

PAPER – 7: DIRECT TAX LAWS

PART II

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 2019-20, unless stated otherwise in the question.

Question 1

On, 1.4.2018, Binu Ltd. of Delhi, a domestic company, engaged in the business of manufacturing of metro rail seats, converted into an LLP by name M/s. Soumya LLP fulfilling all the conditions specified in section 47(xiiib) of the Income-tax Act, 1961. Some of the relevant information is given below in respect of Binu Ltd., as on 31.3.2018:

- (a) Voluntary Retirement Scheme (VRS) expenditure incurred by the company during the PY 2016-17 is ₹ 20 lakhs. The company was allowed deduction of ₹ 4 lakhs each for the PYs 2016-17 & 2017-18 under section 35DDA.*
- (b) 150 equity shares in Toyo Ltd., an Indian company listed in Bombay Stock Exchange was acquired for ₹ 1,900 per share on 31.7.2016. On conversion, these share become the property of M/s. Soumya LLP.*
- (c) Besides other assets transferred to M/s. Soumya LLP by M/s. Binu Ltd., it also transferred two factory buildings. On 1.4.2018, M/s. Soumya LLP leased out one factory building along with plant and machineries and furniture etc. at a consolidated lease rent of ₹ 50,000 per month.*

During the previous year 2018-19, the M/s. Soumya LLP earned a profit of ₹ 25,40,000 after debit/credit of the following items to its Profit and loss account:

- (i) Mr. Binu is the working partner of the LLP. He is also a working partner in another firm. He is actively engaged in the business of both the firms. Binu gets, a salary of ₹ 55,000 p.m. from M/s. Soumya LLP and the same is authorised in the deed of LLP.*
- (ii) Mr. Ayushman, an employee, was deputed to work in the client's office in Mumbai for three months. The LLP has paid his salary in cash for the months when he was in Mumbai, amounting to ₹ 3,45,000 (net of TDS and other deductions), since he did not have a bank account in Mumbai. This payment was included in amount of "salary" debited to profit and loss account. Mr. Ayushman is normally posted in Delhi being the headquarter of M/s. Soumya LLP.*

The Suggested Answers for Paper 7: Direct Tax Laws are based on the provisions of Income-tax Law as amended by the Finance Act, 2018. For May, 2019 examination, the relevant assessment year is A.Y.2019-20.

- (iii) Amount of ₹ 25,000 was paid towards penalty for non-fulfilment of delivery conditions of a contract for sale for the reasons beyond its control.
- (iv) The LLP had provided an amount of ₹ 18 lakhs being the sum estimated as payable to workers based on agreement to be entered with workers union towards periodical wage revision once in 3 years. The provision, is based on a fair estimation of wage and reasonable certainty of revision once in 3 years.
- (v) Depreciation debited to profit and loss account ₹ 5,40,000.
- (vi) Gratuity provisions based on actuarial valuations ₹ 6.5 lakhs. (Gratuity actually paid ₹ 4 lakhs to retired employees debited in Gratuity provision account).
- (vii) Profit on sale of shares of M/s. Toyo Ltd. ₹ 1,27,500. These shares were sold on 31.5.2018 for ₹ 2,750 per share. The highest price of Toyo Ltd. quoted on the stock exchange as on 31.1.2018 was ₹ 2,500 per share.
- (viii) Repairs to plant and machinery include ₹ 59,000 in respect of plant and machinery given on lease.
- (ix) Factory licence fee paid ₹ 15,000 for each factory building.
- (x) Legal fee includes ₹ 26,000 paid to an advocate for drafting and registering the lease agreement.

Additional Information:

- (1) Under an agreement of debt restructuring, the bank has converted unpaid interest amounting to ₹ 9,00,000 up to 31.7.2018 into a new loan account repayable in 3 equal annual instalments. The first instalment was paid in March 2019 by debiting the new loan account.
- (2) Mr. Binu, being a working partner, bought a car which is registered in his own name out of the funds of LLP. The car was used exclusively for the purposes of the business of the LLP only. The depreciation on the car amounts to ₹ 15,000 for the PY 2018-19 which is not included in the depreciation amount debited to profit and loss account.
- (3) Depreciation as per Income-tax Rules ₹ 8,10,000 (including depreciation on the assets given on lease amounting to ₹ 90,000). It does not include depreciation on car.
- (4) The LLP sold import entitlements on 1.5.2018 for ₹ 1,50,000.

This sum is not included in profit and loss account by treating it as capital receipt.

You are required to discuss the implication of such conversion and calculate the total income in the hands of M/s Soumya LLP for the Assessment Year 2019-20. (14 Marks)

Answer

Implication on conversion of company into LLP

Transfer of capital asset or intangible asset by a private company or unlisted public company to a LLP or any transfer of share held by shareholder to LLP in a conversion of private

company into an LLP is not regarded as transfer under section 47 provided the conditions specified therein are satisfied.

Accordingly, transfer of capital asset by Binu Ltd¹, Delhi to M/s Soumya LLP is not regarded as transfer since the conditions specified in section 47(xiiib) as stated in the question stand satisfied and fulfilled.

Computation of Total Income in the hands of M/s Soumya LLP for the A.Y. 2019-20

Particulars		Amount (₹)		
I	Profits and gains of business and profession			
	Net profit as per the profit and loss account		25,40,000	
	Add: Items debited but to be considered separately or to be disallowed			
	(i) Salary to Binu, working partner (to be considered separately) [₹ 55,000 x 12]	6,60,000		
	(ii) Salary paid to Mr. Ayushman, an employee [Under section 40A(3), disallowance is attracted in respect of expenditure for which cash payment exceeding ₹ 10,000 is made on a day to a person. Payment of ₹ 3,45,000 to Mr. Ayushman, an employee, is covered by exception under Rule 6DD since, TDS has been deducted, employee is temporarily posted in Mumbai and does not have a bank account in Mumbai. Since the same has been debited to profit and loss account, no adjustment is required]	-		
	(iii) Penalty for non-fulfilment of delivery conditions of a contract for sale [Penalty for non-fulfilment of delivery conditions of a contract for sale is not on account of infraction of law. Penalty for breach of contract is business or commercial loss and would be allowable]	-		

¹ Considering the fact given in the question that all conditions of section 47(xiiib) have been fulfilled, it is assumed that Binu Ltd. is an unlisted company.

	expenditure under section 37. Since the same has been debited to profit and loss account, no adjustment is required]	
(iv)	Provision for wages payable to workers [The provision is based on fair estimate of wages and reasonable certainty of revision, and thus is allowable as deduction, as ICDS-X requires 'reasonable certainty for recognition of a provision, which is present in this case. As the provision has been debited to profit and loss account, no adjustment is required while computing business income]	-
(v)	Depreciation as per books of account	5,40,000
(vi)	Provision for gratuity [Provision of ₹ 6,50,000 for gratuity based on actuarial valuation is not allowable as deduction as per section 40A(7). However, actual gratuity of ₹ 4,00,000 paid is allowable as deduction. Hence, the difference is to be added back being of ₹ 2,50,000 (₹ 6,50,000 – ₹ 4,00,000)]	2,50,000
(viii)	Repair to plant and machinery given on lease [Lease rent from factory building along with plant and machinery and furniture is chargeable to tax under the head income from other sources, since the main business of the M/s Soumya LLP is manufacturing of metro rail seats and not letting out the properties. Therefore, repairs to such plant and machinery to be deducted from lease income taxable under the head "Income from Other Sources. Since the same has been debited to profit and loss account, it has to be added back]	59,000
(ix)	Factory licence fee paid	15,000

	[Factory licence fee in respect of leased out factory building is to be deducted from lease income taxable under the head "Income from Other Sources". Since the same has been debited to profit and loss account, it has to be added back]		
(x)	Legal fee to advocate for drafting and registering lease agreement [Legal fee to advocate for drafting and registering lease agreement to be deducted from lease income taxable under the head "Income from Other Sources". Since the same has been debited to profit and loss, it has to be added back]	26,000	15,50,000
	Add: Amount taxable but not credited to profit and loss account		40,90,000
	AI(4) Profit on sale of import entitlements [Profit on sale of import entitlements is chargeable to tax under the head "Profits and gains from business and profession" under section 28. Since the same has not been credited to profit and loss account, it has to be added]		1,50,000
	Less: Items credited to profit and loss account, but not includible in business income / permissible expenditure and allowances		42,40,000
(i)	Profit on sale of shares of M/s Toyo Ltd. [Taxable under the head "Capital Gains". Since the same has been credited to profit and loss account, it has to be reduced from business income]	1,27,500	
	AI(a) Voluntary Retirement Scheme expenditure [₹ 20 lakh/5] [One fifth deduction is available in respect	4,00,000	

of payment for voluntary retirement scheme for five years. Where a private company or unlisted company is succeeded by a LLP fulfilling the conditions laid down in section 47(xiiib), then, deduction in respect of voluntary retirement scheme is available to the LLP for the balance years from the year of succession. Hence, deduction of ₹ 4,00,000 is allowable in P.Y. 2018-19 to M/s Soumya LLP being for 3rd year]		
AI(1) Interest paid during the year	3,00,000	
[Conversion of unpaid interest into loan shall not be construed as payment of interest for the purpose of section 43B. The amount of unpaid interest converted into a new loan will be allowable as deduction only in the year in which such converted loan is actually paid. Since ₹ 3 lakhs has been paid in the P.Y. 2018-19, the same is allowable as deduction]		
AI(2) Depreciation on motor car exclusively used for business purpose	15,000	
[Depreciation on motor car bought and used exclusively for the purposes of business is allowable though not registered in the name of the firm. ²]		
AI(3) Depreciation as per Income-tax Rules [₹ 8,10,000 – ₹ 90,000]	7,20,000	
[Depreciation on leased out asset to be deducted from lease income taxable under the head "Income from Other Sources. Since the same has been included in depreciation of ₹ 8,10,000, it has to be reduced from it]		15,62,500
Book Profit		26,77,500
Less: Remuneration to Mr. Binu, a working partner [Subject to limit specified in section 40(b)]		

² Mysore Minerals Ltd. v. CIT (1999) 239 ITR 775 (SC).

	[On first ₹ 3,00,000 of book profit, 90% of book profit or ₹ 1,50,000, whichever is higher and on the balance of book profit, 60% of balance book profit] [₹ 16,96,500 (2,70,000, being 90% of ₹ 3,00,000 + ₹14,26,500, being 60% of ₹ 23,77,500) restricted to actual remuneration paid to Binu. ³	6,60,000	
	Profits and gains from business and profession		20,17,500
II	Capital Gains		
	Sale consideration [150 x ₹ 2,750 per share]	4,12,500	
	Less: Cost of acquisition [150 x ₹ 2,500 per share] [Indexation benefit would not be available]	3,75,000	
	[Higher of		
	(i) ₹ 1,900, actual cost, being the cost of acquisition to Binu Ltd. as per section 49]		
	(ii) ₹ 2,500, being the lower of		
	- Fair market value as on 31.1.2018 [₹ 2,500 per share]		
	- Full value of consideration [₹ 2,750 per share]		
	Long term Capital gains since shares held for more than 12 months [Period of holding of Binu Ltd. is also included]		37,500
III	Income from Other Sources		
	Lease rent [₹ 50,000 x 12]	6,00,000	
	Less: Deduction under section 57		
	Repair of leased out plant and machinery	59,000	
	Factory licence fee in respect of leased out factory building	15,000	
	Legal fee for drafting and registering lease agreement	26,000	

³ It is assumed that Mr. Binu is the only working partner to whom remuneration is authorised by the partnership deed.

	Depreciation of assets given on lease		90,000	
				4,10,000
	Gross Total Income/ Total Income			24,65,000

Question2

- (a) On 1.4.2018, Wuyu Ltd. was amalgamated with Rayu Ltd. satisfying all the conditions mentioned in section 2(1B).

Wuyu Ltd. had the following brought forward losses as assessed till the assessment year 2018-19:

Particulars	₹ in lakhs
Speculation business loss	5
Unabsorbed Depreciation	13
Business loss	150
Unabsorbed expenditure of capital nature on scientific research	3

Rayu Ltd. has computed a profit of ₹ 180 lakhs for the financial year 2018-19 before setting off the eligible losses of Wuyu Ltd. but after providing depreciation @ 15% p.a. on ₹ 140 lakhs, being the consideration at which plant and machinery were transferred by Wuyu Ltd. to Rayu Ltd. The WDV as per Income-tax records of Wuyu Ltd. as on 1.4.2018 was ₹ 98 lakhs.

The above profit of Rayu Ltd. includes speculation business profit of ₹ 15 lakhs.

Compute the total income of Rayu Ltd. for the A.Y. 2019-20 and indicate the losses/other allowances to be carried forward by it. Assume the amalgamation is within the meaning of section 72A of the Income-tax Act, 1961. Give reasons for treatment of each item.

(8 Marks)

- (b) Mr. Robert, a non-resident, (aged 38) operates a ship for the carriage of goods, passengers and livestock between Dubai, Mumbai and Chennai. He provides you the following particulars for the previous year 2018-19:
- Received ₹ 200 Lakhs in India on account of carriage of livestock from Mumbai to London.
 - Received ₹ 50 Lakhs in India on account of carriage of passengers from Dubai to Colombo.
 - Received ₹ 65 Lakhs in Dubai on account of carriage of goods from Chennai to Dubai.

(iv) Expenses incurred during the year in respect of operation of such ships ₹ 195 Lakhs.

(v) Winning from horse races in India ₹ 25 Lakhs

Compute the total income of Mr. Robert Chargeable to tax in India for the assessment year 2019-20. Also, calculate the tax payable thereon. **(6 Marks)**

Answer

(a) Computation of total income of Rayu Ltd for the A.Y. 2019-20

Particulars	₹ (in lakhs)	
Business income before setting-off brought forward losses of Wuyu Ltd.		180.00
<i>Add:</i> Excess depreciation claimed in the scheme of amalgamation of Wuyu Ltd. with Rayu Ltd.		
Value at which plant and machinery is transferred by Wuyu Ltd.	140.00	
WDV in the books of Wuyu Ltd.	<u>98.00</u>	
Excess value accounted by Rayu Ltd.	42.00	
Excess depreciation claimed in computing taxable profits from business of Rayu Ltd. [₹ 42 lacs × 15%] [Explanation 2 to section 43(6)]		<u>6.30</u>
		186.30
<i>Less:</i> Brought forward losses of Wuyu Ltd.		
- business loss of Wuyu Ltd (See Note 1)		(150.00)
- unabsorbed depreciation by virtue of section 32(2) read with section 72A (See Note 1)		(13.00)
- unabsorbed capital expenditure on scientific research by virtue of section 35(1)(iv) read with section 35(4) (See Note 2)		(3.00)
- Speculation business loss (See Note 3)		<u>-</u>
Business income/Total Income		<u>20.30</u>

Notes:

- (1) In the case of amalgamation of companies, the unabsorbed business losses (except speculation business loss) and unabsorbed depreciation of the amalgamating company shall be deemed to be the loss or unabsorbed depreciation of the amalgamated company for the previous year in which the amalgamation was effected and such business loss and unabsorbed depreciation shall be carried

forward and set-off by the amalgamated company for a period of 8 years and indefinitely, respectively.

- (2) As per section 35(4), the provisions relating to unabsorbed depreciation under section 32(2) shall apply in relation to deduction allowable under section 35(1)(iv) in respect of capital expenditure on scientific research related to the business carried on by the assessee. Therefore, unabsorbed capital expenditure on scientific research can be set-off and carried forward in the same manner as unabsorbed depreciation.
- (3) The accumulated loss to be carried forward specifically excludes loss sustained in a speculative business. Therefore, speculative loss of ₹ 5 lacs of Wuyu Ltd. cannot be carried forward by Rayu Ltd. for set-off against its speculative business profit.
- (4) There is no loss or allowance to be carried forward by Rayu Ltd. to A.Y.2020-21.

(b) Computation of total income and tax payable by Mr. Robert

	Amount (₹)
Section 44B provides that profits and gains of a non-resident engaged in the business of operation of ships are to be taken @7.5% of the aggregate of the following amounts:	
(i) paid or payable, whether in or out of India, to the assessee or to any person on his behalf on account of carriage of passengers, livestock, mail or goods shipped at any port in India; and	
(ii) received or deemed to be received in India by or on behalf of the assessee on account of the carriage of passengers, livestock, mail or goods shipped at any port outside India.	
These provisions for computation of the income from the shipping business in case of non-residents would apply notwithstanding anything to the contrary contained in the provisions of sections 28 to 43A.	
Accordingly, profits from shipping business of Mr. Robert computed as follows:	
(i) Amount received in India on account of carriage of livestock from Mumbai to London	200 lakhs
(ii) Amount received in India on account of carriage of passengers from Dubai to Colombo	50 lakhs
(iii) Amount received in Dubai on account of carriage of goods from Chennai to Dubai	<u>65 lakhs</u>
Total amount received	<u>315 lakhs</u>
Profits and gains chargeable under head profits and gains from	23,62,500

business or profession @7.5% of the total amount received		
Income from other sources		
Winning from horse races in India [assumed to be the gross amount]		<u>25,00,000</u>
Total Income		48,62,500
Tax on winning from horse races @ 30%		7,50,000
Tax on balance income of ₹ 23,62,500		
Upto ₹ 2,50,000	Nil	
₹ 2,50,001 – ₹ 5,00,000	12,500	
₹ 5,00,001 – ₹ 10,00,000	1,00,000	
₹ 10,00,001 – ₹ 23,62,500	<u>4,08,750</u>	<u>5,21,250</u>
		12,71,250
Add: Health and Education Cess @4%		<u>50,850</u>
Tax liability		13,22,100
Less: Tax deduction at source on winnings from horse races [31.2% of ₹ 25,00,000]		<u>7,80,000</u>
Tax payable [See Note below]		<u>5,42,100</u>

Note: The tax payable would get further reduced by the amount of tax paid under section 172(4). The amount of tax payable under section 172 would be 41.6% (being the rate applicable to a foreign company) of 7.5% of ₹ 265 lakhs (being the amounts payable for goods shipped at a port in India) = ₹ 8,26,800. After reducing this amount, the tax refundable on total income would be ₹ 2,84,700.

Question 3

- (a) *Supporting the Girl Child, a charitable trust, is registered under section 12AA of the Act. On 1.4.2018, it got merged with M/s. Ananya P Ltd., which is a company engaged in manufacturing of stationery items. All the assets and liabilities of the erstwhile trust became the assets and liabilities of M/s. Ananya P Ltd who is not entitled for registration under section 12AA of the Act. The trust appointed a registered valuer for the valuation of its assets and liabilities. From the following particulars (including the valuation report), calculate the tax liability in the hands of the trust arising as a result of such merger:*
- (i) *Stamp duty value of land held ₹ 15 lakhs. However; if this land is sold in the open market, it would ordinarily fetch ₹ 17 lakhs. The book value of the land is ₹ 20 lakhs.*
 - (ii) *75,000 equity shares in Idom Ltd. traded in Bombay Stock Exchange. The lowest price per share on 1.4.2018 was ₹ 75 and the highest price on that day was ₹ 85. The book value was ₹ 67 lakhs.*

- (iii) 55,000 preference shares held in Niharika Ltd. The shares will fetch ₹ 44 lakhs, if they are sold in the open market on 1.4.2018. Book value was ₹ 25 Lakhs.
- (iv) Corpus fund as on 1.4.2018 ₹ 15 Lakhs.
- (v) Outside liabilities ₹ 90 lakhs
- (vi) Provision for taxation ₹ 5 lakhs.
- (vii) Liabilities in respect of payment of various utility bills ₹ 6 lakhs.

Note: Give reasons for treatment of each item. **(8 Marks)**

- (b) Mr. Kalpesh, aged 56 years, a resident individual furnishes the following particulars of income earned by him in India and country "T" for the previous year 2018-19. India has not entered into double taxation avoidance agreement with country "T".

Particulars	Amount (₹)
Income from profession carried on in India	6,00,000
Agricultural Income in Country "T"	75,000
Dividend from a company incorporated in Country "T"	1,20,000
Royalty income from a literary book from Country "T"	4,00,000
Expenses incurred for earning royalty	60,000
Business loss in Country "T"	75,000

As per income-tax law of Country "T" Business loss is not eligible for set off against any other incomes. The rate of income-tax in country "T" is 20%.

Compute total income and tax payable by Mr. Kalpesh in India for A.Y. 2019-20 assuming that he satisfies all conditions for the purpose of section 91. **(6 Marks)**

Answer

- (a) As per section 115TD, the accreted income of "Supporting the Girl Child", a charitable trust, registered under section 12AA which is merged with M/s Ananya P Ltd., an entity not entitled for registration under section 12AA, would be chargeable to tax at maximum marginal rate @ 34.944% [30% plus surcharge @12% plus cess@4%].

Computation of accreted income and tax liability in the hands of the trust arising as a result of merger with Ananya Pvt. Ltd. for A.Y. 2019-20

Particulars	Amount (₹)
Aggregate FMV of total assets as on 1.4.18, being the specified date (date of merger) [See Working Note 1]	1,21,00,000
Less: Total liability computed in accordance with the prescribed method of valuation	

[See Working Note 2]	<u>96,00,000</u>
Accreted Income	<u>25,00,000</u>
Tax Liability @ 34.944% of ₹ 25,00,000	8,73,600
Working Notes:	
(1) Aggregate fair market value of total assets on the date of merger	
- Land, being an immovable property	17,00,000
[The fair market value of land would be higher of ₹ 17 lakhs i.e., price that the land would ordinarily fetch if sold in the open market and ₹ 15 lakhs, being stamp duty value as on the specified date]	
- Quoted equity shares in Idom Ltd. [75,000 x ₹ 80 pe share]	60,00,000
[₹ 80 per share, being the average of the lowest (₹ 75) and highest price (₹ 85) of such shares on the date of merger]	
- 55,000 preference shares of Niharika Ltd.	
[The fair market value which it would fetch if sold in the open market on the date of merger i.e. FMV on 1.4.2018]	<u>44,00,000</u>
	1,21,00,000
(2) Total liability	
- Outside liabilities	90,00,000
- Corpus Fund of ₹ 15 lakhs [not includible]	-
- Provision for taxation ₹ 5 lakhs [not includible]	-
- Liabilities in respect of payment of various utility bills [since this liability is an ascertained liability]	<u>6,00,000</u>
	96,00,000

(b) Computation of total income of Mr. Kalpesh for A.Y.2019-20

Particulars	₹	₹
Profits and Gains of Business or Profession		
Income from profession carried on in India	6,00,000	
Less: Business loss in Country T	<u>75,000</u>	5,25,000
Income from Other Sources		
Agricultural income in Country T [Not exempt u/s 10(1)]	75,000	
Dividend received from a company incorporated in Country T	1,20,000	
Royalty income from a literary book in Country T (after		

deducting expenses of ₹ 60,000)	<u>3,40,000</u>	<u>5,35,000</u>
Gross Total Income		10,60,000
Less: Deduction under Chapter VIA		
Under section 80QCB – Royalty income of a resident from a literary book⁴		<u>3,00,000</u>
Total Income		<u>7,60,000</u>
Computation of tax liability of Mr. Kalpesh for A.Y.2019-20		
Particulars		₹
Tax on total income [20% of ₹ 2,60,000 plus ₹ 12,500]		64,500
Add: Health and education cess @4%		<u>2,580</u>
Tax Liability		67,080
Calculation of Rebate under section 91:		
Average rate of tax in India [i.e., ₹ 67,080 / ₹ 7,60,000 x 100]	8.826%	
Average rate of tax in Country T	20%	
Doubly taxed income pertaining to Country T		₹
Agricultural Income		75,000
Royalty Income [₹ 4,00,000 – ₹ 60,000 (Expenses) – ₹ 3,00,000 (deduction under section 80QCB)] ⁵		40,000
Dividend income		<u>1,20,000</u>
		2,35,000
Less: Business Loss set off		<u>75,000</u>
		<u>1,60,000</u>
Rebate under section 91 on ₹ 1,60,000 @ 8.826% [being the lower of average Indian tax rate (8.826%) and foreign tax rate (20%)]		<u>14,122</u>
Tax Payable		<u>52,958</u>
Tax Payable (Rounded off)		52,960

Question 4

(a) Discuss the liability of TDS provisions in the following independent cases:

- (i) X Ltd. is a producer of natural gas. During the year, it sold natural gas worth ₹ 20,50,000 to M/s Hawa Co., a partnership firm. It also incurred ₹ 2,00,000 as

⁴ It is assumed that the royalty earned outside India has been brought into India in convertible foreign exchange within a period of six months from the end of the previous year.

⁵ Doubly taxed income includes only that part of income which is included in the assessee's total income. The amount deducted under Chapter VIA is not doubly taxed and hence, no relief is allowable in respect of such amount – CIT v. Dr. R.N. Jhanji (1990) 185 ITR 586 (Raj.).

freight for the transportation of gas. It raised the invoice and clearly bifurcated the value of gas as well as the transportation charges.

- (ii) *Beta Ltd, gave a contract to Alpha Ltd. for the supply of 2000 pens on which the logo of Beta Ltd. was printed. The raw materials were purchased by Alpha Ltd. from C Ltd., which is not related to Beta Ltd. The consideration paid for the pens was ₹ 1,50,000.*
- (iii) *M/s. Taba Ltd. enters into a contract with Mr. Babu for the transportation of its products from its plant to warehouses. It pays a lump-sum amount of ₹ 2,50,000 to Mr. Babu for the year at the year end. Mr. Babu is engaged in the business of plying goods carriages on hire. Mr. Babu is not an assessee under Income-tax Act and thus did not provide PAN to Taba Ltd.*
- (iv) *M/s. Sunivesh Investors is engaged in the business of stock broking, depositories, mobilisation of deposits and marketing of public issues. It is a registered member of Bombay Stock Exchange. Every year it makes payment amounting to ₹ 10 lakhs, to the Stock Exchange by way of transaction charges in respect of fully automated online trading facility. This service is available to all members of the stock exchange in respect of every transaction that is entered into. Would it be liable for tax deduction under section 194J? **(8 Marks)***
- (b) *Muskaan Ltd. (MK India) is an Indian company that manufactures cricket kits in India. MK India is eligible for deduction under section 10AA of the Income-tax Act, 1961. For its UK sales, MK India has entered into a marketing arrangement with Kits Sports (KS UK), a UK incorporated firm. MK India uses the patented design provided by KS UK for manufacturing of cricket kits by it. MK India supplied 30,000 sports kits to KS UK for ₹ 5,000 per kit. In the assessment, the Assessing Officer, increased the price charged by MK India from KS UK to ₹ 6,000 per kit. MK India accepts such transfer price adjustment adopted by the Assessing officer. As a result, there is an increase in the income of MK India. You are required to answer the following questions in this respect:*
- (1) *Would MK India and KS UK be treated as associate enterprises for the purposes of transfer pricing adjustment adopted by the Assessing Officer?*
- (2) *What is the liability of KS UK in respect of the change in Arm's Length Price (ALP) in respect of purchases made by it from MK India?*
- (3) *MK India contends that since the income is increased because of the arm's length price adopted by the Assessing Officer, the deduction claimed by it under section 10AA should also be increased accordingly, since the amount of deduction is based upon the amount of the export sale. Discuss whether the contention of MK India is valid. **(6 Marks)***

Answer

- (a) (i) TDS u/s 194C is attracted on any sum payable to a resident contractor for carrying out any work. Since X Ltd., the producer of natural gas sells as well as transports the gas to the purchaser, M/s. Hawa Co., a partnership firm, till the point of delivery, where the ownership of gas is simultaneously transferred, the manner of raising the sale bill (whether the transportation charges are embedded in the cost of gas or shown separately) does not alter the basic nature of such contract which remains essentially a 'contract for sale' and not a 'works contract' as envisaged in section 194C.

Therefore, in such circumstances, TDS provisions under section 194C are not applicable on the component of Gas Transportation Charges payable by M/s. Hawa Co. to X Ltd.⁶ Consequently, there is no liability to deduct tax at source under section 194C in this case.

- (ii) TDS u/s 194C is attracted on any sum payable to a resident contractor for carrying out any work. However, "work" shall not include manufacturing or supplying a product according to the requirement or specification of a customer by using raw material purchased from a person, other than such customer, as such a contract is a 'contract for sale'.

In this case, since Alpha Ltd. has to supply pens to Beta Ltd. by using materials purchased from C Ltd., the contract for supply of pens is a 'contract for sale' and not a works contract. Consequently, there is no liability to deduct tax at source under section 194C in this case.

- (iii) Tax is not required to be deducted at source under section 194C from the sum credited or paid to the account of a contractor, during the course of the business of plying, hiring or leasing goods carriages, if he furnishes his PAN to the deductor.

In this case, since Mr. Babu has not furnished his PAN to M/s. Taba Ltd., M/s. Taba Ltd. has to deduct tax at source@20% as per section 206AA on lumpsum payment of ₹ 2,50,000 to Mr. Babu, since the same exceeds the aggregate threshold of ₹ 1,00,000.

- (iv) Under section 194J, TDS is attracted in respect of, *inter alia*, fees for technical services. Technical services like managerial and consultancy services are in the nature of specialised services made available by the service provider to cater to the special needs of the customer-user as may be felt necessary. It is the above feature that distinguishes or identifies a service provider from a facility offered

However, the service provided by the BSE for which transaction charges are paid does not satisfy the test of specialized, exclusive and individual requirement of the user or the consumer who may approach the service provider for such assistance or

⁶ CBDT Circular No. 9/2012 dated 17.10.2012

service. Therefore, the transaction charges paid to BSE by its members are not for technical services but are in the nature of payments made for facilities provided by the stock exchange. Such payments would, therefore, not attract the provisions of tax deduction at source under section 194J.⁷

Accordingly, payment of transaction charges of ₹ 10 lakhs by M/s. Sunivesh Investors to BSE in respect of fully automated online trading facility would not be liable for tax deduction at source under section 194J.

- (b) (1) Manufacturing of cricket kits by MK India is wholly dependent on the use of patented design provided by KS UK and therefore MK India and KS UK are deemed to be associated enterprises as per section 92A(2).

Supply of cricket kits by MK India, a resident, to KS UK, a non-resident, would be an international transaction between associated enterprises, and hence, transfer pricing provisions would be attracted in this case.

- (2) The increased amount of ₹ 3 crore shall be treated as an advance given by M.K. India to KS UK which is required to be repatriated by KS UK within 90 days from the date of order.
- (3) As per the first proviso to section 92C(4), in respect of the increased income of ₹ 3 crores, no deduction under section 10AA shall be allowed to MK India.

Hence, the contention of MK India that deduction under section 10AA should be increased is **not** valid.

Question 5

- (a) Answer any **two** out of the following **three** questions:

- (i) Mr. Raja, a resident individual died on 15.1.2019. Some reassessment proceedings in respect of his income chargeable to tax were pending on that date. Mr. Nitin is the legal heir of Late Raja. The Assessing Officer continued the reassessment proceedings without bringing the legal heir Mr. Nitin on record though Mr. Nitin informed the demise of Raja and also participated in the assessment. After the completion of assessment, Mr. Nitin contends that the order of assessment is bad in law. Decide the validity of the contentions of Mr. Nitin.
- (ii) SRM Tech Ltd. is engaged in the manufacture of multi-layer tubes and other specialty packaging and plastic products. It came out with an initial public issue of shares during the relevant assessment year and deposited the share application money received in banks. The share capital was received by the SRM Tech Ltd. to meet capital expenditure for setting up of its factory. As the funds were not immediately required, it made temporary deposits with bank which earned interest. This interest income of ₹ 1.71 crores was treated as abatement of capital cost of the

⁷ It was so held by the Supreme Court in CIT v. Kotak Securities Ltd (2016) 383 ITR 1

project/factory by the company and set off such interest earned against public issue expenses, in the books of account. The AO is of the opinion that the same should be treated as revenue receipt and taxed the same as income from 'Other Sources'. Decide the correctness of action of the Assessing Officer.

- (iii) M/s Jonga and Jonga decided to expand its jeep product line and entered into an agreement with K Inc., an American company, which agreed to sell it dies, welding equipment and die models. The purchase consideration was agreed at \$ 65000 including cost, insurance and freight and K Inc., agreed to advance a loan to the assessee at 6% interest per annum repayable after 10 years in instalments. The Reserve Bank of India and the concerned Ministry approved the loan agreement.

Later on, XL Inc., took over K Inc., and agreed to waive the principal amount of loan advanced by K Inc., to Jonga and Jonga and to cancel the promissory notes as and when they matured. This was communicated to the assessee-company which filed its return showing ₹ 35 Lakh as cessation of liability in its books of account.

The Income-tax Officer concluded that the waiver of the loan amount represented income and held that the sum of ₹ 35 Lakh is taxable under section 28(iv) as income. The alternate argument of the Revenue authorities was that the sum would be taxable under section 41(1) as a waiver of a trading liability.

Examine the validity of Assessing Officer's action. **(2 x 4 = 8 Marks)**

- (b) M/s. Raghuram Co. Ltd., Mumbai entered into the following agreements with various non-resident entities during the previous year 2018-19:
- (i) Paid ₹ 4,00,000 to M/s. Neil Inc., a company based in USA for online advertisement of its products. M/s. Neil Inc., does not have a PE in India.
 - (ii) Paid ₹ 50,000 to Mr. David, a non-resident individual, against providing digital space for online advertisement of its products.
 - (iii) Paid ₹ 1,55,000 to M/s LOX Ltd., for providing a platform for sale of its used furniture items. M/s. LOX Ltd., is a company based in New Zealand and does not have a PE in India.

Discuss the relevant provisions of Income-tax Act, in respect of such agreements and also state the tax implications of such payments. **(6 Marks)**

Answer

- (a) (i) The issue under consideration in this case is whether the order of assessment of deceased person completed without bringing the legal representative on record is bad in law.

As per section 159(2), for making a reassessment of the income of the deceased person, any proceeding taken against the deceased before his death shall be

deemed to have been taken against the legal representative and may be continued against the legal representative from that stage.

In a case where an assessee dies pending any assessment proceedings, the Assessing Officer is required to pass appropriate orders of assessment after due notice to legal representative of deceased assessee.

However, in the instant case, the Assessing Officer continued the assessment proceedings without bringing Mr. Nitin, the legal heir, on record by issuing any notice for such proceedings after the death of his father on 15.01.2019.

Therefore, the contention of the Mr. Nitin that the order of assessment is bad in law, is correct.

Note – *The facts of the case are similar to the facts in CIT vs. Dalumal Shyamumal (2005) 276 ITR 62 wherein the above issue came up before the MP High Court. The above answer is based on the rationale of the High Court in the said case.*

- (ii) The issue under consideration is whether the interest income from share application money is taxable under the head ‘Income from Other Sources’, or can the same be set-off against public issue expenses.

The assessee-company is statutorily required to keep share application money in a separate account till the allotment of shares was completed. Part of the share application money would normally have to be returned to unsuccessful applicants, and therefore, the entire share application money would not ultimately be appropriated by the company. The interest earned was inextricably linked with the requirement of raising share capital.

Any surplus money deposited in the bank for the purpose of earning interest is liable to be taxed as “Income from Other Sources”. However, the share application money is deposited with the bank not to make additional income but to comply with the statute. The interest accrued on such deposit is merely incidental.

Moreover, the issue of shares relates to capital structure of the company and hence, expenses incurred in connection with the issue of shares are to be capitalized.

Thus, the contention of the Assessing Officer that the interest accrued by SRM Tech Ltd. of ₹ 1.71 crores on deposit of share application money with bank is taxable as income from other sources is **not correct**.

Such interest is eligible for set off against the public issue expenses and hence, not taxable as “Income from Other Sources”

Notes –

- (1) *The facts of the case are similar to the facts in CIT v. Sree Rama Multi Tech Ltd. [2018] 403 ITR 426, wherein the above issue came up before the Apex*

Court. The above answer is based on the rationale of the Supreme Court in the said case.

- (2) **Alternative Answer** – The facts given in the question do not mention about the statutory requirement of deposit of application money. Also, it states that the share capital was received by SRM Tech Ltd. to meet the capital expenditure for setting up its factory. Reference to share capital instead of share application money appears to indicate that the process of allotment is complete. Furthermore, it is mentioned that as the funds were not immediately required, the company made temporary deposits with bank which earned interest.

Due to these reasons, it is possible to take a view that interest earned on temporary deposit of share capital (and not share application money) with bank, which is to be used to meet the capital cost of factory, is deductible from the cost of the asset(s). It was so held by the Karnataka High Court in ***Pr Commissioner Of Income Tax vs M/S Bank Note Paper Mill India Pvt. Ltd.***

Even if this view is taken, the contention of the Assessing Officer would be **incorrect**.

- (iii) The issue under consideration is whether the sum due by the assessee, M/s. Janga and Janga, to K Inc, which has been waived off later on by XL Inc. (which took over K Inc.), constitutes taxable income in the hands of the assessee.

As per section 28(iv), the value of any benefit or perquisite, whether convertible into money or not, arising from business or the exercise of the profession is chargeable to tax under the head “Profits and gains from business or profession”.

Where an allowance or deduction has been made in any assessment year in respect of trading liability incurred by assessee and the assessee has obtained some benefit in respect of such trading liability by way of remission or cessation thereof, then, the value of benefit accruing to him shall be taxed as business income under section 41(1) of that previous year

For applicability of section 28(iv), income must arise from business or profession and the benefit received has to be in non-monetary form. In the instant case, the amount of ₹ 35 lakh, being a cash receipt, therefore, does not fall under section 28(iv).

Further, for being covered under section 41(1), the assessee-company should have claimed an allowance or deduction in any assessment for any year in respect of a trading liability incurred by the assessee. Subsequently, during any previous year, if the creditor waives such liability, the assessee-company would be liable to pay tax under section 41.

In the instant case, the loan was taken for procurement of capital assets, namely, plant, machinery and tooling equipment. The purchase amount had not been debited to the trading account or to the profit and loss account in any of the

assessment years. Hence, waiver of such loan would not tantamount to cessation of a trading liability.

Thus, the action of Assessing Officer is not correct. The amount of loan waived would not be taxable either under section 41(1) or under section 28(iv).

Notes -

(1) As per section 2(24)(xviii), assistance in the form of waiver by the Central Government or State Government or any authority or body or agency in cash or kind to the assessee would be included in the definition of “income”. In this case, the waiver is by a foreign company, and hence, is not included within the scope of definition of “income” under section 2(24).

Further, it may be noted that as per Explanation 10 to section 43(1), deduction on account of, subsidy or grant or reimbursement, by whatever name called, received from any person has to be made while computing actual cost. Since waiver has not been expressly included in the said Explanation, it is possible to take a view that the same is not deductible while computing the actual cost. However, if a view is taken that “waiver” is included within the scope of the phrase “by whatever name called” in the said Explanation, then, the same has to be deducted while computing actual cost.

*(2) The facts of the case are similar to the facts in **CIT v. Mahindra and Mahindra Ltd. [2018] 404 ITR 1**, wherein the above issue came up before the Apex Court. The above answer is based on the rationale of the Supreme Court in the said case.*

- (b) Chapter VIII of the Finance Act, 2016, provides for an equalisation levy of 6% of the amount of consideration for specified services received or receivable by a non-resident not having permanent establishment (PE) in India, from a resident in India who carries out business or profession, or from a non-resident having PE in India.

“Specified services” means -

- (i) Online advertisement;
- (ii) Any provision for digital advertising space or any other facility or service for the purpose of online advertisement;
- (iii) Any other service as may be notified by the Central Government.

However, equalization levy is not chargeable where the aggregate amount of consideration for specified service received or receivable in a previous year by the non-resident from a person resident in India and carrying on business or profession, or from a non-resident having a PE in India, does not exceed ₹ 1 lakh.

Further, equalization levy is not attracted where payment for specified service is not for the purposes of carrying out business or profession.

- (i) In this case, equalisation levy @6% is chargeable on the amount of ₹ 4,00,000 received by M/s Neil Inc., a non-resident not having a PE in India, from

M/s Raghuram Co. Ltd., an Indian company for online advertisement of its products. Accordingly, M/s Raghuram Co. Ltd. is required to deduct equalisation levy of ₹ 24,000 i.e., @6% of ₹ 4 lakhs, being the amount paid towards online advertisement services provided by M/s Neil Inc.

Non-deduction of equalisation levy would attract disallowance under section 40(a)(ib) of 100% of the amount paid to M/s. Neil Inc. while computing business income of M/s. Raghuram Co. Ltd.

- (ii) In this case, equalisation levy is **not** chargeable as the amount of consideration of ₹ 50,000 for digital space for online advertisement paid to Mr. David does not exceed ₹ 1,00,000.
- (iii) In this case, equalisation levy is **not** chargeable on the amount of ₹ 1,55,000 received by M/s LOX Ltd., a non-resident not having a PE in India, from M/s Raghuram Co. Ltd., an Indian company, since the said payment was for providing a platform for sale of its used furniture items and not for the purposes of carrying on business or profession.

Question 6

- (a) *Mr. Jayant and Mr. Basant, created, a trust, out of the insurance policy amount received upon the death of their father. The trust deed named Jayant and Basant as the trustees and Mrs. Kamla and Mrs. Vimla (their sisters) as the beneficiaries. However, it is the discretion of the trustees that they may either accumulate the net income of the trust or pay the same to any one or both the beneficiaries. During the previous year 2018-19, the total income of the trust amounted to ₹ 10,50,000. You are required to discuss the relevant provisions of the Income-tax Act in this regard and calculate the tax payable by the trust, if any.*

What would be your answer if the trust was created under the 'Will' of the deceased father and such trust is the only trust so created under the 'Will'? **(4 Marks)**

- (b) *Under the provisions of a tax treaty between India and Country V, if a resident of country V makes any capital gains by selling the shares in any Indian Company, such capital gains will be taxable only in Country V and it will be exempt from tax in India. However, as an exception it is also provided that, such exemption is not available if the, transferor holds more than 10% interest in the equity capital of the Indian Company. VFX Ltd., a resident in Country V floated two wholly owned subsidiaries in country V. On 1.4.2018, both the subsidiaries bought 9% shareholding in XYZ Co. Ltd., an Indian Company. These subsidiaries do not have any other income. On 31.12.2018, both of them sold the investment in XYZ Co. Ltd. Each of the subsidiaries claim exemption from Indian capital gains tax amounting to ₹ 2.5 crores from such sale, as each is holding less than 10% equity shares in the Indian Company. Can GAAR be invoked in such case to deny the treaty benefit?*

Will your answer be different if the capital gain tax on such sale is calculated at ₹ 1.2 crores each? **(4 Marks)**

- (c) *For the Assessment Year 2018-19, Mr. John, was directed to carry out a special audit of his accounts under section 142(2A) on 1.8.2018, without giving him an opportunity of being heard.*

Answer the following questions in this regard:

- (i) *Can the assessee contend that since reasonable opportunity of being heard is not provided to him by the Assessing Officer, such notice requiring the special audit of accounts is not valid?*
- (ii) *If the assessee decides to get his books of account audited under section 142(2A), what will be the due date by which he has to submit the audit report (including the extended time, if any, allowed to him)?*
- (iii) *If the assessee intentionally does not comply with the directions. How much penalty can be levied on him?*
- (iv) *For failure to get the books of account audited 'under section 142(2A), can prosecution proceedings be launched against the assessee? If yes, what will be the quantum of punishment for such default?*
- (v) *Can the assessee approach the Settlement Commission to grant immunity from penalty and prosecution proceedings initiated against him? If yes, discuss the power of Settlement Commission to grant immunity in this regard.* **(6 Marks)**

Answer

- (a) The trust created by Mr. Jayant and Mr. Basant out of the insurance policy amount received upon the death of their father is a private discretionary trust, as it vests with the trustees a discretionary power to pay the beneficiaries, or accumulate the income, as the trustees think fit.

In case of a private discretionary trust, declared by a duly executed trust deed, where the shares of the beneficiaries are unknown⁸, as in this case, the trustees, Mr. Jayant and Mr. Basant, would be liable as representative assesseees.

Since the income of the trust does not include profits and gains of business, it is taxable at the maximum marginal rate of 35.88% [i.e., 30% + surcharge@15% + cess@4%]. The tax payable would be ₹ 3,76,740, being 35.88% of ₹ 10,50,000.

⁸ It is presumed that the shares are unknown.

However, where the trust is created under the "Will" of the deceased father and such trust is the only trust so created under the "Will", then, the income of the trust would be chargeable to tax as if it were the income of an association of persons.

- (b) The arrangement by VFX Ltd., a resident in Country V, of floating two wholly owned subsidiaries and splitting the investment in equity shares of the Indian company through such subsidiaries appears to be with the intention of obtaining tax benefit under the treaty between India and Country V, so that the individual subsidiaries do not hold more than 10% interest in the equity capital of the Indian company.

Further, there appears to be no commercial substance in creating two subsidiaries as they do not change the economic condition of investor VFX Ltd. in any manner (i.e. on business risks or cash flow), and reveals a tainted element of abuse of tax laws.

Since the tax benefit in the P.Y.2018-19 in aggregate is ₹ 5 crores (₹ 2.5 crores x 2), which exceeds the specified threshold of ₹ 3 crores, the arrangement can be treated as an impermissible avoidance arrangement and GAAR can be invoked. Consequently, treaty benefit would be denied by ignoring the two subsidiaries, or by treating the two subsidiaries as one and the same company for tax computation purposes.

If the capital gains tax on such sale is calculated at ₹ 1.2 crores each, the tax benefit of ₹ 2.4 crores would be less than the specified threshold of ₹ 3 crores. Hence, GAAR cannot be invoked in such case.

- (c) (i) As per the proviso to section 142(2A), the Assessing Officer shall not direct the assessee to get the accounts audited unless the assessee has been given a reasonable opportunity of being heard.

Accordingly, the contention of the assessee that notice requiring special audit is not valid since reasonable opportunity of being heard has not been provided to him by the Assessing Officer **is correct**.

- (ii) The maximum period (including extended time, if any, allowed) within which the assessee has to submit his audit report is 180 days from 1.8.2018, being the date on which direction to carry out a special audit of accounts under section 142(2A) is received by the assessee. Accordingly, in this case, the assessee has to submit his audit report by 27.1.2019.
- (iii) Penalty of ₹ 10,000 is leviable under section 272A(1)(d) for failure to comply with a direction issued under section 142(2A).
- (iv) If the assessee wilfully fails to comply with a direction issued to him under section 142(2A), he shall be punishable with rigorous imprisonment for a term which may extend to one year and with fine under section 276D.

- (v) The assessee can approach the Settlement Commission to grant immunity from penalty and prosecution, if the additional amount of income-tax payable on income disclosed in the settlement application exceeds ₹ 50 lakh, where the assessee is the subject matter of search and ₹ 10 lakh, in other cases.

If the Settlement Commission is satisfied that the assessee has co-operated with it in the conduct of proceedings before it and has made a true disclosure of income, and the manner in which such income has been derived, it may grant to such person immunity from penalty and prosecution for failure to comply with direction under section 142(2A).

However, the Settlement Commission cannot grant immunity from prosecution where prosecution proceedings have been initiated before the date of receipt of application under section 245C.