Final
Group III
Paper 16 : DIRECT TAX LAWS & INTERNATIONAL TAXATION
(SYLLABUS – 2016)

Objective Type Questions

1. (a) Multiple Choice Questions:

1.	**What is the due date of filing the return of income in case of a company who is not required to furnish a report in Form No. 3CEB under section 92E?**	
	a.	**September 30 of the assessment year**
	b.	**November 30 of the assessment the year**
	c.	**July 31 of the assessment year**
	d.	**June 30 of relevant assessment the year**
	Reason: The due date of filing the return in case of a company who is required to furnish a report in Form No. 3CEB u/s 92E is November 30 of the relevant assessment year and due date of filing the return in case of any other assessee, whose account is liable to audit, is 30th September of the relevant assessment year.	

2.	**Section 44C of the Income tax Act imposes restriction on deduction in respect of head office expenditure in the case of non-residents. As per such provision, head office expenditure cannot exceeds –**	
	a.	**5% of adjusted total income**
	b.	**3% of adjusted total income**
	c.	**8% of adjusted total income**
	d.	**10% of adjusted total income**
	Reason: As per sec. 44C, in case of a non-resident assessee, head office expenditure shall not be allowed (in computing the income chargeable under the head "Profits and gains of business or profession") in excess of the higher of the following amount: **(i)** an amount equal to 5% of the adjusted total income; or **(ii)** the amount of so much of the expenditure in the nature of head office expenditure incurred by the assessee as is attributable to the business or profession of the assessee in India.	

3.	While preparing the annual accounts for the purpose of computation of book profit u/s 115JB following shall be the same as have been adopted for the purpose of preparing such accounts and laid before the company at its annual general meeting–	
	a.	**the accounting policies**
	b.	**the accounting standards**
	c.	**both (a) and (b)**
	d.	**none of the above**

	Reason: Every company shall prepare its Statement of Profit and Loss for the relevant previous year in accordance with the provisions of Schedule III to the Companies Act, 2013. However, in case of banking, insurance or electricity company, such statement should be prepared as per provisions of the Act which governs such company. ☛ While preparing the annual accounts: a) the accounting policies; b) the accounting standards followed for preparing such accounts; c) the method and rates adopted for calculating the depreciation, shall be the same as have been adopted for the purpose of preparing such accounts and laid before the company at its annual general meeting.

4.	The liability to pay interest under section 234B would arise when the advance tax plus TDS/TCS to the credit of the assessee is less than —	
	a.	75% of the assessed tax
	b.	**90% of the assessed tax**
	c.	60% of the assessed tax
	d.	100% of the assessed tax
	Reason: Provision of section 234B is applicable if a person, who is required to pay advance tax, fails to pay - **(a)** advance tax at all; or **(b)** 90% of assessed tax as advance tax	

5.	No tax is to be deducted if the amount of professional fees or technical fees or royalty or non-compete fees (excluding director's fees)paid during the financial year does not exceed _________.	
	a.	**₹ 30,000**
	b.	₹ 50,000
	c.	₹ 15,000
	d.	₹ 10,000
	Reason: As per sec. 194J, threshold limit is ₹ 30,000	

Answer:

1.	a
2.	a
3.	c
4.	b
5.	a

Descriptive Type Questions

2. What is the difference between 'minimum alternate tax' under section 115JB and 'alternate minimum tax' under section 115JC?

Answer:

Difference between 'minimum alternate tax' and 'alternate minimum tax' are as under:

Particulars	**Alternate Minimum Tax (AMT)**	**Minimum Alternate Tax (MAT)**
Applicability	It is applicable on all assessee (other than company) who has claimed any deduction under: • Sec. 80H to Sec. 80RRB (other than sec. 80P); or • Sec. 35AD *less* depreciation u/s 32 • Sec.10AA **Exception:** The provisions shall not apply to an individual or a HUF or an AOP or a BOI, whether incorporated or not, or an artificial juridical person, if the adjusted total income of such person does not exceed ₹ 20 lakh.	It is applicable on Companies.
Income	It is calculated on Adjusted Total Income.	It is calculated on Book Profit.
Meaning of income	Adjusted total income means the total income as per income tax provisions in normal course as increased by deduction under: • Sec. 80H to Sec. 80RRB (other than sec. 80P); or • Sec. 35AD *less* depreciation u/s 32 • Sec.10AA	Book Profit means the profit as per profit and loss account of the company prepared in accordance with Schedule III of the Companies Act 2013 as increased/decreased by certain items specified in Explanation to Section 115JB.
Rate of Tax	Rate of AMT is 18.5%. + surcharge + cess	Rate of MAT is 18.5%. + surcharge + cess
Credit	AMT paying assessee can claim its credit for 15 assessment years.	MAT paying companies can claim their credit for 15 assessment years.
Change of constitution	AMT credit in case of change in constitution is not available.	Change in constitution, that is, conversion of private limited company or unlisted public company into LLP shall result in lapse of MAT credit which would have been available to be set off to the company if such conversion had not taken place.
Exempted Income	LLP will not be liable to pay AMT on incomes exempt from tax.	Companies are liable to pay MAT on the income exempted u/s 10(38).

Brought forward loss & unabsorbed depreciation	While computing AMT, brought forward losses and unabsorbed depreciation both shall be taken into account. For the calculation of AMT brought forward loss and unabsorbed depreciation liable to be set-off shall be in accordance with normal provisions of the Income-tax Act, 1961.	While computing MAT, what is allowable to be deducted is brought forward loss or unabsorbed depreciation whichever is less and not both. For the calculation of MAT brought forward loss and unabsorbed depreciation liable to be set off shall be in accordance with books of account.
	Such set-off of losses or depreciation shall reduce the amount of loss or depreciation to be carried forward in next year.	Such set off of losses or depreciation shall not affect the amount of loss or depreciation to be carried forward in next year.
Deductions	Deductions, rebates, allowances and adjustments except that provided in Chapter VI-A under the heading "C - Deductions in respect of certain incomes" and Section 10AA *are available* in computing Adjusted Total Income.	Deductions, rebates, allowances and adjustments except to the extent covered by the Explanation to Section 115JB *are not available* in computation of Book Profit.

3. The net profit of Sri Ltd. an Indian company, as per its profit and loss account prepared as per the Income-tax Act, 1961 is ₹ 90,00,000 after debiting and crediting following items:

	₹
Provision for income-tax	**5,00,000**
Provisions for deferred tax	**3,00,000**
Proposed dividend	**7,50,000**
Depreciation including depreciation on revaluation of assets ₹ 20,00,000 debited to profit and loss account	**60,00,000**
Profit from industrial unit in SEZ area	**80,000**
Provision for permanent diminution in the value of investments	**70,000**
Compute tax liability under section 115JB for the assessment year 2018-19.	

Answer:

Computation of Book Profit for the purpose of Sec. 115JB

Particulars	Details	Amount
Net profit as per books of accounts		90,00,000
Add:		
Provision for income tax	5,00,000	
Provisions for deferred tax	3,00,000	
Proposed dividend	7,50,000	
Depreciation	60,00,000	75,50,000
		1,65,50,000
Less:		
Depreciation (without considering depreciation on revaluation)	40,00,000	
Provision for permanent diminution in the value of investments	70,000	
Profit from industrial unit in SEZ area	Nil	40,70,000
Book Profit		1,24,80,000

Computation of Tax Liability under section 115JB

Particulars	Amount
Book profit u/s 115JB	1,24,80,000
18.5% of book profit	23,08,800
Add: Surcharge [As total income exceeds₹ 1,00,00,000/-]	1,61,616
Tax & Surcharge	24,70,416
Add: Education Cess & SHEC @ 3%	74,112
Tax Liability u/s 115JB [R/off]	25,44,530

The tax liability u/s 115JB is required to be compared with tax liability calculated on income calculated as per other provisions of the Act.

4. How the foreign institutional investors are taxed for the capital gains arising from transfer of securities?

Answer:

Tax on income of Foreign Institutional Investors (FII) from securities or capital gains arising from their transfer [Sec. 115AD]

Where the total income of a Foreign Institutional Investor includes:

(a) income (other than income by way of dividends u/s 115-O) received in respect of securities (other than unit referred to in sec. 115AB); or

(b) income by way of short-term or long-term capital gains arising from the transfer of such securities, the income-tax payable shall be the aggregate of:

- **(i)** The amount of income-tax calculated on the income in respect of securities referred to in clause (*a*), if any, included in the total income, at the rate of 20% [however, tax on income by way of interest referred to in sec. 194LD shall be @ 5%];
- **(ii)** The amount of income-tax calculated on the income by way of short-term capital gains referred to in clause (*b*), if any, included in the total income, at the rate of 30%. However, the amount of income-tax calculated on the income by way of short-term capital gains referred to in sec. 111A shall be at the rate of 15%.
- **(iii)** The amount of income-tax calculated on the income by way of long-term capital gains referred to in clause (*b*), if any, included in the total income, at the rate of 10%; and
- **(iv)** The amount of income-tax with which the Foreign Institutional Investor would have been chargeable had its total income been reduced by the amount of income referred to in clause (*a*) and clause (*b*).

<u>Tax point</u>

- Where the gross total income of the Foreign Institutional Investor:
  - **(a)** consists only of income in respect of securities referred to in clause (a) above, no deduction shall be allowed to it u/s 28 to 44C or 57 or under Chapter VIA;
  - **(b)** includes any income referred to in clause (a) or clause (b), the gross total income shall be reduced by the amount of such income and the deduction under Chapter VIA shall be allowed as if the gross total income as so reduced, were the gross total income of the Foreign Institutional Investor.
- Nothing contained in the first and second provisos to section 48 shall apply for the computation of capital gains.

5. Compute the income-tax in the following cases:

(a) Royalty of ₹ 20 lakh received by a foreign company from an Indian concern in pursuance of an agreement approved by the Central Government in the previous year 2017-18.

(b) ₹ 20 lakh long-term capital gains received by an overseas financial organisation on transfer of unit purchased in foreign currency.

Answer:

(a) As per Section 115A(i)(b), the rate of income tax applicable on royalty is 10%.
Therefore, Income tax = 10% of ₹ 20,00,000= ₹ 2,00,000
Education cess& SHEC = 3% of ₹ 2,00,000 = ₹ 6,000
Total tax payable = ₹ 2,00,000 + ₹ 6,000 = ₹ 2,06,000

(b) Long term Capital Gain = ₹ 20,00,000
Income-tax u/s 115AB = 10% of ₹ 20,00,000 = ₹ 2,00,000
Education cess& SHEC = 3% of ₹ 2,00,000 = ₹ 6,000
Total tax payable = ₹ 2,00,000 + ₹ 6,000 = ₹ 2,06,000

However, if the units are equity-oriented fund then the Long term capital gains on the same shall be exempt u/s 10(38)

6. During the previous year 2017-18, a charitable trust earned an income of ₹ 10 lakh out of which ₹ 8 lakh was received during the previous year 2017-18 and the balance ₹ 2 lakh was received during the previous year 2018-19. To claim full exemption of ₹ 10 lakh in the previous year 2017-18, state –

(i) What is the maximum amount which can be accumulated to be utilized for charitable or religious purposes at a later date?

(ii) How much amount should actually be spent during the previous year 2017-18?

(iii) How much amount will be deemed to be utilized during the previous year 2017-18 and within what time should it be actually utilized?

Answer:

A trust is allowed to accumulate 15% of its income and such accumulation will be treated as application of income. In other words, to claim 100% exemption of income 85% of income must be applied for charitable purpose.

As per Sec.11(1), where due to certain reasons, application of income is below 85% of its income, trust can apply for deferment of application of income. Such application must be made before due date of filing of return. Such deferment is allowed for the previous year in which such income is actually received and the previous year subsequent to such year.

In the light of above provisions,

Income of the Previous year	A	₹ 10,00,000
Less: Free accumulation i.e. 15% of income	B = A * 15%	₹ 1,50,000
Income to be applied	C = A – B	₹ 8,50,000
Less: Deferment of application of income which is not yet received [if applied u/s 11(1)]	D	₹ 2,00,000
Amount applied in the previous year	C – D	₹ 6,50,000
Taxable income		**Nil**

As per above estimation,

1. ₹ 1,50,000 can be freely accumulated to be utilized for charitable or religious purposes at a later date
2. ₹ 6,50,000 must be applied in the previous year for charitable purpose.
3. An application for deferment must be made for ₹ 2,00,000 which has not yet received. Such amount must be applied for charitable purposes within 1 year from the end of the financial year in which it is received i.e. amount must be applied within 31/3/2019.

7. Discuss place of effective management.

Answer:

Place of effective management" means a place 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.' Circular 6/2017 dated 24-01-2017 provides that the process of determination of POEM would be primarily based on the fact as to whether or not the company is engaged in active business outside India (ABOI).

Particulars	POEM
Company is engaged in active business outside India	
- If the majority meetings of the board of directors of the company are held outside India	Outside India
- If Board of directors of the company are standing aside and not exercising their powers of management and such powers are being exercised by either the holding company or any other person (s) resident in India	In India
Company is not engaged in active business outside India then following are required to be ascertained: 1. The person(s) who actually make the key management and commercial decision for conduct of the company's business as a whole 2. Place where these decisions are in fact being made	
If such place is in India	In India

<u>**Tax point**</u>

- A company shall be said to be engaged in "active business outside India" if
  a) the passive income is not more than 50% of its total income; and
  b) the passive income is less than 50% of its total assets are situated in India; and
  c) the passive income is less than 50% of total number of employees are situated in India or are resident in India; and
  d) the payroll expenses incurred on such employees is less than 50% of its total payroll expenditure.
- Passive income of a company shall be aggregate of:
  (i) income from the transactions where both the purchase and sale of goods is from / to its associated enterprises; and
  income by way of royalty, dividend, capital gains, interest (except for banking company or public financial institution) or rental income.

8. Write notes on TDS on income of units of investment fund u/s 194LBB

Answer:

TDS on income of units of Investment Fund [Sec. 194LBB]

Who is responsible to deduct tax: The person responsible for making the payment of any income, other than that proportion of income which is of the same nature as income referred to in sec. 10(23FBB), to a unit holder in respect of units of an investment fund specified in clause (a) of the Explanation 1 to sec. 115UB

When tax shall be deducted: At the time of payment or crediting the payee, whichever is earlier.

Rate of TDS:

Payee	Rate of TDS
Resident	10%
Non-resident (not being a company)	30%
Foreign Company	40%

Note: Where the payee is a non-resident (not being a company) or a foreign company, deduction shall not be made in respect of any income that is not chargeable to tax.

Exemption or relaxation from the provision
When the recipient applies to the Assessing Officer in Form 13 and gets a certificate authorising the payer to deduct tax at lower rate or deduct no tax [Refer sec. 197]

9. Write notes on belated return and revised return

Answer:

Belated Return [Sec. 139(4)]
If an assessee fails to file return within the time limit allowed u/s 139(1) or within the time allowed under a notice issued u/s 142(1), he can file a belated return.

Time limit: Assessee may file such return -
- before the end of the relevant assessment year; or
- before the completion of assessment (u/s 144),

- whichever is earlier.

However, if an assessee files a belated return, he would be liable to fee u/s 234F and interest u/s 234A.

Revised Return [Sec. 139(5)]

If an assessee discovers any omission or wrong statement (bonafide in nature) in the return filed, he can revise his return u/s 139(5).

Time limit: Assessee may file the revised return -
- before the end of the relevant assessment year; or
- before completion of regular assessment,

- whichever is earlier.

Notes
a) **Replacement of original return:** Once a revised return is filed, it replaces the earlier return. This signifies that the revised return should be complete in itself and not merely an accessory to the original return.
b) **Revision of revised return:** A revised return can again be revised i.e. a second revised return can be filed u/s 139(5) for correcting any omission or wrong statement made in the first revised return within specified time.
c) **Revision of belated return:** A belated return u/s 139(4) can be revised.

d) **Revision of loss return:** A loss return can be revised
e) Return filed pursuant to notice u/s 142(1) cannot be revised.

10. In response to the notice from the Assessing Officer, an assessee company has filed a return of loss for the A.Y 2018-19 on 15-3-2019 claiming the following items to be carried forward to the next A.Y.:

Loss under the head capital gains	**₹ 45,000**
Business loss	**₹ 2,74,000**
Depreciation unabsorbed	**₹ 3,92,000**

Discuss the validity of the claims made by the assessee.

Answer

As per sec. 142(1)(i), if an assessee has not submitted a return of income within the time allowed u/s 139(1), the Assessing Officer may require him to submit a return in the prescribed form on or before the date specified in the notice.

Where belated return is filed, following losses shall not be allowed to be carried forward as per sec. 80:

Loss under the head capital gains	₹ 45,000
Business loss	₹ 2,74,000

However, unabsorbed depreciation of ₹ 3,92,000 shall be allowed.

11. Videsh Ltd., a US company has a subsidiary, Hind Ltd. in India. Videsh Ltd. sells mobile phones to Hind Ltd. for resale in India. Videsh Ltd. also sells mobile phones to Bharat Ltd. another mobile phone reseller. It sold 48,000 mobile phones to Hind Ltd. at ₹ 12,000 per unit. The price fixed for Bharat Ltd. is ₹ 11,000 per unit.

The warranty in case of sale of mobile phones by Hind Ltd. is handled by itself, whereas, for sale of mobile phones by Bhart Ltd., Videsh Ltd. is responsible for warranty for 6 months. Both Videsh Ltd. and Hind Ltd. extended warranty at a standard rate of ₹ 500 per annum.

On the above facts, how is the assessment of Hind Ltd. going to be affected? Show your calculations also.

Answer:

Computation of Arms Length Price

Particulars	Amount
Cost of Mobile Phone sold to Bharat Ltd.	11,000
Less: Cost of Warranty	250
Arm's Length Price	10,750

Computation of Increase in Total Income

Particulars	Amount (in lacs)
Cost of mobile phone acquired from Videsh Ltd. [₹ 12,000 x 48,000]	5,760
Less: Arm's length Value [₹ 10,750 x 48,000]	5,160
Therefore, Increase in Total Income	600

12. Reddy India Ltd. is an India company. For the previous year 2017-18, the following incomes are noted from the books of account of the tax payer.

	₹
Income from a business in India	**3,80,000**
Income from a business in foreign country with whom India has ADT agreement	**2,16,000**

According to the ADT agreement, ₹ 2,16,000 is taxable in India. However, it can also be taxed in the foreign country @ 11.85% which can be set off against Indian tax liability. Find out the India tax liability for the assessment year 2018-19. Indian rate of tax is 30.9%

Answer:

Computation of Indian Tax Liability for the Assessment Year 2018-19

Particulars	Amount
Income from business in India	3,80,000
Income from a business in foreign country with whom India has ADT agreement	2,16,000
Total Income	5,96,000
Total tax payable in India @ 30.9%	1,84,164
Less: Tax paid in foreign country@ 11.85%	25,596
Net Indian Taxable Liability	1,58,570

13. Mahesh, aged 64 years, is resident and ordinarily resident in India. His income is ₹ 16,80,000 from a business in India and ₹ 5,45,000 from a business in a foreign country with whom India has agreement for avoidance of double taxation (ADT). According to the ADT agreement, income is taxable in the country in which it is earned and not in other country. However, in the other country, such income can be included for computation of tax rate.

According to the tax laws of the foreign country, Mahesh has paid ₹ 32,000 as tax in that country. During the previous year, Mahesh has paid ₹ 28,000 as tuition fee for his daughter in India and ₹ 90,000 as tuition fee for his son outside India for full time education. Mahesh has also received an interest of ₹ 48,000 on Government securities. Find out the tax liability of Mahesh for the assessment year 2018-19.

Answer:

Computation of Total Income of Mahesh for the Assessment Year 2018-19

Particulars	₹
Business income in India	16,80,000
Interest on Government Securities	48,000
Gross Total Income	17,28,000
Less: Deduction u/s 80C	28,000
Total Income	17,00,000
Add: Foreign income to be included for rate purpose	5,45,000
Total	22,45,000
Tax on above	4,98,005
Less: Relief u/s 90 [₹ 5,45,000 x 22.18%[1]]	1,20,881
Tax Payable (Rounded off)	3,77,120

[1]Average rate of tax = ₹ 4,98,005 / ₹ 22,45,000 x 100 = 22.18%

14. Write notes on Power of Commissioner (Appeals) u/s 251

Answer:

Powers of Commissioner (Appeals) u/s 251

1. Against an order of assessment	To confirm, reduce, enhance or annul the assessment
2. Against an order imposing a penalty	To confirm or cancel such order or vary it so as either to enhance or to reduce the penalty;
3. Against the order of assessment in respect of which the proceeding before the Settlement Commission abates u/s 245HA	To confirm, reduce, enhance or annul the assessment after taking into consideration all the material and other information produced by the assessee before, or the results of the inquiry held or evidence recorded by, the Settlement Commission, in the course of the proceeding before it and such other material as may be brought on his record
4. Relating to any other case	To pass such orders as he thinks fit.

Notes:
1. The Commissioner (Appeals) may consider and decide any matter arising out of the proceedings in which the order appealed against was passed, notwithstanding that such matter was not raised before the Commissioner (Appeals) by the appellant.
2. Commissioner (Appeals) shall not enhance an assessment or a penalty or reduce the amount of refund unless the appellant has had a reasonable opportunity of showing cause against such enhancement or reduction.
3. An assessment order, which is void ab initio cannot become a valid order simply by virtue of the fact that it has been confirmed by an appellate authority.

15. Difference between provision of sec. 263 and sec. 264

Answer:

Difference between provision relating to revision u/s 263 and 264 are as follow:

Basis	**Sec. 263**	**Sec. 264**
Which order can be revised	Order, which is prejudicial to the interest of revenue.	Order, which is prejudicial to the interest of assessee.
Proceedings at the motion of	At the own motion of the Pr. Commissioner or commissioner.	At the own motion of the Pr. Commissioner or commissioner or on the application of the assessee.
Scope	Revision is possible of the issues which have not been considered and decided in an appeal, i.e., doctrine of partial merger is applicable	Revision u/s 264 is not possible on any issue if an appeal has been filed, i.e., doctrine of total merger is applicable
Time limit for application	Assessee does not apply	Within 1 year from the date on which the order in question was communicated to the assessee
Time limit for passing a revisional order	2 years from the end of the financial year in which the order sought to be revised was passed.	• Where the Pr. Commissioner or commissioner acts on his own motion:within 1 year from the date of original order. • Where the application is made by the assessee: within 1 year

		from the end of the financial year in which such application is made.
Fee	Not applicable	₹ 500 where the application for revision is made by the assessee.
Appeal against order	Appeal can be filed to the Tribunal	No appeal can be filed.
Beneficial to	Revenue	Assessee

16. What is the meaning of Case in the light of provision relating to settlement commission.

Answer:

Case means any proceeding for assessment, of any person in respect of any assessment year or assessment years which may be pending before an Assessing Officer on the date on which an application is made.

Tax point

1. A proceeding for assessment or reassessment or recomputation u/s 147 shall be deemed to have commenced:
   (a) from the date on which a notice u/s 148 is issued for any assessment year;
   (b) from the date of issuance of the notice referred above, for any other assessment year or assessment years for which a notice u/s 148 has not been issued, but such notice could have been issued on such date, if the return of income for the other assessment year or assessment years has been furnished u/s 139 or in response to a notice u/s 142;
2. A proceeding for making fresh assessment in pursuance of an order u/s 254 or sec. 263 or sec. 264, setting aside or cancelling an assessment shall be deemed to have been commenced from the date on which such order, setting aside or cancelling an assessment was passed;
3. A proceeding for assessment or reassessment for any of the assessment years u/s 153A / 153C shall be deemed to have commenced on the date of issue of notice initiating such proceeding and concluded on the date on which the assessment is made;
4. A proceeding for assessment for any assessment year, other than aforesaid proceedings shall be deemed to have commenced from the date on which the return of income for that assessment year is furnished u/s 139 or in response to a notice served u/s 142 and concluded on the date on which the assessment is made; or on the expiry of the time specified for making assessment u/s 153(1), in case where no assessment is made.

17. Describe the quantum of penalty to be levied u/s 270A

Answer

Quantum of penalty [Sec. 270A (7) & (8)]

- 50% of the amount of tax payable on under-reported income [Sec. 270A(7)]
- 200% of the amount of tax payable on under-reported income, where under-reported income is in consequence of any misreporting thereof by any person - [Sec. 270A(8)]

18. What are the objectives of tax planning?

Answer:

Tax planning is an exercise undertaken to minimize tax liability through the best use of all available allowances, deductions, exclusions, exemptions, etc. The objectives of tax planning cannot be regarded as offending any concept of the taxation laws and subjected to reprehension of reducing the inflow of revenue to the Government's coffer, so long as the measures are in conformity with the statue laws and the judicial expositions thereof. The basic objectives of tax planning are:

a. Reduction of Tax liability

Tax law provides multiple choices and options to taxpayers. This necessary offer of options within tax legislation creates the opportunity for choice on the part of the tax payer. However, due to lack of awareness of legal requirements, in many a cases, a taxpayer may suffer heavy taxation. Through proper tax planning and awareness, a tax payer may reduce such heavy tax burden.

b. Minimisation of litigation

In the matter of taxation, the tax payers will try to pay the least tax and on the other hand, the tax administrator will attempt to extract the maximum. This conflict behaviour may results into litigations. However, where proper tax planning is adopted by the tax payer in conformity with the provisions of the taxation laws, the incidence of litigation can be minimised. This saves him from the hardships and inconveniences caused by the unnecessary litigations.

c. Productive investment

A tax payer may reduce heavy tax burden through proper tax planning. Such reduction results into reduction in cash-outflow. In the days of credit squeeze and dear money conditions, even a rupee of tax decently saved may be taken as an interest-free loan from the Government, which perhaps, an assessee need not repay. Such retained cash can be utilised in other productive venture which also provide additional earning to the taxpayer. That means, proper tax planning is a measure of proper utilisation of available resources which in turn maximise the cash-inflow and minimise the tax burden.

d. Healthy growth of economy

The growth of a nation's economy is synonymous with the growth and prosperity of its citizens. In this context, a saving of earnings by legally sanctioned devices fosters the growth of both, because savings by dubious means lead to generation of black money, the evils of which are obvious. Conversely, tax-planning measures are aimed at generating white money having a free flow and generation without reservations for the overall progress of the nation. Tax planning assumes a great significance in this context.

e. Economic stability

Tax planning results in economic stability by way of:

(i) productive investments by the tax payers; and

(ii) harnessing of resources for national projects aimed at general prosperity of the national economy and reaping of benefits even by those not liable to pay tax on their incomes.

19. A company wants to raise capital of ₹ 40,00,000 for a project wherefrom earnings before tax would be 30% of the capital employed. The company can raise debt finance @ 12% p.a.

The following three alternatives for raising capital are available for the company:

(i) ₹ 40,00,000 by equity capital
(ii) ₹ 20,00,000 by equity capital and ₹ 20,000,000 by loans
(iii) ₹ 8,00,000 by equity capital and ₹ 32,00,000 by loans.

Assume that the company would distribute the entire amount of profits and dividend. The tax rate is 30% and dividend distribution tax rate is 20%.

Work out which one of the above three alternatives should the company opt to minimise its tax liability?

Answer:

Computation of Tax Benefit in different Alternative

Particulars	Alt – (i)	Alt – (ii)	Alt – (iii)
Equity Capital	40,00,000	20,00,000	8,00,000
12% loans	—	20.,00,000	32,00,000
EBIT	12,00,000	12,00,000	12,00,000
Cost to Company			
Interest on loan	—	2,40,000	3,84,000
Net Profit before tax and dividend	12,00,000	9,60,000	8,16,000
Tax Payable @ 30% (A)	3,60,000	2,88,000	2,44,800
Profit after tax	8,40,000	6,72,000	5,71,200
Dividend Distribution Tax @ 20.358% (B)	1,68,000	1,34,400	1,14,240
Profit after cost of capital	6,72,000	5,37,600	4,56,960
Total tax paid (A +B)	**5,28,000**	**4,22,400**	**3,59,040**

20. How to compute total undisclosed foreign income and asset u/s 5 of Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015.

Answer:

- In computing the total undisclosed foreign income and asset of any previous year of an assessee:
  - No deduction in respect of any expenditure or allowance or set off of any loss shall be allowed to the assessee, whether or not it is allowable in accordance with the provisions of the Income-tax Act.
  - Any income,—
    a) which has been assessed to tax for any assessment year under the Income-tax Act prior to the assessment year to which this Act applies; or
    b) which is assessable or has been assessed to tax for any assessment year under this Act, shall be reduced from the value of the undisclosed asset located outside India, if, the assessee furnishes evidence to the satisfaction of the Assessing Officer that the asset has been acquired from the income which has been assessed or is assessable, as the case may be, to tax.

- The amount of deduction in case of an immovable property shall be the amount which bears to the value of the asset as on the first day of the financial year in which it comes to the notice of the Assessing Officer, the same proportion as the assessable or assessed foreign income bears to the total cost of the asset.

Illustration:

A house property located outside India was acquired by an assessee in the previous year 2009-10 for ₹ 50 lakh. Out of the investment of ₹ 50 lakh, ₹ 20 lakh was assessed to tax in the total income of the previous year 2009-10 and earlier years. Such undisclosed asset comes to the notice of the Assessing Officer in the year 2018-19. If the value of the asset in the year 2018-19 is ₹ 1 crore, the amount chargeable to tax shall be ₹ 60,00,000 i.e.,:

₹ 1,00,00,000 – (₹ 20,00,000 / ₹ 50,00,000) = ₹ 60,00,000

21. What is thin capitalization?

Answer:

Thin Capitalization

A company is typically financed or capitalized through a mixture of debt and equity. The way a company is capitalized often has a significant impact on the amount of profit it reports for tax purposes as the tax legislations of countries typically allow a deduction for interest paid or payable in arriving at the profit for tax purposes while the dividend paid on equity contribution is not deductible. Therefore, the higher the level of debt in a company, and thus the amount of interest it pays, the lower will be its taxable profit. For this reason, debt is often a more tax efficient method of finance than equity. Multinational groups are often able to structure their financing arrangements to maximize these benefits. For this reason, country's tax administrations often introduce rules that place a limit on the amount of interest that can be deducted in computing a company's profit for tax purposes. Such rules are designed to counter cross-border shifting of profit through excessive interest payments, and thus aim to protect a country's tax base.

Under the initiative of the G-20 countries, the Organization for Economic Co-operation and Development (OECD) in its Base Erosion and Profit Shifting (BEPS) project had taken up the issue of base erosion and profit shifting by way of excess interest deductions by the MNEs in Action plan 4. The OECD has recommended several measures in its final report to address this issue.

In view of the above, sec. 94B was inserted in line with the recommendations of OECD BEPS Action Plan 4, to provide that interest expenses claimed by an entity to its associated enterprises shall be restricted to 30% of its earnings before interest, taxes, depreciation and amortization (EBITDA) or interest paid or payable to associated enterprise, whichever is less.

22. Khazana Ltd is an Indian Company engaged in the business of developing and manufacturing Industrial components. Its Canadian Subsidiary Techpro Inc. supplies technical information and offers technical support to Khazana for manufacturing goods, for a consideration of Euro 1,00,000 per year. Income of Khazana Ltd is ₹ 90 Lakhs. Determine the Taxable Income of Khazana Ltd if Techpro charges Euro 1,30,000 per year to other entities in India. What will be the answer if Techpro charges Euro 60,000 per year to other entitles. (Rate per Euro may be taken at ₹ 50.)

Answer:

Computation of Total Income of Khazana Ltd

Particulars	Amount	Amount
When price charged for Comparable Uncontrolled Transaction	€ 1,00,000	€ 50,000
Price actually paid by Khazana Ltd [€1,00,000 x ₹ 50]	50,00,000	50,00,000
Less: Price charged in Rupees (under ALP)		
[€1,30,000 x ₹ 50]	65,00,000	
[€60,000 x ₹ 50]		30,00,000
Incremental Profit on adopting ALP (A)	(15,00,000)	20,00,000
Total Income before adjusting for differences due to Arm's Length Price	90,00,000	90,00,000
Add: Difference on account of adopting Arms Length Price [if (A) is positive]	NIL	20,00,000
Total Income of Khazana Ltd.	**90,00,000**	**1,10,00,000**

Note: u/s 92(3), Taxable Income cannot be reduced on applying ALP. Therefore, difference on account of ALP which reduces the Taxable Income is ignored.