PAPER – 7: DIRECT TAX LAWS

Working notes should form part of the answer.
*Question No.**1** is compulsory.*
*Answer any **five** questions from the remaining **six** questions.*
All questions relate to Assessment Year 2017-18, unless stated otherwise in the question.

Question 1

(a) Viraj Exports Limited, a domestic company, earned profit of ₹ 95 lakhs as per statement of Profit and Loss for the year ended 31.03.2017, after debiting or crediting the following items:

			₹
(i)	*Items debited to statement of profit and loss :*		
	(a)	*Provision for Income-tax (including interest of ₹ 50,000)*	*5,00,000*
	(b)	*Sales tax liability*	*70,000*
	(c)	*Depreciation*	*4,00,000*
	(d)	*Interest to financial institutions unpaid before due date of filing of return of income*	*1,20,000*
	(e)	*Reserves for currency exchange fluctuation*	*1,30,000*
	(f)	*Penalty for infraction of law*	*60,000*
(ii)	*Items credited to statement of profit and loss:*		
	(a)	*Dividend received on investment in Indian companies*	*1,40,000*
	(b)	*Long term profit on sale of rural agricultural land*	*10,00,000*
	(c)	*Profit on unit established in SEZ*	*8,00,000*
	(d)	*Net agricultural income*	*6,00,000*
	(e)	*Royalty received from patents developed and registered in India*	*40,00,000*

Other Information:

(a) Depreciation as per the Income-tax Act, 1961 ₹ 3,50,000.

(b) Depreciation (as per books) includes ₹ 1,90,000 on account of revaluation of assets.

(c) Interest on borrowed capital ₹ 1,00,000 payable to Y, not debited to profit and loss account.

(d) Profit and Loss account in balance sheet on the assets side as at 31.03.2017 was ₹ 4,70,000 which included unabsorbed depreciation of ₹ 4,10,000.

(e) The company is an eligible assessee as per the provisions of section 115BBF of the Income-tax Act, 1961.

Compute the minimum alternate tax under section 115JB of the Income-tax Act, 1961.

(10 Marks)

The Suggested Answers for Paper 7:- Direct Tax Laws are based on the provisions of Income-tax law as amended by the Finance Act, 2016, which is relevant for May, 2017 examination. The relevant assessment year is A.Y.2017-18.

(b) Alpha Ltd. has two industrial undertakings. Unit 1 is engaged in the production of television sets and unit 2 is engaged in the production of refrigerators. The company has, as part of its restructuring program, decided to sell unit 2 as a going concern, by way of slump sale for ₹ 300 lakhs to a new company called Beta Ltd., in which it holds 85% equity shares. The following are extracted from the balance sheet of Alpha Ltd. as on 31st March, 2017:

	(₹ in lakhs)	
	Unit-1	***Unit-2***
Fixed assets	*112*	*158*
Debtors	*88*	*68*
Inventories	*85*	*22*
Liabilities	*33*	*65*

	(₹ in lakhs)
Paid-up share capital	*231*
General Reserve	*160*
Share premium	*39*
Revaluation reserve	*105*

The company had set up unit 2 on 1st April, 2012. The written down value of the block of fixed assets for tax purpose as on 31st March, 2017 is ₹ 130 lakhs out of which ₹ 75 lakhs are attributable to Unit 2.

(i) Determine what would be the tax liability of Alpha Ltd. on account of this slump sale;

(ii) How can the restructuring plan of Alpha Ltd. be modified, without changing the amount of consideration, in order to make it more tax efficient? (10 Marks)

Answer

(a) Computation of Book Profit for levy of MAT under section 115JB for A.Y.2017-18

Particulars	₹	₹
Net Profit as per Statement of Profit and Loss		95,00,000
Add: Net profit to be increased by the following amounts as per *Explanation 1* below section 115JB(2):		
- Provision for income-tax (including interest of ₹ 50,000) [As per *Explanation 2* below section 115JB(2), income-tax shall include, *inter alia*, any interest charged under the Act, therefore, whole of the amount of provision for income-tax including ₹ 50,000 towards interest	5,00,000	

payable to be added back as per clause (a) of *Explanation 1* below section 115JB(2)]		
- Depreciation [to be added back as per clause (g) of *Explanation 1* below section 115JB(2)]	4,00,000	
- Reserves for currency exchange fluctuation [amount carried to any reserves, by whatever name called, to be added back as per clause (b) of *Explanation 1* below section 115JB(2)]	1,30,000	
		10,30,000
		1,05,30,000
Less: Net profit to be decreased by the following amounts as per *Explanation 1* below section 115JB(2):		
- Dividend received on investment in Indian companies [Dividend income is to be reduced while computing the book profit as per clause (ii) of *Explanation 1* below section 115JB(2), since such dividend is exempt under section 10(34)]	1,40,000	
- Net agricultural income [Net agricultural income is to be reduced as per clause (ii) of *Explanation 1* below section 115JB(2), since it is exempt under section 10(1)]	6,00,000	
- Royalty received from patents developed and registered in India [Such royalty is to be reduced while computing book profit as per clause (iig) of *Explanation 1* below section 115JB(2) since the same is chargeable to tax under section 115BBF]	40,00,000	
- Depreciation other than depreciation on revaluation of assets is to be reduced while computing book profit as per clause (iia) of *Explanation 1* below section 115JB(2) [₹ 4,00,000 – ₹ 1,90,000]	2,10,000	
- Unabsorbed depreciation or brought forward business loss, whichever is less, as per books of account. [Lower of unabsorbed depreciation ₹ 4,10,000 and brought forward business loss ₹ 60,000 as per books of account is to be reduced while computing book profit as per clause (iii) of *Explanation 1* below section 115JB(2)]	60,000	
		50,10,000
Book Profit		**55,20,000**

Computation of Minimum Alternate Tax payable under section 115JB

Particulars	₹
18.50% of book profit (₹ 55,20,000 x 18.50%)	10,21,200
Add: Education cess@2%	20,424
Secondary and higher education cess@1%	10,212
Minimum Alternate Tax under section 115JB	10,51,836
MAT liability (rounded off)	**10,51,840**

Notes:

(1) Only the specified items mentioned under *Explanation 1* below section 115JB(2) can be added back to the net profit as per the Statement of Profit and Loss prepared as per the Companies Act for computing book profit for levy of MAT. Since the following items are not specified in the said *Explanation 1*, the same cannot be added back for computing book profit:

- Sales tax liability
- Unpaid interest to financial institutions
- Penalty for infraction of law

(2) Long term profit on sale of rural agricultural land is not chargeable to tax under the normal provisions of the Income-tax Act, 1961, since rural agricultural land is not a capital asset as per section 2(14). However, the same cannot be reduced while computing book profit, since no express provision is there under section 115JB to exclude such profits while computing book profit. Therefore, profit on sale of rural agricultural land reflected in the statement of profit and loss shall be part of book profit, though the same is not chargeable to tax as per the normal provisions of the Act, since rural agricultural land is not a capital asset under section 2(14).

Note - An alternate view is possible that the capital gains on sale of rural agricultural land is to be reduced while computing book profit, by considering the same as agricultural income [based on the interpretation derived from a plain reading of clause (a) of section 2(1A) alongwith *Explanation 1* thereto].

(3) As per the proviso to section 115JB(6), the profits from unit established in special economic zone cannot be excluded while computing the book profit, and hence, such income would be liable for MAT.

(4) No adjustment is required in respect of interest on borrowed capital of ₹ 1,00,000 payable to Y, not debited to profit and loss account, since the net profit as per the Statement of Profit and Loss prepared as per the Companies Act and the items specified for exclusion/inclusion under section 115JB alone have to be considered while computing the book profit for levy of MAT.

(5) Depreciation as per Income-tax Act, 1961 is not relevant for computing book profit for levy of MAT.

(b) Computation of Capital Gain on Slump Sale

(i) As per section 50B, any profits or gains arising from the slump sale effected in the previous year shall be chargeable to income-tax as capital gains arising from the transfer of capital assets and shall be deemed to be the income of the previous year in which the transfer took place. If the assessee owned and held the undertaking transferred under slump sale for more than 36 months before slump sale, the capital gain shall be deemed to be **long-term capital gain.**

Indexation benefit is not available in case of slump sale [Section 50B(2)]

Ascertainment of tax liability of Alpha Ltd. from slump sale of Unit-2

Particulars	₹
Slump sale consideration	3,00,00,000
Less: Cost of acquisition (net worth) [*See Working Note below*]	1,00,00,000
Long-term capital gain (as Unit-2 is held for more than 36 months)	**2,00,00,000**
Calculation of tax liability	
Income tax @20% on long term capital gain under section 112	40,00,000
Surcharge @7%, since total income exceeds ₹ 1 crore but does not exceed ₹ 10 crore	2,80,000
	42,80,000
Education cess@2% and Secondary and higher education cess @1%	1,28,400
Total tax liability	**44,08,400**
Working Note: Net Worth of Unit -2	
WDV of block of assets	75,00,000
Debtors	68,00,000
Inventories	22,00,000
	1,65,00,000
Less: Liabilities	65,00,000
Net Worth	**1,00,00,000**

(ii) **Tax Advice**

(a) Transfer of any capital asset by a holding company to its 100% Indian subsidiary company is exempt from tax under section 47(iv). Therefore, if it is possible for Alpha Ltd., it should try to acquire the entire shareholding of Beta Ltd and make Beta Ltd its wholly owned subsidiary. Thereafter upon slump sale, the resultant capital gain shall not attract tax liability.

However, in such case also, Alpha Ltd. should not transfer any shares in Beta Ltd. for 8 years from the date of slump sale.

(b) Alternatively, if acquisition of 15% share is not feasible, Alpha Ltd. may think about demerger plan of Unit 2 to get the exemption from tax by virtue of section 47(vib).

Question 2

Preetam Motors Limited is engaged in manufacturing and selling of cars, having an annual turnover of ₹ 5000 lakhs. The net profit of the company as per Profit and Loss account for the year ended 31st March, 2017 is ₹ 150 lakhs, after debiting or crediting the following items:

(i) One time licence fee of ₹ 20 lakhs paid to a foreign company for obtaining franchise on 10.06.2016.

(ii) Dividend of ₹ 12 lakhs received from a foreign company in which the company holds 32% of equity share capital of the company. ₹ 50,000 was also expended on earning this income.

(iii) ₹ 6 lakhs paid to H Ltd. towards feasibility study conducted for examining proposals for technological advancement relating to existing business; however, the project was abandoned without creating a new asset.

(iv) Payments due to railways for use of the assets for transportation of cars during F.Y 2016-17, the company is likely to make the payment in the month of December 2017 ₹ 2 lakhs.

(v) Contributions made to an approved research association used for the purpose of research in social science or statistical research under section 35(1)(iii) ₹ 1 lakh.

(vi) Deprecation charged to the statement of profit and loss account ₹ 20 Lakhs.

(vii) The opening and closing stock for the year were ₹ 90 lakhs and ₹ 68 lakhs, respectively. They were overvalued by 10%.

(viii) Payment of ₹ 18,000 and ₹ 12,000 by cash on 15th February, 2017 by two separate vouchers to a contractor who carried out work at office premises.

(ix) Legal fees incurred in defending title of factory premises of the company ₹ 3 lakhs.

(x) Profit of ₹ 3 lakhs from hedging contracts entered into for meeting out the loss in foreign currency payment towards an imported machinery purchased from Germany for ₹ 90 lakhs, which was installed on 20.12.2016.

(xi) The company, during the year, employed 100 new workers in the factory, which was 15% of the existing work force employed on the last day during the earlier year. It paid ₹ 15 lakhs as additional wages. The workmen were employed from 01.05.2016.

(xii) Profit on sale of land ₹ 20 lakhs.

(xiii) Provision for warranty is made for all vehicles sold on scientific and reliable basis for replacement of some spares, free of cost. The statistical data indicates that without such warranty, no customer is prepared to buy a vehicle.

***Additional Information**:*

(a) Normal depreciation allowable as per the Income-tax Act, 1961 ₹ 22 lakhs.

(b) Additional depreciation on plant and machinery imported and installed during December 2016 has not `been considered while calculating depreciation as per the Income-tax Act, 1961 as above. The company is not eligible for any deduction under section 35AD of the Income-tax Act, 1961.

(c) The land sold during the year for ₹ 70 lakhs (Guideline Value as per stamp valuation authority ₹ 60 lakhs) was purchased by the company during F.Y. 2012-13. This was the only land available with the company as on 01.04.2016.

(d) Cost inflation index F.Y. 2012-13: 852, F.Y. 2016-17: 1125.

Compute the total income and tax payable by Preetam Motors Ltd. (giving reasons for treatment of each item) for the A.Y.2017-18. Ignore MAT provisions. (16 Marks)

Answer

Computation of Total Income of Preetam Motors Ltd. for the A.Y.2017-18

	Particulars	Amount (₹)
I	**Profits and gains of business and profession**	
	Net profit as per profit and loss account	1,50,00,000
	***Add:* Items debited but to be considered separately or to be disallowed**	
(i)	**Licence fee for obtaining franchise ₹ 20,00,000 *less* depreciation thereon of ₹ 5,00,000**	15,00,000
	[Franchise is in the nature of an intangible asset eligible for depreciation @ 25%. Since one-time licence fees of ₹ 20 lakh paid to a foreign company for obtaining franchise has been debited to profit and loss account, the same has to be added back].	
	Depreciation @ 25% has to be provided in respect of the intangible asset, since it has been used for more than 180 days during the previous year]	
(iii)	**Payment to H Ltd. for feasibility study**	NIL
	[Payment towards feasibility study conducted for examining proposals for technological advancement relating to the existing business, where the project was abandoned without creating a new asset, is allowable as revenue expenditure **(**as per the Delhi High Court ruling in *CIT v. Priya Village Roadshows Ltd. (2011) 332 ITR 594)*. Therefore, ₹ 6 lakhs paid towards feasibility study would be an allowable expenditure.	
	Since such expenditure has already been debited to profit and loss account, no further adjustment is required.]	
(iv)	**Payment due to railways for use of railway assets**	2,00,000
	[As per section 43B, sum payable to Indian Railways for use of railway assets is allowable as deduction in the year in which the liability to pay such sum is incurred, only if payment is made on or before the due date of filing of return.	

	Since the payment of ₹ 2 lakhs is likely to be made in December, 2017 i.e., after the due date of filing return of income, the same would be disallowed in the P.Y.2016-17. Since such payment is debited to the profit and loss account, the same has to be added back]		
(vi)	**Depreciation debited in books of accounts**		20,00,000
(vii)	**Over-valuation of opening and closing stock** [₹ 22 lakhs × 10/110]		2,00,000
	[The amount by which stock is over-valued has to be added for computing business income. ₹ 22 lakhs (₹ 90 lakhs, being the opening stock less ₹ 68 lakhs, being the closing stock) being the difference between opening and closing stock, has to be adjusted to remove the effect of over-valuation]		
(viii)	**Cash payments to a contractor** for office work (₹18,000+ ₹12,000)		30,000
	[As per section 40A(3), cash payments exceeding ₹ 20,000 in a day to a person is disallowed. Hence, cash payment of ₹18,000 and ₹12,000 to a contractor for office work is disallowed, since the aggregate cash payments to him in a day in respect of an expenditure exceeds the limit of ₹ 20,000]		
(ix)	**Legal fees**		Nil
	[Legal fees incurred in defending title to factory premises is a revenue expenditure incurred the purpose of business and is, therefore, allowable as deduction *[Dalmia Jain & Co. Ltd. v. CIT (1971) 81 ITR 754 (SC)]* Since the legal fees is already debited to profit and loss account, no further adjustment is required]		
			1,89,30,000
	Less: **Items credited to statement of profit and loss, but not includible in business income**	**Amount (₹)**	
(ii)	**Dividend received from foreign company less expenditure incurred to earn dividend (**₹ 12,00,000 **-** ₹ 50,000**)**	11,50,000	
	[Dividend of ₹12 lakhs received from foreign company is to be taxed under the head "Income from other sources". Since the same has been credited to profit and loss account, it has to be deducted while computing business income. Consequently, expenditure of ₹ 50,000 relating to the same which has been debited to profit and loss account has to be added back. In effect, the net amount of ₹ 11,50,000 has to be deducted]		
(x)	**Profit from hedging contract**	3,00,000	
	[Hedging contract is entered into for safeguarding against any loss that may arise due to currency fluctuation. The profit from such contract entered into for meeting loss in foreign		

	currency payments towards imported machinery has to be adjusted against the cost of plant and machinery. Since such amount has been credited to profit and loss account, the same has to be deducted]		
(xii)	**Profit on sale of land** [Chargeable to tax under the head "Capital Gains"]	20,00,000	**34,50,000**
			1,54,80,000
	Less: **Expenditure to be allowed**		
(v)	**Contribution to approved research association for social science or statistical research** [Contribution to approved research association for social science or statistical research qualifies for weighted deduction@125% under section 35(1)(iii). Since 100% of contribution has already been debited to the statement of profit and loss, the balance 25% has to be deducted while computing business income].	25,000	
(a)	**Depreciation as per Income-tax Act, 1961** [Since there is a reduction in the cost of plant and machinery on account of hedging profit of ₹ 3,00,000, the excess depreciation on ₹ 3,00,000 has to be added back to depreciation given as per Income-tax Act, 1961. Hence, ₹ 22,00,000 – ₹ 22,500 (₹ 3,00,000 x 7.5%, being 50% of 15%, since the machinery is put to use for less than 180 days)] **Alternate view**: Since the question states that additional depreciation (given in point (b) of "Additional Information) has not been considered on imported plant and machinery, it is possible to assume that in the absence of specific mention, normal depreciation (mentioned in point (a) of "Additional Information") has been considered on such plant and machinery. If this view is taken, ₹ 22,00,000 is the correct figure of depreciation and no further adjustment is required.	21,77,500	
(b)	**Additional depreciation on plant and machinery** [Since plant and machinery was purchased on 20.12.2016, it was put to use for less than 180 days during the year. Hence additional depreciation is to be restricted to 10% (i.e., 50% of 20%) of ₹ 87 lakhs, being actual cost of new plant & machinery after adjusting profit from hedging contract.[1]]	8,70,000	
			30,72,500
	Profits and gains from business and profession		**1,24,07,500**

[1] *Balance additional depreciation of ₹ 8.7 lakhs can be claimed in the next year i.e., A.Y.2018-19*

II	**Capital Gains**		
	Full value of consideration[2]	70,00,000	
	Less: Indexed cost of acquisition [₹ 50,00,000 × 1125/852]	66,02,113	
	Long-term capital gain		3,97,887
III	**Income from Other Sources**		
	Dividend received from foreign company		12,00,000
	[As per section 115BBD, dividend received by an Indian company from a foreign company in which it holds 26% or more in nominal value of the equity share capital of the company, would be subject to a concessional tax rate of 15%. This rate of 15% would be applied on gross dividend, in the sense, that no expenditure would be allowable in respect of such dividend. Therefore, dividend of ₹ 12 lakhs received from a foreign company, in which it holds 32% in nominal value of equity share capital, would be subject to tax@15%. No deduction is allowable in respect of ₹ 50,000 expended on earning this income.]		
	Gross Total Income		**1,40,05,387**
	***Less:* Deductions under Chapter VI-A**		
	Deduction under section 80JJAA		
	[Preetam Motors Ltd. is eligible for deduction under section 80JJAA since it is subject to tax audit under section 44AB for A.Y. 2017-18 (as its total turnover exceeds ₹ 1 crore) and it has employed additional employees during the P.Y. 2016-17. Additional wages is ₹ 15 lakhs Deduction under section 80JJAA = 30% of ₹ 15 lakhs]		**4,50,000**
	Total Income		**1,35,55,387**
	Total Income (rounded off)		1,35,55,390

Computation of tax payable of Preetam Motors Ltd. for the A.Y.2017-18

Particulars	Amount (₹)
Tax@ 15% on dividend from specified foreign company of ₹ 12,00,000	1,80,000
Tax@20% under section 112 on long term capital gain of ₹ 3,97,890	79,578

[2] *The provisions of section 50C would **not** be attracted as the stamp duty value is less than the actual consideration.*

Tax@30% on the balance total income of ₹1,19,57,500[3]	35,87,250
	38,46,828
Add: Surcharge @7% (since total income > ₹1 crore but < ₹10 crore)	2,69,278
	41,16,106
Add: Education cess@2%	82,322
Secondary and higher education cess@1%	41,161
Total tax liability	**42,39,589**
Total tax liability (rounded off)	**42,39,590**

Question 3

(a) Vaamana Pvt. Ltd., has share capital in the form of equity shares. The shares were held up till 31st March, 2015 by four members, C, D, E and F equally. The company made losses/profits for the past three assessment years as follows:

Assessment Year	Business Loss (₹)	Unabsorbed Depreciation (₹)	Total (₹)
2013-14	Nil	5,00,000	5,00,000
2014-15	Nil	2,00,000	2,00,000
2015-16	6,00,000	6,00,000	12,00,000
Total	**6,00,000**	**13,00,000**	**19,00,000**

The above figures have been accepted by the Income-tax Department.

During the previous year ended 31.3.2016, C sold his shares to A and during the previous year ended 31.3.2017, D sold his shares to B.

The profits for the past two previous years are as follows:

31.3.2016 ₹ 8,00,000 (before charging depreciation of ₹ 1,00,000)

31.3.2017 ₹ 15,00,000 (before charging depreciation of ₹ 1,50,000)

Compute the total income for the A.Y. 2017-18. Workings must form part of your answer.

(10 Marks)

(b) D, an individual, filed his return of income for the assessment year 2017-18, erroneously offering for taxation, interest received from notified Relief Bonds exempt under section 10(15), in the said return. The Assessing Officer completed the assessment under section 143(3) on 20.12.2017 accepting the income returned by D. D had furnished complete particulars relating to the interest income in the return of income. D approaches you for

[3] *Since Preetam Motors Ltd. has an annual turnover of ₹ 50 crores, the rate of tax would be 30% for A.Y.2017-18 (considering that the annual turnover of P.Y.2014-15 > ₹ 5 crores)*

advice regarding the steps to be taken to secure exemption of the income. Advise D about the various remedies available under the Income-tax Act, 1961 for the redressal of his grievance. (3 Marks)

(c) A manufacturing company was transporting two of its machines from unit 'X' to unit 'Y' on 1st September, 2016 by a truck. On account of a civil disturbance, both the machines were damaged. The insurance company paid ₹ 5 lakhs for the damaged machines. On these facts, for submitting the return of income for the previous year ending 31st March, 2017, your advice is sought as to, -

(i) Whether the damage of machines results in any transfer vis-a-vis exigibility to capital gains?

(ii) How the amounts received from the insurance company are to be treated for taxability?

(iii) Whether there will be any impact on the written down value of the block of plant and machinery as at 31st March, 2017? (3 Marks)

Answer

(a) C, D, E and F are the four shareholders of Vamana Pvt. Ltd. The shareholding pattern of the company in the last three financial years are given below:

As on 31st day of March	C	D	E	F	A	B
	%	%	%	%	%	%
2015	25	25	25	25	-	-
2016	-	25	25	25	25	-
2017	-	-	25	25	25	25

As per section 79, in case of a closely held company, no loss incurred in the previous year shall be carried forward and set off against the income of the subsequent previous year unless the shares carrying at least 51% of the voting power of the company are beneficially held on the last day of the previous year in which the loss is sought to be set off, by the same shareholders, who beneficially held the shares carrying at least 51% of the voting power on the last day of the previous year in which the loss was incurred.

Since shareholders holding at least 51% of the voting power are the same in the P.Y.2014-15 and P.Y.2015-16, the restriction imposed by section 79 is not applicable for set-off of losses of the P.Y.2014-15 against income of the P.Y.2015-16.

Thus, the total income of Vamana Pvt. Ltd. for the A.Y.2016-17 would be as follows:

Particulars	₹
Business profit	8,00,000
Less: Current year's depreciation	1,00,000

		7,00,000
Less: Brought forward business loss as per section 72(2)	6,00,000	
Unabsorbed depreciation of A.Y. 2013-14	1,00,000	7,00,000
Total Income		**Nil**

Note: Balance unabsorbed depreciation relating to the earlier assessment years can be carried forward to the next assessment year i.e., A.Y. 2017-18 for set-off against income of that year. There is no brought forward business loss and the restriction contained in section 79 is not applicable in case of carry forward of unabsorbed depreciation.

Section 32 governs the carry forward and set off of depreciation for which the shareholding pattern is not relevant at all.

Consequently, the total income for A.Y.2017-18 will be determined as under –

Particulars	₹	₹
Business income		15,00,000
Less: Current year's depreciation		1,50,000
		13,50,000
Less: Unabsorbed depreciation :-		
Assessment year 2013-14 (₹ 5,00,000 – ₹ 1,00,000, being the set-off in the A.Y.2016-17)	4,00,000	
Assessment year 2014-15	2,00,000	
Assessment year 2015-16	6,00,000	
		12,00,000
Total Income for A.Y. 2017-18		**1,50,000**

(b) The following remedies are available to Mr. D under the Income-tax Act, 1961:

(1) **File an appeal before the Commissioner (Appeals):** D can file an appeal under section 246A, against the order of assessment under section 143(3), to the Commissioner (Appeals). An appeal can be filed by an assessee even against inclusion in assessment, of such income erroneously included by him in the return of income [*Delhi High Court in CIT v. Bharat General Reinsurance Co. Ltd. (1971) 81 ITR 303].*

(2) **File a revision petition:** In the alternative, D can file a revision petition under section 264 with the Principal Commissioner or Commissioner of Income-tax seeking exemption of interest from Relief Bonds, not claimed in the return of income and not allowed in the order of assessment.

(3) **File an application for rectification:** The other course of action D could take is to file an application under section 154 with the Assessing Officer, seeking rectification of the order of assessment made. The consistent judicial view is that exemption not claimed by the assessee and not allowed by the Assessing Officer, though the

material relating thereto was in the return of income, constitutes a mistake apparent from the record.

(c) As per section 45(1A), receipt of insurance compensation in the form of money or any asset is to be treated as consideration and capital gain is accordingly to be charged to tax.

The two qualifying conditions prescribed are

(a) the compensation should have been received because of damage or destruction of capital asset; and

(b) the damage or destruction is as a result of, *inter alia*, civil disturbance.

As per the facts of the case, both the conditions are satisfied and therefore, the compensation is to be treated as consideration. By applying the provisions of section 45(1A), our advice to the company regarding the issues raised are as follows:

(i) in the case of damage or destruction as a result of civil disturbance, there is no actual transfer; but it will be treated as deemed transfer and profit and gains from receipt of insurance compensation will be chargeable to tax as capital gain.

(ii) the receipt of insurance compensation of ₹ 5 lakhs has to be treated as the full value of consideration received as a result of transfer of such capital asset.

(iii) in the instant case, as per the provisions of section 43(6)(c), the receipt of compensation of ₹ 5 lakhs calls for adjustment in the written down value of the block of assets. If the written down value is more than ₹ 5 lakhs, then, ₹ 5 lakhs should be deducted from written down value. On the other hand, if the written down value is less than ₹ 5 lakhs, the difference would be treated as short term capital gain[4].

Question 4

*Answer any **four** out of the following five cases (Your answer should cover these aspects: (i) Issue involved, (ii) Provisions applicable, (iii) Analysis and (iv) Conclusion):*

(a) ECO & Co. filed an application for advance ruling for A.Ys. 2010-11, 2011-12 and 2012-13 with the Authority for Advance Ruling (AAR). For the assessment years 2010-11 and 2011-12, notices under section 143(2) were issued to the assessee and subsequently, before the date of filing application with AAR, notice under section 142(1) along with questionnaire was issued. For the assessment year 2012-13, notice under section 143(2) was issued before the date of filing of application with the AAR and notice under section 142(1) along with questionnaire was served on the assessee after the date of filing of application with the AAR.

Can the AAR reject the application on the ground that proceedings are already pending?

(You may assume that the provisions relating to Advance Ruling for the earlier assessment years were the same as those prevailing for the A. Y. 2017-18) (4 Marks)

[4] *It is assumed that no asset was acquired in respect of the block in the relevant previous year*

(b) Atlant Italy, a company incorporated in France, was engaged in manufacture, trade and supply equipment and services for GSM Cellular Radio Telephones Systems. It supplied hardware and software to various entities in India. Software licensed by assessee embodied the process which is required to control and manage the specific set of activities involved in the business use of its customers. Software was also made available to its customers, who used it to carry out their business activities. The Assessing Officer contented that the consideration for supply of software embedded in hardware is 'royalty' under section 9(1)(vi)

Examine the correctness of the action of the Assessing Officer. *(4 Marks)*

(c) Mrs. Santosh filed her return of income for the A.Y.2017-18 declaring total income of ₹ 3.15 Lakhs. The return was processed under section 143(1) and later, the case was selected for scrutiny and statutory notice under section 143(2) was issued. The Assessing Officer, after being satisfied with the replies given for the enquires, completed the assessment by accepting the declared income. Subsequently, the Commissioner invoked revisionary jurisdiction under section 263, holding that the Assessing Officer had not made enquiry properly.

Is invoking of revisionary jurisdiction under section 263 justified? *(4 Marks)*

(d) Kumar Bros, the assessee, is a partnership firm. During the course of assessment proceedings, the Assessing Officer noticed that huge amount of cash was accepted by the firm from its partners during the relevant year corresponding to the AY 2017-18. The Assessing Officer was of the view that interest was given to partners on amounts advanced, which conclusively proved that the transaction are between different persons whereby the firm has accepted loans in cash from the partners and thereby initiated penalty proceeding under section 271D in view of violation of section 269SS.

Is the action of Assessing Officer tenable in law? *(4 Marks)*

(e) The assessee, M/s Career Network, a partnership firm comprising of four partners, who have contributed capital in the books of the firm, but failed to explain satisfactorily the source of receipt in their individual hands. The Assessing Officer has proposed to tax the amounts credited in their accounts in the books of the firm as cash credit in the hands of the partnership firm.

Is the action of the Assessing Officer valid? *(4 Marks)*

Answer

(a) (i) Issue Involved: The issue under consideration in this case is whether the Authority for Advance Rulings can reject an application for advance ruling on the ground that proceedings are already pending before an income-tax authority, where a notice under section 143(2) in pre-printed format has been served.

(ii) Provisions applicable: As per the proviso to section 245R(2), the Authority for Advance Rulings shall not allow the application where the question raised in the application is already pending before any income-tax authority.

(iii) Analysis: The facts of the case are similar to the facts in *Hyosung Corporation v. AAR (2016) 382 ITR 371*, wherein the above issue came up before the Delhi High Court. The Court observed that mere issue of notice under section 143(2) in pre-printed format will not amount to 'proceedings pending' for the purpose of applying the proviso to section 245R(2). However, issue of notice under section 142(1) accompanied by a questionnaire before filing of the application by the assessee with the AAR would tantamount to 'proceedings pending' before an income-tax authority.

(iv) Conclusion: Thus, applying the rationale of the Delhi High Court ruling to the case on hand, the application for the assessment year 2012-13 cannot be rejected by the AAR since notice under section 142(1) issued for the assessment year 2012-13 after the date of filing of application will not result in the proceedings being 'already pending' before an Income-tax authority.

However, for the assessment years 2010-11 and 2011-12, the rejection of the application by AAR is tenable in law, since notice under section 142(1) along with detailed questionnaire was issued before the date of filing of such application.

(b) (i) Issue Involved: The issue under consideration in this case is whether consideration for supply of software embedded in hardware would tantamount to 'royalty' for attracting deemed accrual of income under section 9(1)(vi).

(ii) Provisions applicable: As per section 9(1)(vi), income by way of royalty payable by a person who is a non-resident would be deemed to accrue or arise in India, where the royalty is payable in respect of any right, property or information used or services utilized for the purposes of a business or profession carried on by such person in India or for the purposes of making or earning any income from any source in India.

For this purpose, royalty includes transfer of all or any right for use or right to use a computer software irrespective of the medium through which such right is transferred.

(iii) Analysis: The facts of the case are similar to the facts in *CIT v. Alcatel Lucent Canada (2015) 372 ITR 476*, wherein the above issue came up before the Delhi High Court. The Court observed that the software supply is an integral part of GSM mobile telephone system and is used by the cellular operators for providing cellular services to its customers. Where payment is made for hardware in which the software is embedded and the software does not have independent functional existence, no amount could be attributed as 'royalty' for software in terms of section 9(1)(vi).

(iv) Conclusion: In this case, if it is assumed that the software that was loaded on the hardware and embedded in the system does not have any independent existence, then, there could not be any independent use of such software. If it is so assumed, the rationale of the Delhi High Court ruling can be applied to the case on hand. Accordingly, the action of the Assessing Officer in treating the consideration for supply of software embedded in hardware as royalty under section 9(1)(vi) is **not** correct.

Note - Alternate Answer: *The fact that the software does not have independent functional existence forms the basis of the rationale of the Delhi High Court ruling. Since this fact is not explicitly given in the question and neither can it be inferred from the information given in the question, it is possible to take a view that the software has independent functional existence owing to which consideration for supply of software embedded in hardware would tantamount to 'royalty'. This view is possible owing to the language of the question wherein it has been stated that the software is* ***also*** *made available to its customers, who used it to carry out their business activities. Accordingly, if this view is taken, then, the action of the Assessing Officer in treating the consideration for supply of software having independent functional existence as royalty under section 9(1)(vi) would be correct.*

(c) (i) Issue Involved: The issue under consideration is whether mere non-mention or non-discussion of enquiry made by the Assessing Officer in the assessment order justifies invoking of revisionary jurisdiction under section 263 by the Commissioner.

(ii) Provisions applicable: As per *Explanation 2* to section 263(1), an order passed by the Assessing Officer shall be deemed to be erroneous in so far as it is prejudicial to the interests of the revenue, if, in the opinion of the Commissioner, the order is passed without making inquiries or verification which should have been made. In such a case, the Commissioner can invoke revisionary jurisdiction under section 263.

(iii) Analysis: The facts of the case are similar to the facts in *CIT v. Krishna Capbox (P) Ltd. (2015) 372 ITR 310*, wherein the above issue came up before the Allahabad High Court. The Court observed that in a case where all necessary enquiries were made, mere non-discussion or non-mention in the assessment order cannot lead to the assumption that the Assessing Officer did not apply his mind or that he had not made any enquiry on the subject for the Commissioner to invoke revisionary jurisdiction under section 263.

If queries raised during the assessment proceedings have been satisfactorily responded to by the assessee, the mere fact that it is not dealt with in the assessment order would not lead to a conclusion that proper enquiry was not made.

(iv) Conclusion: In this case, it is assumed that the necessary enquiries were made by the Assessing Officer, but the Commissioner invoked revisionary jurisdiction under section 263 merely due non-discussion/non-mention of the same in the assessment order. Accordingly, applying the rationale of the Allahabad High Court ruling to the case on hand, where necessary enquiries were made by the Assessing Officer and satisfactory replies were given by Mrs. Santosh, the action of the Commissioner in invoking revisionary jurisdiction under section 263 on the ground that the Assessing Officer had not made enquiry properly is **not** justified.

Note - Alternate Answer: *The non-discussion or non-mention of enquiry made by the Assessing Officer in the assessment order forms the basis of the rationale of the Allahabad*

High Court ruling. This is, in fact, the reason why the Commissioner came to a conclusion that the Assessing Officer had not made proper enquiries in the said case.

Since this fact is not explicitly given in the question nor can it be inferred from the information given in the question, it is possible to answer the question on the understanding that the Assessing Officer had in fact not made proper enquiry which ought to have been made. In such a case, the Commissioner can invoke revisionary jurisdiction by applying the provisions of section 263(1) read with clause (a) of Explanation 2 thereto.

(d) **(i)** **Issue Involved:** The issue under consideration is whether penalty under section 271D is imposable for cash loans/deposits received by a firm from its partners in violation of the provisions of section 269SS.

(ii) **Provisions applicable:** Section 269SS prohibits any person from taking any loan or deposit exceeding prescribed limit, otherwise than by way of account payee cheque/ bank draft or use of electronic clearing system through a bank account. In case of contravention of the provisions of section 269SS, penalty equal to the amount of loan or deposit is leviable under section 271D.

Section 273B provides that no such penalty would be leviable if the assessee proves that there is reasonable cause for such failure.

(iii) **Analysis:** The facts of the case are similar to the facts in *CIT v. Muthoot Financiers (2015) 371 ITR 408*, wherein the above issue came up before the Delhi High Court. The Court observed that one view is that a partnership firm not being a juristic person, the *inter se* transaction between the firm and partners are not governed by the provisions of sections 269SS and 269T. A contrary view is that the partners of the firm are distinct as civil entities while the firm as such is a separate and distinct unit for the purpose of assessment.

(iv) **Conclusion**: The Delhi High Court opined that the two different legal interpretations on the relationship between firm and partners could constitute a reasonable cause in a given case for not invoking section 271D read with section 273B. The issue being a debatable one, there was reasonable cause for not levying penalty. Hence, applying the rationale of the Delhi High Court ruling to the case on hand, the action of the Assessing Officer, in levying penalty under section 271D in this case is **not** tenable in law.

(e) **(i)** **Issue Involved:** The issue under consideration is whether capital contribution of the individual partners credited to their accounts in the books of the firm can be taxed as cash credit in the hands of the firm, where the partners have admitted their capital contribution but failed to explain satisfactorily the source of receipt in their individual hands.

(ii) **Provisions applicable:** As per section 68, if an assessee fails to explain the nature and source of credit entered in its books of account of any previous year, the sum so credited shall be charged as to income-tax as income of the assessee of that previous year.

(iii) Analysis: The facts of the case are similar to the facts in *CIT v. M. Venkateswara Rao (2015) 370 ITR 212*, wherein the above issue came up before the Telengana & Andhra Pradesh High Court. The Court observed that the amount sought to be treated as income of the firm is the contribution made by the partners to the capital. Where the firm explains that the partners have contributed capital, section 68 cannot be pressed into service.

The Court further observed that when the amount so contributed constitutes the very substratum for the business of the firm, it is difficult to treat the pooling of such capital as cash credit. In the absence of any material to indicate that they are the profits of the firm, the cash credits cannot be assessed in the hands of the firm, though they may be assessed in the hands of individual partners.

(iv) Conclusion: Hence, applying the rationale of the Telengana and Andhra Pradesh High Court ruling to the case on hand, the action of the Assessing Officer, in proposing to tax the amounts credited in the partners accounts in the books of the firm as cash credit in the hands of the firm is **not** valid.

Question 5

(a) Discuss the liability for tax deduction at source in the following cases for the Assessment year 2017-18:

(i) M/s Avtar Limited entered in to an agreement for the warehousing of its products with ABC Warehousing and deducted tax at source as per the provisions of section 194C out of warehousing charges paid during the year ended on 31.03.2017. The A.O. while completing the assessment for Assessment Year 2017-18 of Avtar Limited, asked the company by treating the warehousing charges as rent, as defined in section 194-I, to make payment of difference amount of TDS with interest. It was submitted by the company that the recipient had already paid tax on the entire amount of warehousing charges and therefor, now the difference amount of TDS be not recovered. However, it was prepared to make the payment of due interest of the difference amount TDS.

Examine critically the correctness of the action or the treatment given.

(ii) K Ltd., an event management company, organized a concert of international artists in India. In this connection, it engaged the services of an overseas agent Mr. X from USA, to bring artists to India. He contacted the artists and negotiated with them for performance in India, in terms of the authority given by the company. He did not take part in event organized in India. The company made the payment of commission of ₹ 5 lakhs to the overseas agent, outside India.

(iii) Ram gave a building on sub-lease to M Ltd. with effect from 1-6-2016 on a rent of ₹ 20,000 per month. The company also took on hire machinery from Ram with effect from 1-10-2016 on hire charges of 15,000 per month. The rent for building and hire

charges of machinery for the year 2016-17 were credited by the company to the account of Ram in its books of account on 31-3-2017. (6 Marks)

(b) M Ltd., a US company has a subsidiary, N Ltd., in India. M Ltd. sells computer monitors to N Ltd. for resale in India. M Ltd. also sells computer monitors to K Ltd., another computer reseller. It sells 50,000 computer monitors to N. Ltd. at ₹ 11,000 per unit. The price fixed for K Ltd. is ₹ 10,000 per unit. The warranty in case of sale of monitors by N Ltd. is handled by N Ltd. However, for sale of monitors by K Ltd., M Ltd. is responsible for the warranty for 3 months. Both M Ltd. and N Ltd. offer extended warranty at a standard rate of ₹ 1,000 per annum. On these facts, determine the ALP and the effect on the net profit/income of the assessee-company. (3 Marks)

(c) What is the quantum of penalty that could be levied in each of the following cases:

- *Failure to get books of accounts audited as required under section 44AB within the time prescribed under the Act.*
- *Failure to comply with a direction issued under section 142(2A).*
- *Failure to furnish report from an Accountant, as required under section 92E. (3 Marks)*

(d) Seizures were made from Mr. Murari pursuant to a search conducted in his premises. He filed an application for settlement by claiming to have received the amount by way of loans from several persons. The Settlement Commission accepted his statement and made an order. The CBI, however, conducted enquiry at the instance of the Revenue regarding the claimed amount of loans and opined that the alleged lenders had no means or financial capacity to advance such huge loans to Mr. Murari and were mere name lenders only. The Commissioner filed an application under section 245D(6) praying for the order to be declared void and for withdrawal of benefit granted. Mr. Murari, however, contended that the order of the Settlement Commission was final and any fresh analysis would amount to sitting in judgment over an earlier decision, for which the Settlement Commission was not empowered. Discuss the correctness of Mr. Murari's contention. (4 Marks)

Answer

(a) (i) As per the first proviso to section 201(1), any person (including the principal officer of the company) who fails to deduct the whole or any part of the tax on the amount credited or payment made to a resident payee shall not be deemed to be an assessee-in-default in respect of such tax if such resident payee has included the warehouse charges for computing its income, paid tax thereon and filed its return of income under section 139.

Thus, the difference amount of TDS cannot be recovered from Avtar Ltd., since ABC Warehousing has paid tax on the entire amount of warehousing charges.

However, Avtar Ltd. has to pay interest under section 201(1A)(i) i.e., @1% p.m. or part of month, from the date on which such tax was deductible to the date of furnishing of return of income by such resident payee i.e., ABC Warehousing.

(ii) An overseas agent of an Indian company operates in his own country and no part of his income accrues or arises in India. The commission paid to the non-resident agent for services rendered outside India and remitted directly to him outside India is, thus, not chargeable to tax in India.

Since commission income for contacting and negotiating with international artists by Mr. X, a non-resident, who remains outside India is not subject to tax in India, consequently, there is no liability for deduction of tax at source in respect of commission paid to him by K Ltd.

(iii) Tax is deductible under section 194-I on rent, if the aggregate amount of rental income paid or credited to a person exceeds ₹ 1,80,000. Tax is deductible at the time of payment or credit, whichever is earlier. Rent includes payment under any lease or sub-lease for use of*, inter alia*, building and machinery.

The aggregate amount credited by M Ltd. to the account of Ram in its books of account on 31.3.2017 towards rent for the P.Y.2016-17 is ₹ 2,90,000 [i.e., ₹ 2,00,000 (₹ 20,000 × 10) for building and ₹ 90,000 (₹ 15,000 × 6) for machinery]. Hence, M Ltd. has to deduct tax @10% on rent credited for building and tax @ 2% on rent credited for machinery.

(b) M Ltd., the foreign company, and N Ltd., the Indian company, are associated enterprises since M Ltd. is the holding company of N Ltd. M Ltd. sells computer monitors to N Ltd. for resale in India. M Ltd. also sells identical computer monitors to K Ltd., which is not an associated enterprise. The price charged by M Ltd. for a similar product transferred in comparable uncontrolled transaction is, therefore, identifiable. Therefore, Comparable Uncontrolled Price (CUP) method for determining arm's length price can be applied.

For sale of monitors by K Ltd., M Ltd. is responsible for warranty for 3 months. The price charged by M Ltd. from K Ltd. includes the charge for warranty for 3 months.[5] Hence arm's length price for computer monitors being sold by M Ltd. to N Ltd[6]. would be:

Particulars	₹
Sale price charged by M Ltd. from K Ltd.	10,000
Less: Cost of warranty included in the price charged to K Ltd. (₹ 1,000 x 3/12)	250
Arm's length price	9,750
Actual price paid by N Ltd. to M Ltd.	11,000
Difference per unit	**1,250**
No. of units supplied by M Ltd. to N Ltd. = 50,000	
Addition required to be made in the computation of total income of N Ltd. (₹ 1,250 × 50,000)	6,25,00,000[7]

[5] While applying CUP method, the price in comparable uncontrolled transaction needs to be adjusted to account for difference, if any, between the international transaction (i.e. transaction between M Ltd. and N Ltd.) and uncontrolled transaction (i.e. transaction between M Ltd. and K Ltd.) and the price so adjusted shall be the arm's length price for the international transaction.

[6] It is assumed that N Ltd. has not entered into an advance pricing agreement or opted to be subject to Safe Harbour Rules.

[7] No deduction under Chapter VI-A would be allowable in respect of the enhanced income of ₹ 6.25 crores.

(c) The penalty leviable in each case is :-

(i) **Failure to get books of accounts audited as required under section 44AB of the Income-tax Act, 1961** – As per section 271B, a sum equal to ½% of the total sales, turnover or gross receipts, as the case may be, in business, or of the gross receipts in profession, in such previous year or years, or a sum of ₹ 1,50,000, whichever is less, is leviable for failure to get books of account audited as per the requirement under section 44AB.

(ii) **Failure to comply with a direction issued under section 142(2A)** – As per section 272A(1)(d), a sum of ₹ 10,000 is leviable for failure to comply with a direction issued under section 142(2A).

(iii) **Failure to furnish report from an accountant as required by section 92E** – As per section 271BA, a sum of ₹ 1,00,000 is leviable for failure to furnish report from an accountant as required under section 92E.

(d) Section 245D(6) states that every order passed under section 245D(4) by the Settlement Commission has to provide for:-

(i) the terms of settlement; and

(ii) that the settlement would become void, if it is subsequently found by the Settlement Commission that it has been obtained by fraud or misrepresentation of facts.

The facts of the case are similar to the facts in *CIT vs. Om Prakash Mittal (2005) 273 ITR 326*, wherein the above issue came up before the Supreme Court. The Supreme Court observed that the foundation for settlement is an application which an assessee can file at any stage of a case relating to him in such form and manner as may be prescribed. The fundamental requirement of the application under section 245C is that there must be full and true disclosure of the income along with the manner in which it has been derived.

Merely because it has been provided under section 245-I that the order of settlement is conclusive, it does not take away the power of the Settlement Commission to decide whether the settlement order has been obtained by fraud or misrepresentation of facts.

If the Commissioner is able to establish that the earlier decision was void because of misrepresentation of facts, then, it is open for the Settlement Commission to decide the issue. It cannot be called by any stretch of imagination to be a review of the earlier judgment or the subsequent Bench sitting in appeal over the earlier Bench's decision

Applying the rationale of the Supreme Court ruling in *Om Prakash Mittal's* case to the case on hand, Mr. Murari's contention is not correct.

Question 6

(a) EF Limited, an Indian company, is engaged in manufacturing electronic components. 74% of shares of the company are held by EF Inc., incorporated in USA. EF Limited has borrowed funds from EF Inc. at LIBOR plus 150 points. The LIBOR prevalent at the time of borrowing is 4% for US $. The borrowings allowed under the External Commercial

Borrowing Guidelines issued under Foreign Exchange Management Act are LIBOR plus 200 basis points.

Discuss whether the borrowing made by EF Limited is at arm's length ('LIBOR' means London inter-bank offer rate). *(3 Marks)*

(b) The Assessing Officer lodged a complaint against M/s Emerald, a firm, under section 276CC of the Income-tax Act 1961 for failure to furnish its return of income for the A.Y.2017-18 within the due date under section 139(1). The tax payable on the assessed income, as reduced by the advance tax paid and tax deducted at source, was ₹ 60,000. The appeal filed by the firm against the order of assessment was allowed by the Commissioner (Appeals). The Assessing Officer passed an order giving effect to the order of the Commissioner (Appeals). The tax payable by the firm as per the said order of the Assessing Officer was ₹ 1,000. The Assessing Officer has accepted the order of the Commissioner (Appeals) and has not referred an appeal against it to the Income-tax Appellate Tribunal. The firm desires to know about the maintainability of the prosecution proceeding in the facts and circumstances of the case.

Advise the firm suitably. *(3 Marks)*

(c) An Assessing Officer entered a hotel premises run by a person, in respect of whom he exercises jurisdiction at 8 p.m., for the purpose of collecting information, which may be useful for the purpose of the Act. The hotel is kept open for business everyday between 9 am to 9 pm. The hotelier claims that the Assessing Officer could not enter the hotel after sunset.

The Assessing Officer wants to take away with him the books of account kept at the hotel.

Examine the validity of claim made by the hotelier and the proposed action of the Assessing Officer with reference to the provisions of section 133B of the Income-tax Act 1961. (3 Marks)

(d) PA Consulting (P) Ltd., an Indian company established in the in the year 2000, having turnover of ₹ 9.3 crores reports total income of ₹ 10,50,000 for the previous year ended 31.03.2017. Tax deducted at source by different payers amounted to ₹ 24,450.00 and tax paid in foreign country on a doubly taxed income amounted to ₹ 10,000 for which the company is entitled to relief under section 90 as per the Double Taxation Avoidance Agreement.

During the year, the company paid Advance tax as under:

Date of Payment	*Advance Tax Paid (₹)*
15-06-2016	*40,000*
12-09-2016	*65,000*
15-12-2016	*1,00,000*
15-03-2017	*62,000*

The company filed its return of income for the A.Y. 2017-18 on 15th October, 2017. There is no international transaction.

Computing interest, if any, payable by the company under sections 234A, 234B and 234C. Assume that transfer pricing provisions are not applicable. *(7 Marks)*

Answer

(a) EF Inc., USA and EF Limited, the Indian company, are associated enterprises since the former holds 74% shares in the latter.

The arm's length rate of interest can be determined by using **Comparable Uncontrolled Price Method (CUP method)** having regard to the rate of interest on external commercial borrowing permissible as per the guidelines issued under Foreign Exchange Management Act.

The interest rate permissible is LIBOR plus 200 basis points i.e., 4% + 2% = 6%, which can be taken as the arm's length rate. The interest rate applicable on the borrowing by EF Limited, India from EF Inc., USA, is LIBOR plus 150 basis points i.e., 4% + 1.5% = 5.5%. Since the rate of interest, i.e. 5.5% is less than the arm's length rate of 6%, the borrowing made by the EF Ltd. is not at arm's length.

However, in this case, the taxable income of EF Ltd., India, would be lower if the arm's length rate is applied. Hence, no adjustment is required since the law of transfer pricing will not apply if there is a negative impact on the existing profits.

Note - *One of the methods for determination of arm's length price in an international transaction is Comparable Uncontrolled Price method (CUP). Under the CUP method, the price charged or paid for property transferred or services rendered in a comparable uncontrolled transaction, or a number of such transactions, is identified.*

Such price is adjusted to account for differences, if any, between the international transaction and the comparable uncontrolled transaction or between the enterprises entering into such transactions, which could materially affect the price in the open market. The adjusted price so arrived at is taken to be an arm's length price in respect of the property transferred or services provided in the international transaction.

(b) Section 276CC provides for prosecution for willful failure to furnish a return of income within the prescribed time, in a case where tax would have been evaded had the failure not been discovered.

Since the amount of tax which would have been evaded does not exceed ₹ 25 lakh, the imprisonment would be for a term of 3 months to 2 years. In addition, fine would also be attracted.

However, in a case where the return of income is not filed within the due date, prosecution proceedings will not be attracted if the tax payable by the assessee on the total income determined on regular assessment, as reduced by the advance tax, if any, paid and any tax deducted at source, does not exceed ₹ 3,000.

In this case, even though the tax liability of the firm as per the original order of assessment exceeded ₹ 3,000, however, as a result of the order of the Commissioner (Appeals), it got reduced to ₹ 1,000, which is less than ₹ 3,000.

Therefore, since the tax liability of the firm on final assessment was determined at ₹ 1,000, the prosecution proceedings are not maintainable.

In *Guru Nanak Enterprises v. ITO (2005) 279 ITR 30*, where the facts were similar, the Supreme Court held that prosecution was unwarranted

(c) As per section 133B(2), an income-tax authority has the power to enter any place of business during the hours at which such place is open for the conduct of business.

The hotel is open from 9.00 a.m. to 9.00 p.m. for the conduct of business. The Assessing Officer entered the hotel at 8.00 p.m. which falls within the working hours.

The claim made by the hotelier to the effect that the Assessing Officer could not enter the hotel after sunset is not in accordance with law.

As per section 133B(3), an income tax authority acting under section 133B shall, on no account, remove or cause to be removed from the place wherein he has entered, any books of account.

Hence, the proposed action of the Assessing Officer to take away with him the books of account kept at the hotel is ***not*** valid in law.

(d) Computation of interest under sections 234A, 234B and 234C

Interest under section 234A

Since the return of income has been furnished by PA Consulting Ltd. on 15th October, 2017, i.e., 15 days after the due date for filing return of income (30.9.2017), interest under section 234A will be payable for 1 month@1% on the amount of tax payable on the total income, as reduced by tax reliefs and prepaid taxes.

Particulars	₹
Tax on total income (₹ 10,50,000 x 30.9%[8])	3,24,450
Less: Advance tax paid	2,67,000
Less: Tax deducted at source	24,450
Less: Relief of tax allowed under section 90	10,000
Tax payable on self assessment	23,000
Interest = ₹ 23,000 x 1% =	230

Interest under section 234B

Where the advance tax paid by the assessee is less than 90% of the assessed tax, the assessee would be liable to pay interest under section 234B.

Computation of Assessed tax	₹
Tax on total income (₹10,50,000 x 30.9%)	3,24,450
Less: Tax deducted at source	24,450
Less: Relief of tax allowed under section 90	10,000
Assessed tax	2,90,000
90% of assessed tax = ₹ 2,90,000 x 90% =	2,61,000

[8] *Since annual turnover is greater than ₹ 5 crores (assumed that in the F.Y.2014-15 also, the turnover was greater than ₹ 5 crores).*

Since the advance tax paid by PA Consulting Ltd. (₹ 2,67,000) is more than 90% of the assessed tax (₹ 2,61,000), the company is not liable to pay interest under section 234B.

Interest under section 234C

Particulars	₹
Tax on total income (₹ 10,50,000 x 30.9%)	3,24,450
Less: Tax deducted at source	24,450
Less: Relief of tax allowed under section 90	10,000
Tax due on returned income/Total advance tax payable	**2,90,000**

Calculation of interest payable under section 234C:

Date (a)	Advance tax paid till date (b) (₹)	Minimum % of tax due on returned income to be paid till date to avoid interest under section 234C (c)		Advance tax payable till date in case condition mentioned in (c) is not met	Short-fall	Manner of computation of interest	Interest
		%	Amount (₹)		(₹)		(₹)
15.06.2016	40,000	12%	34,800	15%	-	See Note below	Nil
15.09.2016	1,05,000	36%	1,04,400	45%	-		Nil
15.12.2016	2,05,000	75%	2,17,500	75%	12,500	12,500 x 1% x 3 months	375
15.03.2017	2,67,000	100%	2,90,000	100%	23,000	23,000 x 1%	230
Interest payable under section 234C (Nil + Nil + ₹ 375 + ₹ 230)							₹ 605

Note - *Since the advance tax paid by PA Consulting (P) Ltd. on 15th June, 2016 is more than 12% of the tax due on returned income (i.e., ₹ 2,90,000) and the advance tax paid on 12th September, 2016 is more than 36% of the tax due on returned income, the company is not liable to pay any interest under section 234C in respect of these two quarters.*

Question 7

(a) Anushtup Chandra, Balram and Vasudev were partners in a partnership firm, engaged in wholesale grains trade. On 30-06-2016, it was agreed that the firm to be dissolved from the close of business hours that day and that Mr. Vasudev was entitled to continue the business of the firm w.e.f. the next day. One of the terms for dissolution was that the stock as on 30-06-2016 would be valued at the cost price of ₹ 10 lakhs, despite the market value being ₹ 12 lakhs.

You are required to examine, whether in computing the income of the dissolved firm, the stock can be valued at ₹ 10 lakhs, since it has been so agreed upon and the business of the firm is continued by a partner, in the light of the decision of the Supreme Court in Shakti Trading Co. vs. CIT.

Your answer should touch upon the applicable covenants of the ICDS. Will there be any change in your answer, had the dissolution taken place on 31-3-2016? (6 Marks)

(b) Mr. Prajapathi intends to sell a piece of urban residential plot held for 48 months, to Mr. Vasan, for a consideration of ₹ 2 crores, in February, 2017. This asset had been held as investment by Mr. Prajapathi. Both parties are willing to enter into a written agreement in this regard. Initial payment will be ₹ 40 lakhs. The buyer is given 12 months time for completing the sale, at which point of time, balance amount has to be paid. Following two options are considered:

(i) Payment of ₹ 10 lakhs by account payee cheque on the date of the agreement and ₹ 30 lakhs by cash, the same day, and

(ii) Payment of ₹ 10 lakhs by account payee cheque on the date of the agreement and ₹ 30 lakhs by ECS through a bank within seven days.

An increase of 30% in stamp duty is anticipated with effect from 1st April, 2017.

The parties seek your advice to plan suitably for reduction of capital gains. Advise them suitably as to what payment mode is to be adopted. Should the agreement in question be registered? (4 Marks)

(c) Vivshvakshena & Co. is a partnership firm. For the year ended 31-3-2017, the following particulars are made available to you in respect of its trading business, for which books of account are maintained:

(i) Secret commission of ₹ 50,000/- paid to a Government official.

(ii) ₹ 12 lakhs paid as commission to a partner's son at 0.5% of the sales value, without deduction of tax at source. Partner has 25% share in firm.

(iii) Loss in the above business, after considering the above items debited to the profit and loss account are: Business loss ₹ 80 lakhs, Unabsorbed depreciation ₹ 19 lakhs.

In addition, the firm has a warehouse business covered by section 35AD. Loss suffered therein is ₹ 55 lakhs.

The firm has filed the return of income for the assessment year 2017-18 on 29-11-2017.

Specify the items (with quantum) which are eligible for carry forward to the subsequent years.

Will your answer be different, if the firm has filed its return of income on 29-12-2017? (6 Marks)

Answer

(a) Under section 145(1), income chargeable under the heads "Profits and gains of business or profession" or "Income from other sources" shall be computed in accordance with either the cash or mercantile system of accounting regularly employed by the assessee.

Section 145(2) empowers the Central Government to notify in the Official Gazette from time to time, income computation and disclosure standards to be followed by any class of assessees or in respect of any class of income.

Accordingly, the Central Government has, in exercise of the powers conferred under section 145(2), notified income computation and disclosure standards (ICDSs) to be followed by all assessees (other than an individual or a Hindu undivided family who is not required to get his accounts of the previous year audited in accordance with the provisions of section 44AB), following the mercantile system of accounting, for the purposes of computation of income chargeable to income-tax under the head "Profit and gains of business or profession" or "Income from other sources", from A.Y. 2017-18.

Therefore, in this case, the partnership firm has to follow the ICDSs notified by the Central Government from A.Y.2017-18 (P.Y.2016-17).

In case of dissolution of*, inter alia,* a partnership firm, Paragraph 24 of ICDS II on Valuation of Inventories requires the inventory on the date of dissolution to be valued at the net realisable value, whether business is discontinued or not.

Therefore, if the firm is dissolved on 30.6.2016 (i.e., during the P.Y.2016-17), the inventory on the date of dissolution has to be valued at the net realizable value of ₹ 12 lakhs[9] as per ICDS II, even though one of the partners is continuing the business of the firm.

If the firm was dissolved on 31.3.2016 (i.e., during the P.Y.2015-16), the valuation of inventory would be governed by the Supreme Court ruling in *Shakti Trading Co. vs. CIT (2001) 250 ITR 871*, where it was held that if the firm is dissolved and the business is continued by one of its partners, the firm is entitled to adopt cost or market price, whichever is lower. In this case, the inventory would be valued at ₹ 10 lakhs, being the lower of cost and net realizable value.

(b) Under section 50C, in case of transfer of a capital asset being land or building or both (in this case, an urban residential plot), the value adopted or assessed by the stamp valuation authority for the purpose of payment of stamp duty shall be taken as the full value of consideration for the purposes of computation of capital gains, where the actual consideration is less than such value. The stamp duty value on the date of transfer has to be considered for the purpose of section 50C.

Where the date of the agreement fixing the amount of consideration for the transfer of the urban residential plot and the date of registration are not the same, the stamp duty value on the date of the agreement may be taken for the purposes of computing the full value of consideration. However, the stamp duty value on the date of agreement can be adopted only in a case where the amount of consideration, or a part thereof, has been received by way of an account payee cheque or account payee bank draft or use of electronic clearing system through a bank account, on or before the date of the agreement for the transfer of such plot.

There is no specific requirement under the Act that the agreement should be registered.

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[9] *It is assumed that the market value given in the question is the net realisable value*.

Advice for reduction of capital gains tax liability

In both the options given in the question, part payment of ₹10 lakhs is made by account payee cheque on the date of the agreement. Therefore, in both the options, the stamp duty value on the date of agreement can be taken as the full value of consideration.

Mr. Prajapathi, thus, need not bear the burden of paying capital gains tax on increased stamp duty applicable from 1st April, 2017, if he exercises either of the options for making the initial payment of ₹40 lakhs.

Advice for mode of payment

In Option (i), however, the balance initial payment of ₹ 30 lakhs is proposed to be paid by way of cash. This would be in contravention of the provisions of section 269SS, which requires any sum of money receivable, whether as advance or otherwise, in relation to transfer of immovable property, to be paid by way of account payee cheque/bank draft or by way of electronic clearing system through a bank account, if the same exceeds the threshold of ₹ 20,000. Penalty equivalent to the sum so received in contravention of the provisions of section 269SS would be imposable under section 271D.

Therefore, if Option (i) is exercised, even though the capital gains tax liability of Mr. Prajapathi would not be affected, the provisions of section 269SS would be violated and penalty of ₹ 30 lakhs would be attracted under section 271D.

Accordingly, Option (ii) should be exercised to get the benefit of adoption of stamp duty value on the date of agreement and avoid contravention of the provisions of section 269SS and the consequent penalty under section 271D.

(c) The partnership firm's turnover exceeds ₹ 1 crore, hence, it is liable to tax audit under section 44AB. Therefore, its due date for filing return of income for A.Y.2017-18 is 30.9.2017.

In this case, the firm has filed its return of loss under section 139(3) after the due date i.e., on 29.11.2017. Hence, it is not eligible for carry forward of its business loss of ₹ 75,90,000 under section 72(1) **[See Working Note below]** and its loss of ₹ 55,00,000 from specified business (referred to in section 35AD) as per section 73A(2), since, as per section 80 read with section 139(3), filing of return of income on or before the due date is necessary for carry forward of such losses.

However, there is no such restriction for carry forward of unabsorbed depreciation under section 32(2). Therefore, it can carry forward its unabsorbed depreciation of ₹ 19 lakhs to A.Y.2018-19.

The answer will remain the same even if the firm has filed its return of income on 29-12-2017, since both 29.11.2017 and 29.12.2017 fall beyond the due date of filing of return of income for the said firm.

Working Note:

Computation of business loss to be carried forward as per section 72(1)

Particulars		₹
Loss as per profit and loss account		(80,00,000)
Add:	Secret commission to a Government official not allowable as per section 37 as it is an expenditure incurred for a purpose which is an offence and prohibited by law	50,000
	30% of commission paid to partner's son without deduction of tax at source to be disallowed under section 40(a)(ia)	3,60,000
Business loss computed as per the provisions of the Income-tax Act, 1961		(75,90,000)