C, deduction in respect of repayment of housing loan is allowable, if the loan is taken from, *inter alia*, an employer company, where such employer company is a public company or public sector company.

Accordingly, in this case, no deduction would be allowable to Mr. Bharadwaj in respect of repayment of housing loan, since such loan is taken from his employer company XYZ Private Limited, not being a public company or a public sector company.

(c) **Computation of taxable income and tax payable of Amrutha for A.Y. 2018-19**

Particulars	₹	₹
<b>Profits and gains from business and profession</b>		
Income from sole proprietary concern in India	50,00,000	
Share of profit from a partnership firm in India of ₹ 30 lakhs, is exempt	Nil	
Business profit	50,00,000	
Less: Business Loss <sup>3</sup> in Country A (USD 10,000 x ₹ 64/USD <sup>4</sup> )	<u>6,40,000</u>	43,60,000
<b>Income from Other Sources</b>		
Agricultural income from rubber estate in Country A, is taxable in India (USD 70,000 x ₹ 64/USD)		<u>44,80,000</u>
<b>Gross Total Income/ Total Income</b>		<b>88,40,000</b>
<b>Tax on total income</b>		
Tax on ₹ 88,40,000 [30% x ₹ 78,40,000 plus ₹ 1,12,500]		24,64,500
Add: Surcharge@10%, since total income exceeds ₹ 50 lakhs		<u>2,46,450</u>
		27,10,950
Add: Education cess & SHEC @3%		<u>81,329</u>

<sup>2</sup> It is assumed that political party is a registered party.

<sup>3</sup> It is assumed that eight years has not expired from the assessment year in which such business loss was incurred.

<sup>4</sup> It is also assumed that foreign currency conversion rate i.e., Rs. 64/USD (given in the question) was also prevailing on the last day of the previous year in which such business loss in Country A was incurred.

Average rate of tax in India [i.e., ₹ 27,92,279/₹ 88,40,000 x 100]	31.59%	27,92,279
Average rate of tax in Country A [i.e., USD 10,500/USD 70,000]	15%	
Doubly taxed income [₹ 44,80,000 – ₹ 6,40,000]	38,40,000	
Rebate under section 91 on ₹ 38,40,000 @15% (lower of average Indian tax rate and rate of tax in Country A)		<u>5,76,000</u>
<b>Tax payable in India [₹ 27,92,279 – ₹ 5,76,000]</b>		<b><u>22,16,279</u></b>
<b>Tax payable (rounded off)</b>		<b>22,16,280</b>

**Notes:**

- (1) Since Amrutha is resident in India for the P.Y.2017-18, her global income would be subject to tax in India. She would be allowed deduction under section 91 provided all the following conditions are fulfilled:-
- She is a resident in India during the relevant previous year.
  - Income accrues or arises to her outside India during that previous year.
  - Such income is not deemed to accrue or arise in India during the previous year.
  - The income in question has been subjected to income-tax in Country A in her hands and she has paid tax on such income in Country A.
  - There is no agreement under section 90 for the relief or avoidance of double taxation between India and Country A, where the income has accrued or arisen.

Amrutha is eligible for deduction under section 91 since all the conditions specified thereunder stand fulfilled by her during the previous year.

- (2) The above solution has been worked out assuming that the agricultural income of USD 70,000 is the gross amount.

Alternatively, if it is assumed that the agricultural income of USD 70,000 is net of taxes, in such case, the total income would be ₹ 95,12,000 (₹ 43,60,000 plus agricultural income of ₹ 51,52,000 (USD 80,500 x ₹ 64/USD)), tax payable without relief under section 91 would be ₹ 30,20,691 and relief under section 91 would be ₹ 5,88,523 [₹ 45,12,000 [₹ 51,52,000 – ₹ 6,40,000] x 13.0435% (USD 10,500/USD 80,500)] and net tax payable would be ₹ 24,32,170 (rounded off).

**Question 3**

- (a) *X Ltd. is a company in which the whole of its share capital was held by Y Ltd. Both X Ltd. and Y Ltd. are Indian companies. X Ltd. had made investment in shares of ABC Ltd. in 1979 for ₹ 3,00,000 which it sold to Y Ltd. on April 1, 2009 for a consideration of ₹ 30,00,000.*

The fair market value of these shares of ABC Ltd., as on April 1, 2001 is ₹ 20,00,000. Y Ltd. disinvested 5% of the shares held by it in X Ltd., in January 2018 by sale to public. It sold the shares in ABC Ltd. in March 2018 acquired by it from X Ltd. for a sum of ₹ 70,00,000.

Discuss the issue with relevant provisions and tax effects of these transactions in the hands of X Ltd. and Y Ltd. in the relevant assessment years.

The cost inflation index Value for the Financial Year 2017-18 is 272. **(7 Marks)**

- (b) Dr. Juhi reports to you that her gross receipt from her medical profession for the year ended 31-03-2018 is ₹ 49,20,000. Her net income as per income and expenditure account is ₹ 26,40,000 before adjustment of depreciation of ₹ 2,10,000. She did not pay any amount by way of advance tax during the financial year 2017-18. She has two residential house properties, of which one is self-occupied for residence and another is let out for the monthly rent of ₹ 10,000 during the financial year 2017-18.

Advise Dr. Juhi with reference to section 44ADA on filing of return with optimal tax liability besides compliance cost. Assume that she approached you in April, 2018 and you have given your advise then. **(7 Marks)**

- (c) Nikanu Ltd. is an Indian Company involved in manufacturing and trading in cotton garments under the brand name "PCOTT". In order to expand its exports sale, it launched a massive publicity campaign in overseas market. For the purpose of online advertising, it hired the Sky Inc., a New York based company which has no permanent establishment in India and paid ₹ 10 lakhs for its services in the previous year 2017-18.

Discuss the tax and TDS implications of such transaction both in the hands of Nikanu Ltd. and Sky Inc. **(3 Marks)**

- (d) "The term 'Advance ruling' includes within its scope, a determination by the Authority for Advance Rulings only in relation to a transaction undertaken by a non-resident applicant". Discuss the correctness or otherwise of this statement, as per the income tax law. **(3 Marks)**

**Answer**

- (a)

Particulars	
(i)	<p><b><u>Sale of shares of ABC Ltd. by X Ltd. to Y Ltd. on 1.4.2009</u></b></p> <p>Since both X Ltd and Y Ltd. are Indian companies and Y Ltd. holds 100% of shares of X Ltd., the transfer of capital asset, namely, shares of ABC Ltd., by X Ltd. to Y Ltd. would not be treated as a transfer for attracting capital gains tax liability as per section 47(v).</p> <p>Hence, no capital gains tax would have been attracted on such transfer in the hands of X Ltd.</p>

(ii)	<b><u>Disinvestment by Y Ltd., of 5% shares held in X Ltd. in January, 2018</u></b>	
	<p>As per section 47A(1), where a holding company ceases to hold 100% of shares of the subsidiary company before the expiry of a period of eight years from the date of transfer of capital asset, the amount of capital gains not charged to tax at the time of transfer would be deemed to be income chargeable under the head "Capital gains" of the previous year in which transfer took place.</p> <p>However, in this case, the above deeming provision would not apply because the eight year period from the date of transfer expires on 31.3.2017 and the disinvestment by Y Ltd. of 5% shares held in X Ltd. was only in January 2018.</p>	
(iii)	<b><u>Sale of shares of ABC Ltd. by Y Ltd. in March 2018</u></b>	
	<p>This transaction would attract capital gains tax in the hands of Y Ltd. for the A.Y.2018-19. The capital gains would be long-term, since the period of holding is more than 24 months.</p> <p>The cost of acquisition to X Ltd. in the year 1979 (i.e. ₹ 3,00,000) or the fair market value as on 1.4.2001 (₹ 20,00,000), whichever is higher, would be deemed as the cost of acquisition.</p>	
	<b>Computation of capital gains in the hands of Y Ltd.</b>	<b>₹</b>
	Sale consideration	70,00,000
	Less: Indexed cost of acquisition [₹ 20,00,000 x 272/100]	<u>54,40,000</u>
	<b>Long-term capital gains</b>	<b><u>15,60,000</u></b>
	Tax on long-term capital gains@20.6% (₹ 15,60,000 x 20.6%)	3,21,360

**Note** – It is presumed that the shares are not listed on a recognized stock exchange.

(b)

Particulars
<p>Since gross receipts of ₹ 49,20,000 of Dr. Juhi from her medical profession is less than ₹ 50,00,000, she can opt for presumptive tax provisions under section 44ADA.</p> <p>In such a case, her income from medical profession would be ₹ 24,60,000, being 50% of ₹ 49,20,000. Since all deductions allowable under sections 30 to 38 are deemed to have been given full effect to, no deduction in respect of depreciation would be allowable from the income computed on presumptive basis under section 44ADA.</p>

<b>I. <u>Where Dr. Juhi declares income profession on presumptive basis u/s 44ADA</u></b>		
<b>Computation of total income of Dr. Juhi</b>		
<b>Particulars</b>	<b>₹</b>	<b>₹</b>
<b><u>Income from house property</u></b>		
<b>Self-occupied property</b>	Nil	
<b>Let-out Property:</b>		
Annual Value [₹ 10,000 x 12] <sup>5</sup>	1,20,000	
Less: Deduction u/s 24 [30% of ₹ 1,20,000]	<u>36,000</u>	
		84,000
<b><u>Profits and gains from business or profession</u></b>		
Income from medical profession [50% of ₹ 49,20,000]		<u>24,60,000</u>
<b>Total Income</b>		<b><u>25,44,000</u></b>
<b>Computation of tax liability of Dr. Juhi</b>		
<b>Particulars</b>	<b>₹</b>	
Tax on total income = [30% of ₹ 15,44,000 (₹ 25,44,000 – ₹10,00,000) + ₹ 1,12,500]	5,75,700	
Add: Education cess and SHEC@3%	<u>17,271</u>	
<b>Total tax liability</b>	<b>5,92,971</b>	
Add: Interest under section 234B [1% of ₹ 5,92,900 <sup>6</sup> ]	5,929	
Interest under section 234C [1% of ₹ 5,92,900, since the advance tax liability has to be paid in one instalment on or before 15.3.2018]	<u>5,929</u>	
<b>Total tax and interest liability</b>	<b><u>6,04,829</u></b>	
<b>Total tax and interest liability (rounded off)</b>	<b>6,04,830</b>	
Dr. Juhi can, however, declare lower profits than the presumptive profits of ₹ 24,60,000, if she maintains books of accounts under section 44AA and gets the same audited under section 44AB. In such case, she can file return on or before 30.9.2018.		
<b>II. <u>Where Dr. Juhi declares income from profession as per books of account</u></b>		
<b>Computation of total income of Dr. Juhi</b>		
<b>Particulars</b>	<b>₹</b>	<b>₹</b>
<b><u>Income from house property</u></b>		
Self-occupied property	Nil	

<sup>5</sup> Rent received is taken as Annual Value in the absence of information relating to fair rent, municipal value and standard rent.

<sup>6</sup> Rounded off as per Rule 119A

<b>Let-out property:</b>		
Annual Value [₹ 10,000 x 12]	1,20,000	
Less: Deduction u/s 24 [30% of ₹ 1,20,000]	<u>36,000</u>	84,000
<b>Profits and gains from business or profession</b>		
Income from medical profession [₹ 26,40,000 – ₹ 2,10,000]		<u>24,30,000</u>
<b>Total Income</b>		<b><u>25,14,000</u></b>
<b>Computation of tax liability:</b>		
Tax on total income = [30% of ₹ 15,14,000 (₹ 25,14,000 – ₹ 10,00,000) + ₹ 1,12,500]		5,66,700
Add: Education cess and SHEC@3%		<u>17,001</u>
<b>Total tax liability</b>		<b>5,83,701</b>
Add: Interest under section 234B [1% of ₹ 5,83,700]		5,837
Interest under section 234C [See Working Note below]		<u>29,477</u>
<b>Total tax and interest liability</b>		<b><u>6,19,015</u></b>
<b>Total tax and interest liability (rounded off)</b>		<b>6,19,020</b>
Although the income from profession computed as per books of account is lower than the income from profession computed on presumptive basis under section 44ADA, however, the cumulative tax and interest liability would be higher by ₹14,190 (i.e., ₹ 6,19,020 - ₹ 6,04,830) in case of the former. Therefore, Dr. Juhi should opt to declare income on presumptive basis under section 44ADA, in which case she has to file her tax return on or before 31 <sup>st</sup> July, 2018.		

**Working Note: Computation of interest under section 234C**

Date	Advance tax payable till date	Short-fall	Rate of interest [1% per month]	Interest
		(₹)		(₹)
15.06.2017	15%	87,555	3% [1% x 3]	2,627
15.09.2017	45%	2,62,665	3% [1% x 3]	7,880
15.12.2017	75%	4,37,775	3% [1% x 3]	13,133
15.03.2018	100%	5,83,700	1%	<u>5,837</u>
				<b><u>29,477</u></b>

**Note** – The above solution has been worked out by considering that Dr. Juhi pays the advance tax required to be paid in April, 2018 itself, after consulting the tax advisor in the month of April, 2018.

- (c) Equalisation levy of 6% is attracted in respect of the amount of consideration exceeding ₹ 1 lakh for, *inter alia*, online advertisement, received or receivable by a non-resident not

having permanent establishment in India, from, *inter alia*, a resident in India who carries on business or profession.

In this case, the payment of ₹ 10 lakhs by Nikanu Ltd., a resident in India (since it is an Indian company) to Sky Inc., New York, a non-resident not having PE in India, for online advertisement services would be subject to Equalisation Levy@6%. Such income is, however, exempt under the Income-tax Act, 1961 by virtue of section 10(50) thereof.

Nikanu Ltd. is required to deduct equalisation levy of ₹ 60,000 i.e., @6% of ₹ 10 lakhs from such payment.

**(d) The statement is not correct.**

As per section 245N, advance ruling not only includes a determination by the AAR in relation to a transaction which has been undertaken or is proposed to be undertaken by a non-resident applicant, but also includes, *inter alia*, determination by the AAR -

- (i) in relation to the tax liability of a non-resident arising out of a transaction which has been undertaken or is proposed to be undertaken by a resident applicant with such non-resident
- (ii) in relation to the tax liability of a resident applicant, arising out of a transaction which has been undertaken or is proposed to be undertaken by such applicant  
and such determination shall include the determination of any question of law or of fact specified in the application.

**Question 4**

- (a) Discuss the TDS/ITCS implications if any, for the following transactions. What is the amount payable to the payee?:
  - (i) X is a bookmaker and Mr. Y is a punter. On 22-01-2018, B has won ₹ 50,000 in Horse Race 1 and suffered a loss of ₹ 20,000 in Horse Race 2.
  - (ii) Mr. Santosh has let out his house property on a monthly rent of ₹ 60,000 from 15-01-2018 to Mrs. Preeti.
  - (iii) H. Ltd., a manufacturer of luxury cars sold 50 cars on 01-09-2017 to NMP Ltd., its dealer, each car costing ₹ 20 Lakhs.
  - (iv) AKL Ltd., a third party administrator on behalf of an Insurance Company has settled medical bills of ₹ 5,00,000 submitted by Kay Hospitals Ltd. from a patient under a cashless scheme. **(1½ x 4 = 6 Marks)**
- (b) Holy Mission Charitable Trust filed an application in Form 10G along with copies of trust deed and registration certificate, for grant of approval under section 80G(5), with the approving authority. In order to verify the stated objects of education, social activities etc. and the facts in the application, the trust was asked to produce the relevant books of account, vouchers, donation book and minutes in original.

After considering the same, the Commissioner rejected the application for approval under section 80G(5) on the ground that the trust had failed to apply 85% of its income.

Whether the order of Commissioner is justified in law? **(4 Marks)**

(c) Surat Limited, engaged in the business of textiles also effected the sales and purchase of shares of other companies. It suffered loss from such transactions:

(1) Whether such company can set off its losses from share trading from the profit of textile business?

(2) If principal business of such company is sale and purchase of shares of other company, then, what would be your answer? **(4 Marks)**

(d) Amar P Ltd., Bangalore is engaged in IT Enabled services. It is the subsidiary of ABC Inc in US. It also provides similar services to a company SAK Ltd. at Singapore. Its billings and other information is as given hereunder:

(i) Billings per month to ABC Inc. - USD 85000

(ii) Billings per month to SAK Ltd. - USD 70000

(iii) ABC Inc has provided a loan of USD 100000 to Amar P Ltd. towards purchase of hardware for executing its project. Rate of interest charged for the said loan is at 3% p.a.

(iv) Direct and indirect cost incurred are USD 100 and USD 200 per hour, respectively.

(v) Amar P Ltd. works 9 hours per day for 15 days to execute the projects for ABC Inc and 8 hours per day for 15 days to execute projects for SAK Ltd. Service was provided by the company to both its customers throughout the year.

(vi) Warranty was provided to SAK Ltd. for a period of 2 years. Cost of warranty is calculated at 1% of direct cost incurred. The cost of warranty is neither included in the direct nor indirect cost.

Assume conversion rate 1 USD = ₹ 64. Compute Arm's Length Price as per the cost-plus method and the amount to be added, if any, to the income of Amar P Ltd. **(6 Marks)**

#### Answer

(a) (i) Any person, being a bookmaker, who is responsible for paying to any person any income exceeding ₹ 10,000 by way of winnings from horse races is liable to deduct tax@30% at the time of payment as per section 194BB.

In a case where the book-maker credits such winnings and debits the losses to the individual account of the punter, tax would be deducted on the winnings before set-off of losses. Thereafter, the net amount, i.e., the winnings after deduction of tax and losses, would be paid to the individual.

Thus, in the present case, Mr. X is liable to deduct tax of ₹ 15,000 (₹ 50,000 x 30%) from winnings of ₹ 50,000. The net amount payable to Mr. B would be ₹ 15,000 (i.e., ₹ 50,000 – ₹ 20,000, being loss – ₹ 15,000, being TDS).

- (ii) Section 194-IB requires any individual responsible for paying to a resident any income by way of rent exceeding ₹ 50,000 per month shall deduct tax @5% of such income at the time of credit or payment of rent for the last month of the previous year, whichever is earlier.

Since Mrs. Preeti, an individual, pays rent exceeding ₹ 50,000 per month in the F.Y. 2017-18 to Mr. Santosh<sup>7</sup>, she is liable to deduct tax at source @5% of such rent for F.Y. 2017-18 under section 194-IB.

Thus, ₹ 7,500 [₹ 60,000 x 5% x 2.5] has to be deducted from rent payable for March, 2018. The rent payable to Mr. Santosh for March, 2018 would be ₹ 52,500.

**Note** – The above answer is based on the provisions of section 194-IB, which would be attracted in Mrs. Preeti's case.

*Alternatively, in case it is assumed that Mrs. Preeti carries on business or profession and her total sales, gross receipts or turnover from the business or profession carried on by her exceeds the monetary limit specified under section 44AB in the immediately preceding financial year, she is required to deduct tax at source @10% under section 194-I in respect of rent payable for use of any land or building, if the rent payable during the financial year exceeds ₹ 180,000. In the present case, since the rent of ₹ 1,50,000 i.e., ₹ 60,000 x 2.5 months is less than ₹ 180,000, no tax is required to be deducted at source under section 194-I.*

- (iii) Every person, being a seller, who receives any amount as consideration for sale of a motor vehicle of the value exceeding ₹ 10 lakhs, shall collect tax from the buyer @1% of the sale consideration as per section 206C(1F).

However, this provision applies only in respect of transactions of retail sales and does not apply to sale of motor vehicles by manufacturers to dealers. Therefore, H Ltd., a manufacturer, is not required to collect tax at source from NMP Ltd., the dealer, on receipt of consideration for sale of motor cars.

Hence, the amount payable by NMP Ltd. to H Ltd. is ₹ 1,000 lakhs i.e., ₹ 20 lakhs x 50.

- (iv) Every person, who is responsible for paying to a resident any sum by way of fees for professional services exceeding ₹ 30,000 shall deduct tax at source at the rate of 10% at the time of credit to the account of the payee or at the time of payment, whichever is earlier, as per section 194J.

<sup>7</sup> It is assumed that Mr. Santosh is resident in India.

“Professional services” include services rendered by a person in the course of carrying on medical profession.

The CBDT has, *vide Circular No.8/2009 dated 24.11.2009*, clarified that since the services rendered by hospitals to various patients are primarily medical services, TPAs (Third Party Administrator’s), who are making payment on behalf of insurance companies to hospitals for settlement of medical/insurance claims etc. under various schemes including cashless schemes are liable to deduct tax at source on all such payments to hospitals etc.

Thus, AKL Ltd., a TPA is liable to deduct tax of ₹ 50,000, being 10% of ₹ 5,00,000 from the payment made to Kay Hospitals Ltd. Hence, the amount payable by AKL Ltd. to Kay Hospitals Ltd. would be ₹ 4,50,000 [₹ 5,00,000 – ₹ 50,000]

- (b) The issue under consideration in the present case is whether an application for grant of approval under section 80G(5) can be rejected on the ground that the trust has failed to apply 85% of its income for charitable purposes.

Section 80G provides that donation to any institution or fund would qualify for deduction thereunder only if it is established in India for a charitable purpose and derives such income which would not be liable to inclusion in its total income under the provisions of, *inter alia*, sections 11 and 12.

Section 80G does not relate to assessment of the trust or the institution whose income is not liable to be included in the computation of taxable income under various provisions of the Act. Primarily, section 80G is related to giving deduction in respect of donations made by a person to such trusts and institutions.

Once a trust is registered under section 12AA, its income from property includes donations received. Such donations are deemed to be income from property, which are not to be included in the total income under section 11 or section 12. The enquiry under section 80G, hence, cannot go beyond that.

The scope of enquiry cannot include an enquiry as to whether, at the close of the previous year, the donee-trust will actually be able to apply 85% of its income. This is because non-fulfillment of some conditions by the donee-trust as regards application or accumulation cannot be ascertained in praesenti, when the donation is made. The question of whether the trust will be able to apply 85% of its income can be determined only from the facts existing at the close of the assessment year.

It was so held by the Gujarat High Court in *CIT v. Shree Govindbhai Jethalal Nathavani Charitable Trust (2015) 373 ITR 619*.

Applying the rationale of the Gujarat High Court ruling to the facts of the present case, the rejection by the Commissioner, of the application made by Holy Mission Charitable Trust for approval under section 80G, on the ground that it had not spent 85% of its income for charitable purposes, is not valid.

- (c) As per section 73(1), loss in speculation business can be set-off only against the profits of any other speculation business and not against any other business or professional income.

*Explanation* below section 73(1) clarifies that where any part of the business of a company consists in the purchase and sale of the shares of other companies, such a company shall be deemed to be carrying on speculation business to the extent to which the business consists of the purchase and sale of such shares.

However, this deeming provision does not apply, *inter alia*, to a company, the principal business of which is the business of trading in shares.

- (i) Since part of the business of Surat Ltd. consists of sale and purchase of shares of other companies, the company would be deemed to be carrying on speculation business to the extent of purchase and sale of such shares.

Thus, the loss from speculative business i.e., loss from share trading cannot be set-off against the profit of textile business of Surat Ltd.

- (ii) If the principal business of Surat Ltd. is to sell and purchase shares of other companies, Surat Limited would not be deemed to be carrying on speculation business.

In such a case, the loss arising from the sale and purchase of shares of other company can be set-off against any other business income. Surat Ltd. can, accordingly, set-off such losses against its profits from textile business.

- (d) **Determination of Gross Margin of Comparable Uncontrolled transaction i.e., of SAK Ltd.**

Particulars	Amt in USD
Direct Cost (USD 100 x 8 hours x 15 days)	12,000
Indirect Cost (USD 200 x 8 hours x 15 days)	<u>24,000</u>
<b>Total Direct and Indirect cost</b>	<b>36,000</b>
Billing per month	<u>70,000</u>
<b>Gross Margin being gross profit</b>	<b><u>34,000</u></b>
<b>Gross Margin to cost (%) [34,000 x 100/36,000]</b>	<b>94.44%</b>
<b>Adjustment for functional difference on account of cost of warranty</b>	
Total Direct and Indirect Cost	36,000
Add: Cost of warranty [1% of direct cost of USD 12,000]	<u>120</u>
<b>Total Cost</b>	<b>36,120</b>

Billing per month	<u>70,000</u>
<b>Margin after cost of warranty being profit margin [70,000 - 36,120]</b>	<b><u>33,880</u></b>
Profit margin to cost (%) [after considering functional difference on account of cost of warranty [33,880 x 100/36,120]	<b>93.80%</b>

**Computation of Arm's Length Price by applying Cost Plus Method**

	ABC Inc (USD)
Direct Cost (USD 100 x 9 hours x 15 days)	13,500
Indirect Cost (USD 200 x 9 hours x 15 days)	<u>27,000</u>
<b>Total Direct and Indirect cost</b>	<b>40,500</b>
Add: Interest on loan of USD 1,00,000 borrowed for purchase of hardware [USD 3,000 (i.e., USD 1,00,000@3%) / 12]	<u>250</u>
<b>Total Cost</b>	40,750
Profit margin by applying the margin of 93.80% of total cost of USD 40,750	<u>38,224</u>
<b>Arm's length price of billing per month</b>	<b>78,974</b>
Arm's length price (in ₹ ) [USD 78,974 x 64] = ₹ 50,54,336	
Actual Billing per month	85,000

In the present case, since actual billing of USD 85,000 per month to the ABC Inc, an AE, is higher than the Arm's length price of USD 78,974 determined by applying cost plus method, no adjustment is to be made to the income of Amar P Ltd.

**Question 5**

- (a) A search as per section 132 of the Act was conducted on 02-01-2018 and cash ₹ 40 lakhs was seized. The assessee moved an application on 30-01-2018 to release such cash with explanation of the nature and sources thereof, which was turned down by the department. Now, the assessee seeks your advice on whether the department can withhold the explained money? If yes, then to what extent, and upto what period? **(4 Marks)**
- (b) AUM Enterprises, a partnership firm, filed its return of income for the A.Y. 2015-16 on 30-07-2015. The assessment u/s 143(3) was completed on 15th June, 2017 and the A.O. made two additions to the income of assessee, namely,
- (i) Addition of ₹ 8 Lakhs for unexplained cash credit u/s 68 and
  - (ii) Addition of ₹ 3 lakhs u/s 40(a)(ia) due to non-furnishing of the evidence of TDS payment.

The assessee, being aggrieved, contested the addition of ₹ 8 Lakhs u/s 68 and appeal to the CIT (A). The appeal was decided on 5<sup>th</sup> January, 2018 against the assessee.

Now, the assessee seeks your advice as to whether it should apply for revision to CIT U/S 264 or for rectification u/s 154 to the A.O. as regards disallowance u/s 40(a)(ia). Advise. **(4 Marks)**

- (c) Pramod, a resident individual of age of 52 years, has not furnished his return of income for the A.Y. 2017-18. However, his total income for such year as assessed u/s 143(3) is ₹ 14 Lakhs.

Whether penalty U/s 270A attracted? If yes, what will be the quantum of penalty leviable? [Note : Assume that this is not a case of misreporting]. **(3 Marks)**

- (d) Can prosecution be launched for the following defaults? Examine the relevant provisions with quantum of prescribed punishment, if any.

(i) The assessee deliberately has failed to comply with the requirement of section 142(i) and/or 142(2A).

(ii) The assessee has failed deliberately to make the payment of tax collected u/s 206C.

(iii) The assessee had restrained and not allowed the officer authorized as per section 132(1)(iib) of the Act to inspect the documents maintained in form of electronic record and the books of account. **(3 Marks)**

- (e) Explain the term "Royalty" as per UN model Tax Convention. Is it different from the definition contained in OECD Model? Discuss. **(3 Marks)**

- (f) Explain the meaning of "Treaty" as per Article 2 of Vienna Convention on Law of Treaties, 1969. Why it come into play? **(3 Marks)**

#### Answer

- (a) As per section 132B, where the person concerned makes an application to the Assessing Officer, within 30 days from the end of the month in which the asset was seized, for release of the asset and the nature and source of acquisition of the asset is explained to the satisfaction of the Assessing Officer, then, the Assessing Officer may, with the prior approval of the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner, release the asset after recovering the existing liability under the Income-tax Act, 1961, etc. out of such asset.

Such asset or portion thereof has to be released within 120 days from the date on which the last of the authorizations for search under section 132 was executed.

In the present case, since the application was made to the Assessing Officer on 30.1.2018 i.e., within the 30 day period, the amount of existing liability may be recovered out of the cash seized and the balance cash may be released within 120 days from the date on which the last of the authorizations for search under section 132 was executed.

**Note** – As per section 132B, one of the conditions for release of an asset is that the nature and source of acquisition of the asset should be explained to the satisfaction of the Assessing Officer. However, in the facts of the question, it has been given that the assessee's application for release of the asset, explaining the sources thereof, was turned down by the Department. If the application was turned down by the Department due to the reason that it was not satisfied with the explanation given by the assessee as to the nature and source of acquisition of the asset, then, the cash cannot be released, since the condition mentioned above is not satisfied.

- (b) Section 264 provides that the Principal Commissioner or Commissioner has no power to revise any order which has been made the subject matter of an appeal to the Commissioner (Appeals), even if the relief claimed in the petition is different from the relief claimed in appeal. The concept of total merger would apply in the case of section 264. It was so held by the Supreme Court in the case of *Hindustan Aeronautics Ltd v. CIT* (2000) 243 ITR 898.

Section 154 provides that where any matter had been considered and decided in any proceeding by way of appeal or revision relating to an order, Assessing Officer may amend the order for rectification of mistake apparent from the record, in relation to a matter other than the matter which has been considered and decided. The concept of partial merger would apply in the case of section 154.

In the present case, since the order passed by the Assessing Officer in respect of the addition of unexplained cash credit of ₹ 8 lakhs became the subject matter of an appeal to the Commissioner (Appeals), the assessee, AUM Enterprise cannot apply for revision under section 264 even if the subject matter of revision i.e., addition of ₹ 3 lakhs under section 40(a)(ia) is different from the subject matter of appeal.

However, AUM Enterprise can apply to the Assessing Officer for rectification of the order in respect of addition of ₹ 3 lakh under section 40(a)(ia), as this matter has not been considered and decided in any proceeding by way of appeal or revision.

In the view of above, the assessee, AUM Enterprise should seek rectification under section 154.

- (c) Mr. Pramod is deemed to have under-reported his income since he has not filed his return of income and his assessed income exceeds the basic exemption limit of ₹ 2,50,000. Hence, penalty under section 270A is leviable in his case.

#### Computation of penalty leviable under section 270A

Particulars	₹	₹
<b><u>Under-reported income:</u></b>		
Total income assessed	14,00,000	
(-) Basic exemption limit	<u>2,50,000</u>	
	<b><u>11,50,000</u></b>	

Tax payable on ₹ 14,00,000 [being, under-reported income of ₹ 11,50,000 plus basic exemption limit of ₹ 2,50,000 [30% of ₹ 4 lakhs + ₹ 1,25,000]	2,45,000	
Add: EC & SHEC@3%	<u>7,350</u>	
	<b>2,52,350</b>	
<b>Penalty leviable@50% of tax payable of ₹ 2,52,350</b>		<b>1,26,175</b>

**Note** - The relevant assessment year for candidates appearing in May, 2018 examination is A.Y.2018-19. The rates of taxes for A.Y.2017-18 have also not been given in the question. The rate of tax for the income range ₹ 2,50,000 to ₹ 5,00,000 has been reduced from 10% to 5% for A.Y.2018-19. Therefore, if penalty is computed considering that Mr. Pramod has not furnished his return of income for A.Y. 2018-19, which is the relevant assessment year for May, 2018 Examination, the answer would be as follows:-

“Mr. Pramod is deemed to have under-reported his income since he has not filed his return of income and his assessed income exceeds the basic exemption limit of ₹ 2,50,000. Hence, penalty under section 270A is leviable in his case.

#### Computation of penalty leviable under section 270A

Particulars	₹	₹
<b>Under-reported income:</b>		
Total income assessed	14,00,000	
(-) Basic exemption limit	<u>2,50,000</u>	
	<b>11,50,000</b>	
Tax payable on ₹ 14,00,000 [being, under-reported income of ₹ 11,50,000 plus basic exemption limit of ₹ 2,50,000 [30% of ₹ 4 lakhs + ₹ 1,12,500]	2,32,500	
Add: EC & SHEC@3%	<u>6,975</u>	
	<b>2,39,475</b>	
<b>Penalty leviable@50% of tax payable</b>		<b>1,19,738</b>

(d)

	Section	Default	Prosecution
(i)	276D	Willful failure to produce books of account and documents as required under section 142(1) or willful failure to comply with a direction to get the accounts audited under section 142(2A)	Rigorous imprisonment for a term which may extend to <b>one year</b> and with fine.

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(ii)	276BB	Deliberate failure to deposit the tax collected under section 206C to the credit of the Central Government	Rigorous imprisonment for a term which shall not be less than <b>three months</b> but which may extend to <b>seven years</b> and with fine.
(iii)	275B	Failure to afford facility to the officer authorised as per section 132(1)(iib)	Rigorous imprisonment for a term which may extend to <b>two years</b> and with fine.

- (e) As per UN Model Tax Convention, “royalty” means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic, or scientific work including cinematograph films, or films or tapes used for radio or television broadcasting, any patent, trade mark, design or model, plan, secret formula or process, or for the use of, or the right to use, industrial, commercial or scientific equipment, or for information concerning industrial, commercial or scientific experience”.

The definition of “royalty” in OECD Model Tax Convention is identical to the definition of “royalty” in UN Model Tax Convention except that the OECD Model specifically excludes the following from the definition of “royalty”:

- Rentals for “films or tapes used for radio or television broadcasting”;
- Equipment rentals like rentals for industrial, commercial or scientific equipment

In certain situations, the lease rental for industrial, commercial or scientific equipment may include an element of “royalty” (e.g. for use of a patent). In such cases, the lease rent may be treated as a “royalty” as per OECD Model Tax Convention to the extent it could be attributed to the use of the patent.

- (f) Article 2 of Vienna Convention on Law of Treaties, 1969 defines “treaty” as an international agreement concluded between States in written form and governed by international law, whether embodied in a single instrument or in two or more related instruments and whatever its particular designation

Treaties (Double Tax Avoidance Agreements) come into play to mitigate hardship caused by subjecting the same income to double taxation.

Tax Treaties attempt to eliminate double taxation and try to achieve balance and equity. They aim at sharing of tax revenues by the concerned States on a rational basis.

#### Question 6

- (a) *Whether the Commissioner (Appeals) is empowered to consider an appeal filed by an assessee challenging the order of assessment in respect of which the proceedings before the Settlement Commission abates? Examine with the relevant provisions of law.*

**(3 Marks)**

**EITHER [Attempt either (b) (i) or (b) (ii)]**

- (b) (i) The regular assessment of Ms. Swati for the A.Y. 2014-15 was completed u/s 143(3) on 16-07-2016. On 18-01-2018, she received a notice issued u/s 148 for income escaping assessment for the same A.Y. 2014-15. Further, on 25-03-2018, during the pendency of such proceeding for income escaping assessment, the A.O. attaches the house property of Ms. Swati.

Now, aggrieved Swati seeks your opinion (being a Chartered Accountant) as to:

- (i) The circumstances under which the A.O. can make provisional attachment of property of the assessee.  
(ii) The period of time for which such attachment can take place.  
(iii) Can such attachment be revoked by the A.O. and if yes, how?

Discuss the relevant provisions of law to satisfy the aggrieved assessee, Ms. Swati.

**(5 Marks)**

- (ii) Denim Ltd. was incorporated on 01-04-2017 to carry on the business of innovation, development, deployment and commercialisation of new processes driven by technology. It holds a certificate of eligible business from the notified IBMC (Inter Ministerial Board of Certification).

Its total turnover and the profits and gains from such business for the P.Y. 2017-18 and expected turnover and profits and gains in the following years are as follows:

Particulars	P.Y.	P.Y.	P.Y.	P.Y.	P.Y.	P.Y.	P.Y.
	2017-18	18-19	19-20	20-21	21-22	22-23	23-24
Total Turnover in Crores	15	18	20	22	24	24.5	24.75
Profits (Losses) in Crores	(2.52)	(1.5)	6.5	8.25	9.5	8	9.50

Is Denim Ltd. eligible for any benefit under the provisions of the Income-tax Act, 1961? If yes, what is the benefit available?

**(5 Marks)**

- (c) Discuss the taxability or otherwise of the following transactions:
- (i) Mr. A purchased 10 acres of agricultural land from Mr. B at the rate of ₹ 2 lakh per acre on 10-05-2017. The guideline value of the land on the date of the transaction was ₹ 3 lakhs per acre. However, he had entered into an agreement for purchase of the land on 10-03-2017 when the guideline value was ₹ 2.20 lakhs per acre. He had paid a token advance of ₹ 1 lakh by account payee cheque.

- (ii) Mr. A received cash gift of ₹ 4.75 lakhs from B on the occasion of his 61<sup>st</sup> birthday which was celebrated like marriage as per tradition, and ₹ 25,000 from C. Both B and C are his distant relatives.
- (iii) Mr. Dileep contributed ₹ 2 lakhs to a Trust created for the purpose of marriage of his friend's daughter.

**Note:** (Guideline value means Assessable stamp duty value)

**(6 Marks)**

- (d) State with reasons whether the following transactions are subject to tax as deemed income.
- (i) XYZ Ltd. is a broadcaster of News Channel in India. It had 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. A, a foreign citizen and a diamond merchant from US, has earned income of ₹ 10 crores from display of uncut and unassorted diamonds in the Bharat Diamond Bourse, a notified special zone in Surat. **(2 x3 = 6 Marks)**

**Answer**

- (a) As per section 251(1)(aa), in disposing of an appeal against the assessment order in respect of which the proceeding before the Settlement Commission abates under section 245HA, the Commissioner (Appeals) has the power to confirm, reduce, enhance or annul the assessment, after taking into consideration the following -
- (1) all the material and other information produced by the assessee before the Settlement Commission in the course of the proceeding before it;
  - (2) the results of the inquiry held by the Settlement Commission in the course of the proceeding before it;
  - (3) the evidence recorded by the Settlement Commission in the course of the proceeding before it; and
  - (4) such other material as may be brought on his record.
- (b) (i) **[First Alternative]**
- (i) As per section 281B(1), the Assessing Officer is empowered to provisionally attach any property of Ms. Swati, by an order in writing, during the pendency of assessment or reassessment proceedings, with the prior approval of the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner or Principal Director General or Director General or Principal Director or Director, if he is of the opinion that it is necessary to do so for the purpose of protecting the interests of the revenue.
  - (ii) As per section 281B(2), the provisional attachment shall be valid for a period of 6 months from the date of the order issued for provisional attachment.

However, the income-tax authority may extend the period of provisional attachment, for reasons to be recorded in writing, by a further period as he thinks fit.

However, the total period of extension shall not exceed two years or sixty days after the date of assessment or reassessment, whichever is later.

- (iii) Section 281B(3) empowers the Assessing Officer to revoke, by an order in writing, provisional attachment of property if Ms. Swati furnishes a guarantee from a scheduled bank, for an amount not less than the fair market value of such provisionally attached property or for an amount which is sufficient to protect the interests of the revenue.

**(ii) [Second Alternative]**

Denim Ltd. is an eligible start-up, since –

- (1) it is a company engaged in eligible business of innovation, development, deployment and commercialization of new processes driven by technology.
- (2) it is incorporated on 1.4.2017, which is during the period 1.4.2016 to 31.3.2019.
- (3) its total turnover does not exceed ₹ 25 crores in any previous year from P.Y.2017-18 to P.Y.2023-24.
- (4) it holds a certificate of eligible business from the notified IMBC.

Therefore, Denim Ltd., being an eligible start-up, is eligible for deduction under section 80-IAC of 100% of the profits and gains derived by it from an eligible business for any three consecutive assessment years, at its option, out of seven years beginning from the year in which the eligible start up is incorporated i.e. P.Y.2017-18.

In the first and second year i.e., P.Y.2017-18 and P.Y. 2018-19, Denim Ltd. has incurred a loss. In the subsequent five years i.e., P.Y. 2019-20, P.Y. 2020-21, P.Y. 2021-22, P.Y. 2022-23 and P.Y. 2023-24, Denim Ltd. has earned profits from eligible business and can hence, claim 100% of its profits as deduction for any three consecutive assessment years under section 80-IAC from the P.Y.2019-20 to P.Y.2023-24.

However, for P.Y.2019-20, the profits eligible for deduction would be the profits after set-off of brought forward losses of P.Y.2017-18 and P.Y. 2018-19, i.e., ₹ 2.48 crores [i.e., ₹ 6.50 crores – ₹ 2.52 crores – ₹ 1.50 crores] would be the profits eligible for deduction under section 80-IAC in the P.Y.2019-20.

Since the profits eligible for deduction in the P.Y.2019-20 gets reduced due to set-off of earlier year losses, it would be advisable for Denim Ltd. to claim deduction in respect of any three years from P.Y.2020-21 to P.Y.2023-24.

- (c) (i) Agricultural land is not a capital asset and hence, there would be no tax implications in the hands of the seller, Mr. B.

In the hands of the buyer, Mr. A, the provisions of section 56(2)(x) would be attracted where any property is received without consideration or for inadequate consideration. "Property" means a **capital asset**, namely, immovable property being land or building or both. In this case, since agricultural land is **not** a capital asset, it would not fall within the definition of property to attract the provisions of section 56(2)(x). Therefore, the provisions of section 56(2)(x) would not be attracted in the hands of Mr. A.

**Note** - If it is assumed that the agricultural land is an urban agricultural land, the tax implications would be as follows:

Mr. B, the seller, can consider the stamp duty value of ₹ 2.20 lakhs per acre on 10.3.2017, being the date of agreement, as the full value of consideration as per section 50C for computation of capital gains (instead of the stamp duty value of ₹ 3 lakhs per acre on 10.5.2017, being the date of sale), since he has received an advance of ₹ 1 lakh by account payee cheque at the time of entering into an agreement.

In the hands of the buyer, Mr. A, ₹ 2 lakhs would be taxable under section 56(2) as "Income from other sources", by considering the difference between the stamp duty value of ₹ 2.20 lakhs per acre on 10.3.2017 and the actual purchase price of ₹ 2 lakh per acre [(₹ 2.20 lakhs – ₹ 2 lakhs) x 10 acres].

- (ii) Since the question mentions that B and C are Mr. A's distant relatives, it is assumed that they do not fall within the definition of "relative" under section 56(2).

Since cash gift exceeding ₹ 50,000 in aggregate from non-relatives, B & C, was received, not on the occasion of marriage but on the occasion of Mr. A's 61st birthday, the said sum of ₹ 5 lakhs [i.e., ₹ 4.75 lakhs from B and ₹ 25,000 from C] is taxable under section 56(2)(x) as "Income from Other Sources" in the hands of Mr. A.

- (iii) Section 56(2)(x) excludes from its scope, any sum of money received from an individual by a trust created or established solely for the benefit of relative of the individual.

In this case, this exclusion would not apply, since ₹ 2 lakhs was received from Mr. Dileep by a trust created for the benefit of his friend's daughter and not his relative. Thus, ₹ 2 lakhs would be chargeable to tax in the hands of the trust.

- (d) (i) As per section 9(1)(vi)(b), any income by way of royalty payable by a person who is a resident would be deemed to accrue or arise in India in the hands of the recipient, except where the royalty is payable in respect of any right, property or information or services utilised for the purposes of 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.

*Explanation 2* to section 9(1)(vi) defines "royalty" to mean consideration for the transfer of any right in respect of, *inter alia*, a process. *Explanation 6* to section

9(1)(vi) clarifies that “process” includes transmission by satellite (including conversion for down-linking of any signal).

Accordingly, the payment made by XYZ Ltd., a resident in India (since it is an Indian company), for downlinking television channels into India and international footprint through the channel, would constitute “royalty”.

Such royalty income would be deemed to accrue or arise in India in the hands of the Malaysian company not having a PE in India, since it is paid by XYZ Ltd., a company resident in India in relation to its business in India.

- (ii) As per section 9(1)(i)(e), in the case of a foreign company engaged in the business of mining of diamonds, no income shall be deemed to accrue or arise in India to it through or from the activities which are confined to display of uncut and unassorted diamonds in any notified special zone.

Since this benefit is available only in case of a foreign company engaged in the business of mining of diamonds, Mr. A, a foreign citizen and a diamond merchant from US, cannot avail of such benefit.

The income of ₹ 10 crores from display of uncut and unassorted diamonds would, accordingly, be deemed to accrue or arise in the hands of Mr. A by virtue of business connection in India.

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