

## PAPER – 7: DIRECT TAX LAWS

Question No.1 is compulsory.

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

Working notes should form part of the respective answers.

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

### Question 1

(a) Zenith Formulations Ltd., an Indian Company engaged in pharmaceutical formulations in Tamil Nadu, started adoption of Ind AS compliance with effect from 1<sup>st</sup> April, 2016. The following particulars are furnished for the year ended 31st March, 2018:-

- (i) The book profits after adjustments of all items specified in section 115JB(2) amounted to ₹ 52.26 lakhs (except the adjustment for brought forward losses), for the year ended 31.3.2018.
- (ii) Brought forward losses as per books are as under : (₹ In lakhs)

Financial Year	Business loss	Depreciation
2014-15	4.60	4.90
2015-16	1.75	2.20

(iii) The business loss of ₹ 4.60 lakhs and ₹ 1.75 lakhs have been deducted while computing book profits under section 115JB for the assessment years 2016-17 & 2017-18, respectively.

(iv) The particulars of Other Comprehensive Income for the year ended 31.03.2018:

(₹ In lakhs)

A: Other Comprehensive Income (OCI) that may be re-classified to profit and loss:		Debit	Credit
(i)	Deferred gain Cash flow hedges		5.50
(ii)	Deferred costs of hedging	1.00	
(iii)	Comprehensive income from discontinued operations		4.20
(iv)	Exchange Differences of foreign exchange operations	2.30	
<b>TOTAL</b>		<b>3.30</b>	<b>9.70</b>

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

<b>B: Other Comprehensive Income (OCI) that will not be re-classified to profit and loss:</b>		<b>Debit</b>	<b>Credit</b>
(i)	Changes in fair values of equity instruments	10.00	
(ii)	Deferred gains on cash flow hedges		7.25
(iii)	Deferred costs of hedging	4.10	
(iv)	Share of other comprehensive income of other associates		3.20
(v)	Remeasurements of post employment benefit obligations		4.45
(vi)	Revaluation surplus for assets		7.50
<b>TOTAL</b>		<b>14.10</b>	<b>22.40</b>

(v) The transition amount as on convergence date (01-04-2016) stood at ₹ 52.50 lakhs (credit balance) including capital reserve of ₹ 8 lakhs and adjustment of ₹ 4.50 lakhs relating to translation difference in a foreign operation.

(vi) The National Company Law Tribunal (NCLT), Chennai Bench has admitted an application under section 7 of Insolvency and Bankruptcy Code, 2016 (IBC) made by financial creditor against the company for initiation of Corporate Insolvency Resolution Process on 30<sup>th</sup> March, 2018.

(1) Compute the MAT liability for the assessment year 2018-19, applying the provisions relating to Ind AS compliant companies.

(2) Assuming that the income tax under normal provisions of Income-tax Act, 1961 for the assessment year 2018-19 works out to ₹ 9.20 lakhs, compute the tax credit, if any, to be carried forward by the company including the period up to which it will be available to be carried forward. **(10 Marks)**

(b) SOL Inc, a notified Foreign Institutional Investor (FII), derived the following incomes from various sources for the financial year 2017-18:-

(1) Income in respect of securities: ₹ 28,50,000  
Expenses incurred in respect thereof: ₹ 50,000

(The above income includes an interest of ₹ 16,00,000 received from an Indian Company on the investment in rupee denominated bonds and dividend income of ₹ 3,50,000 from a domestic company referred to in section 115-O)

(2) Capital Gains:

(i)	Long Term :	
	Sale proceeds on sale of securities on 15.01.2018 :	₹ 52,00,000
	Purchase cost of securities on 25.05.2014 :	₹ 28,00,000
	Cost Inflation Index: 2014-15 : 240; 2017-18: 272	

(ii) Short Term:	
Sale proceeds of equity shares of Company A (January 2018): (STT paid on Company A shares)	₹ 13,50,000
Cost of acquisition (August, 2017) :	₹ 5,50,000
Sale proceeds of equity shares of Company B (December, 2017)	₹ 9,25,000
Cost of acquisition (April, 2017) : (STT not paid on Company B Shares)	₹ 4,85,000

Compute the taxable income of SOL Inc and tax liability for the assessment year 2018-19 as per applicable provisions of the Income-tax Act, 1961, assuming that no other income is derived by SOL Inc (FII) during the financial year 2017-18. **(10 Marks)**

**Answer**

**(a) (1) Computation of MAT liability of Zenith Formulations Ltd. under section 115JB for A.Y.2018-19**

Particulars	₹	₹
Book profit after adjustment of items under section 115JB(2) [except brought forward business loss and unabsorbed depreciation]		52,26,000
Less: Brought forward business loss [₹4,60,000 + ₹ 1,75,000]	6,35,000	
Unabsorbed depreciation [₹4,90,000 + ₹ 2,20,000]	<u>7,10,000</u>	
[Since Zenith Formulations Ltd. is a company against which an application for corporate insolvency resolution process has been admitted by NCLT under section 7 of the Insolvency and Bankruptcy Code, 2016, <b>the aggregate amount of loss brought forward and unabsorbed depreciation is allowed</b> to be reduced from the book profit for the purposes of levy of MAT under section 115JB].		13,45,000
<b>Book profit computed in accordance with Explanation 1 to section 115JB(2)</b>		<b>38,81,000</b>
<b>Add: Items credited to OCI that will not be reclassified to profit or loss:</b>		
Deferred gains on cash flow hedges	7,25,000	
Share of Other Comprehensive Income of Other Associates	3,20,000	

Re-measurement of post-employment benefit obligations	4,45,000	
Revaluation surplus for assets ₹ 7,50,000 [Book profit not to be increased by revaluation surplus for assets as per proviso to section 115JB(2A)]	Nil	<u>14,90,000</u>
		53,71,000
<b>Less: Items debited to OCI that will not be reclassified to profit or loss:</b>		
Deferred costs of hedging	4,10,000	
Changes in fair values of equity instruments ₹ 10,00,000 [Book profit not to be decreased by changes in fair values of equity instruments as per proviso to section 115JB(2A)]	Nil	<u>4,10,000</u>
		49,61,000
<b>Add: One-fifth of Transition amount [Credit Balance]</b>		
Transition amount	52,50,000	
<b>Less: Amounts to be excluded from above</b>		
Capital Reserve	8,00,000	
Transition difference in foreign operations	<u>4,50,000</u>	
	<u>40,00,000</u>	
One-fifth of ₹ 40,00,000		<u>8,00,000</u>
<b>Book Profit for levy of MAT</b>		<b><u>57,61,000</u></b>
MAT on book profit under section 115JB = 18.5% of ₹57,61,000		10,65,785
Add: Education cess and SHEC@3%		<u>31,974</u>
MAT liability for A.Y.2018-19		<b><u>10,97,759</u></b>
MAT liability for A.Y.2018-19 (rounded off)		10,97,760

**(2) Computation of tax credit to be carried forward**

Particulars	₹
MAT liability for A.Y.2018-19 (rounded off)	10,97,760
Income-tax computed as per the normal provisions of the Act for A.Y.2018-19	9,20,000
Since the income-tax liability computed as per the regular provisions of the Income-tax Act, 1961 is less than the MAT payable, the book profit would be deemed to be the total income and tax is leviable @18.5%: The	

total tax liability (rounded off) is ₹10,97,760.	
<b>Computation of tax credit to be carried forward</b>	
Tax payable for A.Y.2018-19 on deemed total income	10,97,760
Less: Income-tax payable as per the normal provisions of the Act	<u>9,20,000</u>
<b>Tax credit in respect of tax paid on deemed income</b>	<b><u>1,77,760</u></b>
[Can be carried forward for 15 Assessment Years i.e., upto A.Y.2033-34]	

(b) **Computation of total income of SOL Inc., a notified FII, for A.Y.2018-19**

Particulars	₹	₹
<b>Investment Income</b>		
Dividend income of ₹ 3,50,000 [Exempt under section 10(34)]	Nil	
Income in respect of securities [₹ 28,50,000 – Dividend ₹ 3,50,000]	25,00,000	25,00,000
[No deduction is allowable in respect of expenses incurred in respect thereof]		
<b>Long-term capital gains on sale of securities</b>		
Sale consideration	52,00,000	
Less: Cost of acquisition	<u>28,00,000</u>	
[Benefit of indexation is not allowable]		24,00,000
<b>Short-term capital gains on sale of STT paid equity shares of Company A</b>		
Sale consideration	13,50,000	
Less: Cost of acquisition	<u>5,50,000</u>	
		8,00,000
<b>Short-term capital gains on sale on equity shares of Company B in respect of which STT is not paid</b>		
Sale consideration	9,25,000	
Less: Cost of acquisition	<u>4,85,000</u>	
		4,40,000
<b>Total Income</b>		<b><u>61,40,000</u></b>

**Computation of tax liability of SOL Inc. for A.Y.2018-19**

Particulars	₹
Tax@5% on interest on ₹ 16,00,000 received from an Indian company on investment in rupee denominated bonds = 5% of ₹ 16,00,000	80,000

Tax@20% on balance investment income of ₹ 9,00,000 [₹ 25,00,000 – ₹16,00,000]	1,80,000
Tax@10% on long-term capital gains = 10% of ₹ 24,00,000	2,40,000
Tax@15% on STT paid short-term capital gains on sale of listed equity shares of CompanyA = 15% of ₹ 8,00,000	1,20,000
Tax@30% on short-term capital gains on sale of listed equity shares of CompanyB on which STT is not paid = 30% of ₹4,40,000	<u>1,32,000</u>
	7,52,000
Add: Education cess and SHEC@3%	<u>22,560</u>
<b>Tax Liability</b>	<b><u>7,74,560</u></b>

**Note** - The computation of total income and tax liability of an FII, whose income comprises solely of investment income and capital gains on sale of securities is governed by the provisions of section 115AD, as per which

- no deduction is allowable in respect of expenditure to earn investment income and
- benefit of indexation is not allowable in respect of long-term capital gains.

The rates at which tax is to be calculated in respect of investment income and capital gains are also provided in section 115AD.

### Question 2

Statement of Profit and Loss account of BAS Industries Ltd. engaged in production and marketing of diversified products, shows a net profit (before tax) of ₹ 72,00,000 for the financial year ended 31<sup>st</sup> March, 2018 after charge of the following items :

#### A : Items debited to the Statement of Profit and Loss:

- Depreciation as per Companies Act, 2013: ₹ 24,00,000
- Interest amounting to ₹ 60,000 for short payment of advance tax paid as per section 234B relating to the assessment year 2016-17.
- Interest and borrowing costs amounting to ₹ 9,50,000 and ₹ 7,00,000 though not meeting the criteria for recognition as a component of cost, included in cost of opening and closing inventory, respectively.
- Expenditure of ₹ 41,000 paid in cash comprising of ₹ 22,000 directly paid to producer of dairy farming products and ₹ 19,000 paid towards printing and stationery items to a trader.
- ₹ 3,50,000 paid to a contractor for carrying out repair work at factory premises. Tax was not deducted at source on this payment.
- ₹ 35,000 towards expenditure for earning income from transfer of carbon credits.

- (vii) Contribution to electoral trust: ₹ 3,00,000 paid by way of cheque.
- (viii) Expenditure towards advertising charges in a brochure of a political party registered under section 29A of Representation of People Act, 1951: ₹ 40,000 paid by way of cheque.
- (ix) Interest on term loans obtained from Cooperative Bank not paid before the due date of filing of return of income (due date being 30.09.2018): ₹ 2,60,000
- (x) Actual contribution to the pension scheme of employees: ₹ 1,50,000

**B: Items credited to the Statement of Profit and Loss:**

- (i) Unrealised rent of ₹ 3,80,000 pertaining to financial year 2014-15 & 2015-16 recovered during the year in respect of a commercial property owned by the company, which was sold by the company on 23.03.2017.
- (ii) Dividends from a specified foreign company including the expenditure of ₹ 20,000 incurred on earning such dividends : ₹ 1,60,000
- (iii) Profit of ₹ 3,00,000 received from hedging contract entered into for meeting out loss in foreign currency payments towards an imported printing machinery valued at ₹ 95 lakhs, installed on 15<sup>th</sup> December, 2017 and put to use from that date.
- (iv) Interest from banks on fixed deposits net of TDS at 10% : ₹ 1,35,000

**Additional Information:**

- (1) Depreciation as per Income-tax Rules: ₹ 28,00,000 exclusive of depreciation on the imported printing machine referred to in item B (iii)
- (2) Expenditure pertaining to previous financial year allowed on due basis, but paid in current financial year in cash on 18.01.2018: ₹ 35,000
- (3) Audit fee for the previous year 2016-17: ₹ 75,000. TDS deducted but not paid in the relevant previous year. However, TDS was paid on 31.12.2017.
- (4) Income from transfer of Carbon Credits amounting to ₹ 4,00,000 included in Net Profit (before tax).
- (5) The eligible salary and dearness allowance for the pension scheme referred to under section 80CCD is ₹ 10,00,000.

Compute the total income of BAS Industries Ltd., for assessment year 2018-19. Give brief reasons for the treatment given to each of the items taken into consideration in computation of income of the company. **(16 Marks)**

## Answer

## Computation of Total Income of BAS Industries Ltd. for the A.Y. 2018-19

Particulars		Amount (₹)	
<b>I</b>	<b>Income from house property</b>		
	Unrealised rent [Taxable under section 25A, even if BAS Industries Ltd. is no longer the owner of commercial property]	3,80,000	
	Less: 30% of above	<u>1,14,000</u>	2,66,000
<b>II</b>	<b>Profits and gains of business and profession</b>		
	Net profit as per the statement of profit and loss	72,00,000	
	<b>Add: Items debited but to be considered separately or to be disallowed</b>		
	(i) Depreciation as per Companies Act, 2013	24,00,000	
	(ii) <b>Interest under section 234B for short payment of advance tax</b>	60,000	
	[Any interest payable for default committed by assessee for discharging his statutory obligations under Income-tax Act, 1961 which is calculated with reference to the tax on income is not allowable as deduction under section 40(a)(ii). Since the same has been debited to statement of profit and loss, it has to be added back] <sup>1</sup>		
	(iii) <b>Interest and borrowing cost included in Opening and Closing inventory</b>	2,50,000	
	[As per ICDS II, Interest and borrowing cost which does not meet the criteria for recognition as a component of the cost, cannot be included in the cost of inventory. Since the same have been included in the opening and closing inventory, the difference between ₹ 9,50,000, being interest included in opening inventory – ₹ 7,00,000, being		

<sup>1</sup>Bharat Commerce and Industries Ltd. v. CIT [1998] 230 ITR 733 (SC)



	interest included in closing inventory, has to be added back]	
(iv)	<p><b>Cash payment in excess of ₹ 10,000</b>  [Disallowance u/s 40A(3) is attracted in respect of expenditure, for which payment exceeding ₹10,000 in a day has been made in cash. Since expenditure of ₹19,000 towards printing and stationery items is debited to the statement of profit and loss, the same has to be added back.  However, payment of ₹ 22,000 to producer for dairy farming products is not disallowed since it is covered under the exceptions specified in Rule 6DD]</p>	19,000
(v)	<p><b>Repair work paid to contractor without deduction of tax at source</b>  [Disallowance of 30% of the amount of ₹ 3,50,000 paid for carrying out repair work to a contractor without deduction of tax at source would be attracted u/s 40(a)(ia)]</p>	1,05,000
(vi)	<p><b>Expenditure for transfer of carbon credits</b>  [Income by way of transfer of Carbon Credits is chargeable to tax under section 115BBG at a flat rate. No deduction is allowed under any provision of the Act in respect of any expenditure or allowance in relation thereto. Since such expenditure is debited to the statement of profit and loss, the same has to be added back]</p>	35,000
(vii)	<p><b>Contribution to electoral trust</b>  [Contribution to electoral trust is not allowable as deduction while computing business profits of the company. Since the contribution has been debited to statement of profit and loss, the same has to be added back while computing business income]</p>	3,00,000
(viii)	<p><b>Advertisement in brochure of a political party</b>  [Advertisement charges paid in respect of brochure published by a political party is not</p>	40,000

	allowable as deduction from business profits of the company as per section 37(2B). Since the expenditure has been debited to statement of profit and loss, the same has to be added back while computing business income]		
(ix)	<b>Interest to co-operative bank not paid before 30.9.2018</b> [Disallowance under section 43B would be attracted for A.Y.2018-19, since the interest was not paid on or before the due date of filing of return]	2,60,000	
(x)	<b>Contribution towards pension scheme of employees</b> [Contribution towards pension scheme, referred to in section 80CCD, of employees is allowed only to the extent of 10% of salary of the employee in the P.Y. i.e., ₹1,00,000 being 10% of ₹ 10,00,000. Therefore, the excess contribution of ₹ 50,000 [i.e., ₹ 1,50,000 – ₹ 1,00,000] is disallowed under section 36(1)(iva).	50,000	
			35,19,000
	<b>Add: Amount taxable but not credited to statement of profit and loss</b>		<b>1,07,19,000</b>
	<b>A(2) Expenditure pertaining to previous financial year</b> [Cash payment in excess of ₹10,000 made in the current year in respect of expenditure allowed on mercantile basis in the previous year, would be deemed as income in the current year.]		35,000
			<b>1,07,54,000</b>
	<b>Less: Items credited to statement of profit and loss, but not includible in business income / permissible expenditure and allowances</b>		
(i)	<b>Unrealised rent</b> [Unrealised rent in respect of commercial	3,80,000	

property is taxable under the head "Income for house property". Since the said rent has been credited to the statement of profit and loss, the same has to be deducted while computing business income]		
<b>(ii) Dividend received from specified foreign company</b> [Dividend received from specified foreign company is taxable under the head "Income from other sources". Since the said dividend has been credited to the statement of profit and loss, the same has to be deducted while computing business income] <i>Note: Since the question does not list the expenditure of ₹ 20,000 incurred on earning dividend income under "A. Items debited to the Statement of Profit and Loss", such expenditure has not been added back.</i>	1,60,000	
<b>(iii) Profit from hedging contract</b> [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 printing machinery has to be adjusted against the cost of machinery. Since the said profit has been credited to the statement of profit and loss, the same has to be deducted while computing business income]	3,00,000	
<b>(iv) Interest from bank fixed deposit</b> [Interest on fixed deposit is taxable under "Income from Other Sources". Since the said interest has been credited to the statement of profit and loss, the same has to be deducted while computing business income]	1,35,000	
<b>A(3) Audit fees of P.Y. 2016-17</b> [30% of ₹ 75,000, being the audit fees disallowed in the P.Y. for non-remittance of TDS on or before due date of filing for P.Y.]	22,500	

	2016-17 would be allowed in the year of payment of TDS i.e., P.Y. 2017-18]		
	<b>A(4) Transfer of Carbon Credits chargeable to tax under section 115BBG</b> [Income by way of transfer of Carbon Credits chargeable under section 115BBG can be treated as business income or income from other sources, depending upon the facts of the case. In this case, since the question mentions that BAS Industries Ltd. is engaged in production and marketing of diversified products, it is logical to assume that the same is in the nature of business income. Since the amount of ₹ 4 lakh has already been credited to statement of profit and loss, no further adjustment is necessary]	Nil	
			9,97,500
	<b>Less: Depreciation as per Income tax Rules</b>		97,56,500
	<b>A(1) Depreciation under section 32</b>	28,00,000	
	<i>Add:</i> Depreciation @7.5% on ₹ 92 lakhs [₹ 95 lakhs, being imported printing machinery - ₹ 3 lakhs, being profit from hedging contract] since, machinery is put to use for less than 180 days].	6,90,000	
	<i>Add:</i> Additional depreciation@10% on ₹ 92 lakhs, since, machinery is put to use for less than 180 days assuming the conditions for claim of additional depreciation are satisfied <sup>2</sup> .	9,20,000	
			44,10,000
	<b>Profits and gains from business or profession</b>		<b>53,46,500</b>
<b>III</b>	<b>Income from Other Sources</b>		
	Dividend from specified foreign company [No deduction is allowable in respect of expenditure incurred on earning dividends]		1,60,000

<sup>2</sup>Balance additional depreciation can be claimed in the A.Y.2019-20

<b>Interest from banks on fixed deposits (Gross)</b> [Interest on banks on fixed deposits is taxable as "Income from other sources"] [₹ 1,35,000 x 100/90]	1,50,000	3,10,000
<b>Gross Total Income</b>		<b>59,22,500</b>
<b>Less: Deduction under Chapter VI-A</b> Under section 80GGB [Contribution by a company to an electoral trust and registered political party is allowable as deduction, since payment is made otherwise than by cash. Expenditure incurred by an Indian company on advertisement in brochure published by political party tantamount to contribution to such political party] [₹ 3,00,000 + ₹ 40,000]		3,40,000
<b>Total income</b>		<b>55,82,500</b>

**Question 3**

(a) Examine in the context of provisions contained under the Income-tax Act, 1961, each of the following independent cases and state in brief whether there exists business connection in each of the cases in India so as to bring the income earned, if any, to tax net in India :-

- (i) ABC Ltd., a company resident in Dubai, had set-up a liaison office at Mumbai to receive trade inquiries from customers in India. The work of the liaison office is not only restricted to forwarding of the trade inquiries to ABC Ltd. but the liaison office also negotiates and enters into the contracts on behalf of ABC Ltd. with the customers in India.
- (ii) XYZ Inc. a resident of USA, has set up a branch at Hyderabad for the purpose of purchase of raw materials for manufacturing its products. The branch office is also engaged in selling the products manufactured by XYZ Inc. and in providing sales related services to customers in India on behalf of XYZ Inc.
- (iii) Mr. Rajesh, a resident in India and based at Delhi, is appointed as an agent by PQR Inc. a company incorporated in UK for tracking the Indian markets. He was canvassing the orders and then communicating to PQR Inc. in UK. He had no authority to accept the orders. All the orders were directly received, accepted and after receipt of the price/value, the delivery of goods was given by PQR Inc. outside India. No purchase of raw material or manufacturing of finished goods took place in India. The agent was entitled to receive the commission on the sales so concluded by PQR Inc. **(6 Marks)**

- (b) *Mr. Rameshwarm, a non-resident Indian, acquired/purchased shares in foreign currency of a company XYZ Ltd. on 1.1.2008 for ₹ 10,00,000. These shares were sold by him in the recognized stock exchange through a broker on 1.1.2017 for ₹ 30,00,000. The amount of sales consideration of the shares of ₹ 30,00,000 so received by him was again invested in purchase of shares of other company ABC Ltd. on 31.03.2017. The shares of ABC Ltd. purchased on 31.03.2017 were also sold by him on 30.06.2017 for ₹ 35,50,000. Discuss the tax implications relating to the two transactions of sales of the shares in the relevant assessment years under the Income-tax Act, 1961 by ignoring the effect of first proviso to section 48. (4 Marks)*
- (c) *Examine whether General Anti-Avoidance Rules (GAAR) can be invoked to deny the treaty benefit in the following case, assuming that all other conditions prescribed for application of GAAR are being satisfied:-*
- X Pvt. Ltd., an Indian Company and Y Pvt. Ltd. (100% subsidiary of YAN Ltd.) located in country "A" formed a joint venture company XY Pvt. Ltd. in India on 01.04.2017. As per the joint venture agreement, 51% of shares are held by X Pvt. Ltd. and 49% are held by Y Pvt. Ltd. in XY Pvt. Ltd. There is no other business activity in Y Pvt. Ltd.*
- Y Pvt. Ltd. is designated as Permitted Transferee of YAN Ltd. Permitted Transferee means though shares of XY Pvt. Ltd. are held by Y Pvt. Ltd. all rights of voting, management, right to sell etc. are vested with YAN Ltd.*
- On 19.03.2018, the shares held by Y Pvt. Ltd. in XY Pvt. Ltd. are sold to P Pvt. Ltd. which is a group company of X Pvt. Ltd. As per the tax-treaty between India and Country "A", there is no tax for capital gains either in source country or in Country "A". Consequently, the capital gains arising to Y Pvt. Ltd. are not taxable in India. (3 Marks)*
- (d) *Specify the quantum of Fee/Penalty, if any, to be levied in the following cases. Your answer must specify the relevant provisions of Income-tax Act, 1961.*
- (i) *Mr. Abhiram, an individual, whose taxable income working out to ₹ 13.25 lakhs, filed the return of Income on 12-03-2019 for the assessment year 2018-19. The due date for furnishing return of income under section 139(1) is 30-09-2018.*
- (ii) *Mrs. Sirisha filed the return of income on 31-01-2019 for the assessment year 2018-19. The due date for furnishing return of income is 31-08-2018 under section 139(1) and her taxable income is ₹ 4.98 lakhs.*
- (iii) *Mr. Robert received a sum of ₹ 2.50 lakhs from Mr. Rajiv on 31-01-2018 in cash in contravention of provisions of section 269ST. (3 Marks)*

#### Answer

- (a) (i) If a Liaison Office is maintained solely for the purpose of carrying out activities which are preparatory or auxiliary in character, and such activities are approved by the Reserve Bank of India, then, no business connection is established.

In this case, had the liaison office's activities been restricted to forwarding of trade inquiries to ABC Ltd., a Dubai based company, its activities would not have constituted business connection. However, the activities of the liaison office extends to also negotiating and entering into contracts on behalf of ABC Ltd. with the customers in India, on account of which business connection is established.

- (ii) As per the opening sentence in *Explanation 2*, to section 9(1)(i) "business connection" shall include any business activity carried out through a person in India acting on behalf of the non-resident. Accordingly, in this case, since the branch office is carrying out a business activity by purchasing raw materials in India for XYZ Inc. and selling finished product manufactured by XYZ Inc. to customers in India and providing sales related services to them on behalf of XYZ Inc., business connection is established.

It may be noted that as per clause (a) of *Explanation 2*, in the case of a non-resident, no business connection would be established if the activities of the person acting on behalf of the non-resident were limited to the purchase of goods or merchandise for the non-resident.

In the present case, however, business connection would be established, since the branch set up at Hyderabad by XYZ Inc. is not solely engaged in purchase of raw materials for XYZ Inc. for manufacturing its products but is also engaged in selling such manufactured products to customers in India and providing sales related services to them on behalf of XYZ Inc.

- (iii) 'Business connection' shall include any business activity carried out through a person acting on behalf of the non-resident. For a business connection to be established, the person acting on behalf of the non-resident –
- (i) must have an authority which is habitually exercised in India to conclude contracts on behalf of the non-resident or;
  - (ii) in a case where he has no such authority, but habitually maintains in India a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the non-resident, or
  - (iii) habitually secures orders in India, mainly or wholly for the non-resident.

In the present case, business connection would not be established, since Mr. Rajesh does not have the authority to accept or conclude orders in India on behalf of PQR Inc. Moreover, all the orders were directly received, accepted and after receipt of the price/value, the delivery of goods was also given by PQR Inc. outside India. Hence, no business connection is established in this case.

- (b) In A.Y.2017-18, since Mr. Rameshwarm, has invested whole of the net consideration on transfer of a foreign exchange asset (being shares purchased in XYZ Ltd. in foreign currency), in shares of ABC Ltd., an Indian company, being a specified asset, within a period of six months, the long-term capital gain of ₹ 20,00,000 (₹ 30,00,000, being the

sale consideration (-) ₹ 10,00,000, being the cost of acquisition) computed ignoring the effect of indexation, would not be chargeable to tax during the assessment year 2017-18, by virtue of the provisions of section 115F.

In A.Y. 2018-19, however, since Mr. Rameshwarm has sold the shares of ABC Ltd. within a period of three years, the amount not chargeable to tax in A.Y.2017-18 i.e., ₹ 20,00,000 would be chargeable to tax as long-term capital gains in the assessment year 2018-19, being the year of sale of such shares.

Further, short-term capital gain of ₹ 5,50,000 (₹ 35,50,000 - ₹ 30,00,000) would arise on transfer of shares of ABC Ltd., since such asset is held for a period of less than 12 months.

**Note** – *The above answer is based on the assumption that STT has not been paid at the time of acquisition of shares and the transaction does not fall in the exempted category notified by the Central Government vide Notification No. S.O.1789(E) dated 5.6.2017. However, if it is assumed that STT has been paid at the time of acquisition of shares or that the transaction falls in the exempted category notified by the Central Government, the long-term capital gain would be exempt under section 10(38). In such a case, there would be no tax liability in the A.Y.2017-18. Accordingly, in the A.Y.2018-19, only short-term capital gain of ₹ 5,50,000 would arise in the hands of Mr. Rameshwarm.*

(c) GAAR may, prima facie, apply, when the following twin conditions are satisfied:

- Main purpose of the arrangement being tax benefit, and
- Existence of tainted benefit.

As per the tax treaty between India and Country “A”, there is no tax on capital gains either in the Source country or in Country “A”. Consequently, the capital gains arising to Y Pvt. Ltd. is not taxable in India.

The arrangement of routing investment through Country “A” would result in a tax benefit. Since there is no business purpose in incorporating a company Y Pvt. Ltd. (100% subsidiary of YAN Ltd.) in Country “A”, it can be said that the main purpose of the arrangement is to obtain a tax benefit.

On the question of whether the arrangement has any tainted element, it is evident that there is no commercial substance in incorporating Y Pvt. Ltd. as it does not have any effect on the business risk of YAN Ltd. or cash flow of YAN Ltd.

Additionally, the fact that all rights of shareholders of Y Pvt. Ltd. (designated as Permitted Transferee) are being exercised by YAN Ltd. instead of Y Pvt. Ltd, indicates that Y Pvt. Ltd lacks commercial substance.

As the twin conditions of main purpose being tax benefit and existence of a tainted element are satisfied, GAAR may be invoked in this case.



- (d) (i) As per section 234F, late fee of ₹ 5,000 is leviable, if the return of income is furnished after the due date specified under section 139(1) but furnished on or before 31<sup>st</sup> December of the assessment year. In other cases, late fee of ₹10,000 is leviable.

Since Mr. Abhiram, an individual, having total income of ₹ 13.25 lakhs, furnished his return of income for A.Y. 2018-19 on 12.3.2019 i.e., after 31<sup>st</sup> December 2018, late fee of ₹ 10,000 is leviable.

- (ii) Late fee of ₹ 5,000 or ₹ 10,000, as the case may be, leviable under section 234F cannot exceed ₹ 1,000, if the total income does not exceed ₹ 5,00,000.

Accordingly, late fee not exceeding ₹ 1,000 is leviable in this case, since Mrs. Sirisha's total income of ₹ 4,98,000 does not exceed ₹ 5,00,000.

- (iii) As per section 271DA, penalty equivalent to the sum received in contravention of the provisions of section 269ST (i.e., receipt of a sum of ₹ 2 lakh or more in aggregate from a person in a day otherwise than by an account payee cheque/bank draft or use of ECS through a bank A/c) is leviable.

Accordingly, penalty of ₹ 2.50 lakhs is leviable on Mr. Robert for receiving a sum of ₹ 2.50 lakhs (being a sum in excess of ₹ 2 lakhs) by way of cash from Mr. Rajiv on 31.1.2018.

#### 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) Anil Food Products (P) Ltd. is engaged in manufacturing and selling various food products. It engaged two transporters for carrying its products to various distributors. In previous year 2016-17, it made payments to two transporters towards freight charges without deduction of tax at source. In course of assessment, the Assessing Officer disallowed 30% freight charges invoking section 40(a)(ia) for failure to deduct tax at source. The assessee contends that section 40(a)(ia) is not applicable as the amount of freight was not 'payable' at the year-end, but had been actually paid during the previous year. Examine the correctness of the contention of the assessee. **(4 Marks)**
- (b) The assessee, X & Sons (HUF), holds 30% of shares in PQR (P) Ltd. During the previous year 2016-17 the assessee received loan from the company. The Assessing Officer treated the loan so received as deemed dividend under section 2(22)(e) in the assessment of the HUF. The company declared in its annual return that the loan was given to the HUF, but the share certificates were issued in the name of the Karta i.e. Mr. X. Is the action of the Assessing Officer valid? **(4 Marks)**
- (c) B. Ltd. is amalgamated with A. Ltd. under a scheme of amalgamation duly approved by the Court. A. Ltd. paid excess consideration over the value of net assets acquired by it, which is treated as goodwill as the extra consideration was paid keeping in view the reputation and existing clientele of B. Ltd. A Ltd. has claimed depreciation on the said

goodwill. The Assessing Officer disallowed such depreciation on the ground that goodwill is not an asset falling under Explanation 3 to section 32(1) of the Income-tax Act, 1961. Is the action of the Assessing Officer correct? **(4 Marks)**

- (d) BSL Ltd., a company formed for manufacturing steel, has started setting up a steel plant in Odisha on 1<sup>st</sup> April, 2016 and estimated time for completion of construction is two years. The company's application for term loan has been sanctioned and 30% of the sanctioned amount was disbursed on 1<sup>st</sup> July, 2016. Part of the loan amount received was not immediately required and the unspent amount was kept in short-term fixed deposit on which the company received interest of ₹ 10 lakhs. The company has not included such interest received in its total income on the ground that such interest is a capital receipt and to be reduced from the interest paid during construction period and net interest paid during construction period is to be allocated to various assets on completion of construction. The Assessing Officer proposes to include such interest in its total income under the head "Income from Other Sources." Is the proposition of the Assessing Officer correct? **(4 Marks)**

- (e) Agroha Education Institution was established under section 10(23C)(iiid) to impart and spread education. It earned net surplus during the previous year 2016-17 and 2017-18 ₹ 6 lakhs and 5 lakhs respectively. It claimed exemption under section 10(23C)(iiid).

The Assessing Officer rejected the claim of exemption of the institution on the ground that the assessee had made profit and did not exist solely for the purpose of education.

Examine the validity of the view taken by the Assessing Officer. **(4 Marks)**

#### Answer

- (a) **Issue Involved:** The issue under consideration is whether the provisions of section 40(a)(ia) would be attracted on the amount of freight which was not 'payable' at the year end but has been actually paid during the previous year.

**Provision applicable:** Non-deduction of tax at source on any sum payable to a resident on which tax is deductible at source would attract disallowance of 30% of such sum under section 40(a)(ia).

**Analysis:** Section 40(a)(ia) covers not only those cases where the amount is payable but also when it is paid. The obligation to deduct tax at source is mandatory and applicable irrespective of the method of accounting adopted. If the assessee follows the mercantile system of accounting, then, the moment amount was credited to the account of the payee on accrual of liability, tax was required to be deducted at source. If the assessee follows cash system of accounting, then, tax is required to be deducted at source at the time of making payment.

Section 40(a)(ia) would be attracted for failure to deduct tax in both cases i.e., when the amount is payable or when the amount is paid, as the case may be, depending on the system of accounting followed by the assessee.

**Conclusion:** The contention of Anil Food Products (P) Ltd. that the provisions of section 40(a)(ia) would not be attracted on the amount of freight which was not 'payable' at the year end but has been actually paid during the previous year is, thus, not correct.

**Note** – *The facts of the case are similar to the facts in Palam Gas Service v. CIT [2017] 394 ITR 300, 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.*

*The CBDT has also issued Circular No.10/2013 dated 16.12.2013 clarifying that the provisions of section 40(a)(ia) would cover not only the amounts which are payable on 31st March of a previous year, but also amounts which are payable at any time during the year. Further, the circular also clarifies that in the context of section 40(a)(ia), the term 'payable' would include 'amounts which are paid during the previous year'.*

- (b) **Issue Involved:** The issue under consideration is whether loan given by a closely held company to a HUF is chargeable to tax as deemed dividend under section 2(22)(e) where the share certificates were issued in the name of the Karta (even though the annual return mentioned the name of HUF)?

**Provision applicable:** As per section 2(22)(e), when a loan is given by a closely held company, it is chargeable to tax as deemed dividend if the loan is given to a shareholder (having more than 10% shares in the company) or to a concern in which the shareholder has substantial interest in the concern. 'Concern' includes HUF.

**Analysis:** In the instant case, loans were given to the HUF, X & Sons. There was some dispute as to who was the shareholder - the Karta, Mr. X or the HUF, X & Sons, as share certificates were issued in the name of the former but the annual return mentioned the latter. In either scenario, section 2(22)(e) would be attracted. If X & Sons was the shareholder, as it held more than 10% shares, situation was covered. If Mr. X was the shareholder, then X & Sons would be the concern in which Mr. X has substantial interest.

Further, on the issue whether a HUF can be a shareholder or not, it was observed that on account of *Explanation 3* to section 2(22)(e), a concern includes a HUF. The loan amount is, therefore, to be assessed as deemed dividend under section 2(22)(e).

**Conclusion:** Thus, the action of the Assessing Officer in treating the loan as deemed dividend under section 2(22)(e), is valid.

**Note** – *The facts of the case are similar to the facts in Gopal & Sons (HUF) v. CIT (2017) 391 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.*

- (c) **Issue Involved:** Is A Ltd. entitled to claim depreciation on the value of goodwill considering it as an asset within the meaning of *Explanation 3* to section 32(1)?

**Provision applicable:** *Explanation 3* to section 32(1) states that the expression 'asset' shall mean, *inter alia*, an intangible asset, being know-how, patents, copyrights,

trademarks, licences, franchises or any other business or commercial rights of similar nature.

**Analysis:** A reading of the words 'any other business or commercial rights of similar nature' in the *Explanation* indicates that goodwill would fall under the said expression. In the process of amalgamation, the amalgamated company had acquired a capital right in the form of goodwill because of which the market worth of the amalgamated company stood increased. 'Goodwill' is, therefore, an asset under *Explanation 3(b)* to section 32(1) and depreciation thereon is allowable under the said section.

**Conclusion:** Thus, in the present case, the action of the Assessing Officer disallowing depreciation on the ground that the goodwill is not an asset, is not correct.

**Note –** *The facts of the case are similar to the facts in CIT v. Smifs Securities Ltd. (2012) 348 ITR 302, 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.*

(d) **Issue Involved:** The issue under consideration is whether the interest income of ₹ 10 lakhs on short-term fixed deposits made out of the unspent amount of term loan disbursed to BSL Ltd., would be –

- (i) a capital receipt, which has to be reduced from the interest paid during construction period; or
- (ii) a revenue receipt to be taxable under the head 'Income from Other Sources'.

**Provision applicable:** Interest which is chargeable to tax under the Income-tax Act, 1961 would be assessable under the head "Income from Other Sources", if such income is not exempt, and is not chargeable to tax under any other head including "Profits and gains of business or profession".

**Analysis:** Interest earned by BSL Ltd. is clearly its income and unless it can be shown that there is exemption under any provision of the Act, like section 10, such income will be taxable.

The fact that the source of income was borrowed money does not detract anything from the revenue character of the receipt.

The interest payable on funds borrowed for the business prior to commencement of such business can be capitalized. However, such interest payable cannot be adjusted against interest received on investment of surplus funds assessable under section 56 under the head "Income from Other Sources".

In this case, since the company had deposited the amount of surplus funds available with it prior to commencement of business with the bank solely for the purpose of earning interest, such interest, in the absence of specific exemption in respect thereof, is chargeable to tax under the head "Income from Other Sources".

**Conclusion:** Thus, the proposal of the Assessing Officer to include the interest of ₹ 10 lakhs on short-term fixed deposit in its total income under the head "Income from Other Sources", is correct.

**Note** – *The facts of the case are similar to the facts in PCIT vs. Sangam Power Generation Co. Ltd., wherein the above issue came before the Allahabad High Court. The above answer is based on the rationale of the Allahabad High Court, in the said case.*

- (e) **Issue Involved:** The issue under consideration is where an institution engaged in imparting education incidentally makes profit, would it lead to an inference that it ceases to exist solely for educational purposes?

**Provision applicable:** Section 10(23C)(iiiad) provides for three requirements, namely,

- (i) the education institution must exist solely for educational purposes;
- (ii) it should not be for purposes of profit; and
- (iii) the aggregate annual receipts of such institution should not exceed the amount as may be prescribed, i.e., Rs.1 crore.

**Analysis:** The following tests would apply for determining whether an educational institution exists solely for education purposes and not for purposes of profit:

- (a) Where an educational institution carries on the activity of education primarily for educating persons, the fact that it makes a surplus does not lead to the conclusion that it ceases to exist solely for educational purposes and becomes an institution for the purpose of making profit;
- (b) The predominant object test must be applied – the purpose of education should not be submerged by a profit making motive;
- (c) A distinction must be drawn between the making of surplus and an institution being carried on "for profit". Merely because imparting of education results in making a profit, it cannot be inferred that it becomes an activity for profit;
- (d) If after meeting expenditure, surplus arises incidentally from the activity carried on by the educational institution, it will not cease to be one existing solely for educational purposes. The ultimate test is whether on an overall view of the matter in the concerned assessment year, the object is to make profit as opposed to educating persons.

**Conclusion:** The view taken by the Assessing Officer to reject the claim of exemption of the institution on the ground that it did not exist solely for the purpose of education, only because it incidentally made some profits, is therefore, not correct.

**Note** – *The facts of the case are similar to the facts in Queen's Educational Society v. CIT (2015) 372 ITR 699 (SC), 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.*

**Question 5**

(a) *Konark Digital Solutions Ltd. is an Indian Company in which Yokohoma Inc., a Singapore based company holds 30% shareholding and voting power. During the previous year 2016-17, the Indian company supplied laptops to the Singapore based company @ \$ 800 per piece. The price of laptop supplied to other unrelated parties in Singapore is @ \$ 1200 per piece. During the course of assessment proceedings, the AO carried out primary adjustments and added a sum of ₹ 130 lakhs, being the difference between actual price of laptop and arm's length price for 500 pieces and it was duly accepted by the assessee. On account of this adjustment, the excess money of ₹ 130 lakhs is available with Yokohoma Inc, Singapore. In this context, you are requested to briefly explain the relevant provisions of Income-tax Act, 1961 and suggest suitable solution for the following issues:*

(i) *What is the effect of this transaction on the taxable income of Konark Digital Solutions Ltd. for the assessment year 2018-19 on the basis that it declared an income of ₹ 250 lakhs and the excess money is still lying with Yokohoma Inc. till today?*

*Assume the rate of exchange as 1 \$ = ₹ 65 and the marginal cost of lending rate of SBI as on 01.04.2017 at 10.75%.*

(ii) *Would taxable income of Konark Digital Solutions Ltd. undergo any change, if the above adjustment carried out resulted in addition of ₹ 90 lakhs as against ₹ 130 lakhs?*

(iii) *What is the impact of this adjustment on taxable income of Konark Digital Solutions Ltd. for assessment year 2018-19, if such adjustment pertains to the previous year 2015-16 as against 2016-17?* **(6 Marks)**

(b) *On 08.12.2017, search operations were conducted on the business premises of Mr. Sadanandam, Stock Broker in Mumbai by IT authorised Officials. Upon conclusion of search, certain documents/assets, which were not recorded in books of account pertaining to various previous years were found, detailed as under:*

<i>An agreement for purchase of flat indicating total consideration at ₹ 50 lakhs together with cash receipt for ₹ 23 lakhs and cheque receipt for ₹ 27 lakhs whereas sale deed registered for ₹ 27 lakhs.</i>	<i>₹ 23 lakhs</i>	<i>P.Y. 2009-10</i>
<i>Jewellery based on the bill held in his desk drawer in his name.</i>	<i>₹ 28 lakhs</i>	<i>P.Y. 2008-09</i>
<i>Promissory note executed by his uncle in proof of loan taken from assessee.</i>	<i>₹ 15 lakhs</i>	<i>P.Y. 2010-11</i>
<i>Fixed deposit receipts from a bank in the name of assessee.</i>	<i>₹ 12 lakhs</i>	<i>P.Y. 2012-13</i>
<i>Shares and securities in name of family members.</i>	<i>₹ 22 lakhs</i>	<i>P.Y. 2013-14</i>

*Pursuant to the above documents/assets found, the Assessing Officer, under section 153A of the Income-tax Act, 1961 has issued notice for all the previous years from 2008-09 to 2016-17.*

*Mr. Sadanandam contends that the Assessing Officer cannot issue notice under section 153A beyond 6 years i.e. prior to P.Y. 2011-12.*

*Advise suitably on the matter in the context of relevant provisions of Income-tax Act, 1961. (4 Marks)*

- (c) *Examine the applicability of provisions relating to deduction/collection of tax at source and compute the liability, if any, for deduction/collection of tax at source in the following cases for financial year ended 31st March, 2018 as per provisions contained under the Income-tax Act, 1961:-*
- (i) *In terms of agreement between A (the Owner of land) and B (Developer and Builder) the Developer, B agrees to allot 5 apartments to the owner in part consideration for providing his land and also agreed to pay a sum of ₹ 25,00,000. In terms of the agreement, Mr. B issued a cheque for ₹ 15,00,000 towards part of consideration on 30.03.2018.*
  - (ii) (1) *Rent of ₹ 60,000 per month deposited by Mr. Shrikanth, software employee on 1<sup>st</sup> of every month in advance, in the account of Mr. Ashok, who does not provide his PAN. The house was taken on rent with effect from 01.07.2017 and he vacated the house on 28.02.2018.*  
 (2) *Would there be any change in TDS, if Mr. Ashok furnished his PAN to the tenant?*
  - (iii) *₹ 19,50,000 credited to the account of Digitec Studios (a partnership firm) on 31.03.2018 by B-TV, Television channel, towards part consideration for shooting of Tele Episode for 10 weeks as per the storyline, contents and specifications of B-TV channel. (6 Marks)*

#### **Answer**

- (a) (i) On account of the primary adjustment of ₹ 130 lakhs made by the Assessing Officer, the total income of Konark Digital Solutions Ltd. for A.Y.2017-18 would increase by ₹ 130 lakhs. In this case, secondary adjustment has to be made since –
- (1) The company has accepted the primary adjustment made by the Assessing Officer;
  - (2) The primary adjustment is in respect of A.Y.2017-18; and
  - (3) The primary adjustment exceeds ₹ 100 lakhs.

Accordingly, the excess money (i.e., ₹ 130 lakhs) available with the associated enterprise (i.e., Yokohoma Inc., Singapore) not repatriated to India within 90 days of the date of the order of the Assessing Officer would be deemed as an advance

made by the Konark Digital Solutions Ltd. to its associated enterprise, Yokohoma Inc. Interest would be calculated on such advance at the rate of six month LIBOR as on 30<sup>th</sup> September + 3%, since the international transaction is denominated in \$. Such interest, if any, for the P.Y.2017-18 would be added to his total income of ₹250 lakhs for A.Y.2018-19.

In order to avoid this tax implication, the excess money (i.e., ₹130 lakhs) available with the associated enterprise (i.e., Yokohoma Inc., Singapore) must be repatriated to India within 90 days of the date of the order of the Assessing Officer.

- (ii) Since secondary adjustment in the books of account is not required if the primary adjustment does not exceed ₹ 100 lakhs, no secondary adjustment needs to be made in the books of account if the primary adjustment for A.Y.2017-18 is only ₹ 90 lakhs. The total income for A.Y.2018-19 would, therefore, be only ₹ 250 lakhs.
  - (iii) Secondary adjustment in the books of account is not required where the primary adjustment is made in respect of A.Y.2016-17 (relevant to P.Y.2015-16) or any earlier assessment year. Therefore, there would be no impact of this adjustment on the taxable income of the company if primary adjustment pertains to P.Y.2015-16. The taxable income would remain at ₹ 250 lakhs.
- (b) In this case, Mr. Sadanandam does not object to issue of notice in relation to income escaping assessment for the P.Y.2012-13 [in relation to bank fixed deposit] and P.Y.2013-14 [in relation to shares and securities in the name of family members], since the period falls within the six previous years immediately preceding the P.Y.2017-18 in which the search was conducted. He is objecting to issue of notice in relation to income escaping assessment beyond the six year period i.e., from P.Y.2008-09 to P.Y.2010-11.

As per section 153A, issuance of notice and assessment or reassessment thereunder can also be made for an assessment year preceding the assessment year relevant to the previous year in which search is conducted which falls beyond six assessment years but not beyond ten assessment years from the end of the assessment year relevant to the previous year in which search is conducted, provided that -

- (i) the Assessing Officer has in his possession books of account or other documents or evidence which reveal that the income which has escaped assessment amounts to or is likely to amount to ₹ 50 lakhs or more in one assessment year or in aggregate in the relevant assessment years;
- (ii) such income escaping assessment is represented in the form of asset which **shall include** immovable property being land or building or both, shares and securities, deposits in bank account, loans and advances.
- (iii) the income escaping assessment or part thereof relates to such year or years; and
- (iv) search under section 132 is initiated on or after 1-4-2017.



Jewellery is, therefore, not included in the meaning of "asset". Accordingly, notice cannot be issued for P.Y.2008-09 in relation to income escaping assessment represented in the form of jewellery.

Further, since the aggregate income escaping assessment represented in the form of assets amounts to only ₹ 38 lakhs [₹ 23 lakhs, being cash payment for purchase of flat in P.Y.2009-10 and ₹ 15 lakhs, being loan given to his uncle in the P.Y.2010-11], the Assessing Officer cannot issue notice under section 153A in relation to income escaping assessment for those years.

Thus, in this case, the contention of Mr. Sadanandam that notice cannot be issued beyond the 6 year period is **correct**.

**Note** – *Since the definition of "asset" is an inclusive one, it is possible to take a view that jewellery also falls within the scope of the above provision, even though not specifically mentioned in the definition. If this view is taken, then, the aggregate income escaping assessment represented in the form of assets would amount to ₹ 66 lakhs [₹ 23 lakhs, being cash payment for purchase of flat in P.Y.2009-10 and ₹ 28 lakhs in the form of jewellery bills for P.Y. 2008-09, ₹ 15 lakhs, being loan given to his uncle in the P.Y.2010-11]. Therefore, the Assessing Officer can issue notice under section 153A in relation to income escaping assessment for those years. Thus, if this view is taken, the contention of Mr. Sadanandam that notice cannot be issued beyond the 6 year period would not be correct.*

- (c) (i) Since the agreement between the owner of land, A, and the developer and builder, B, is in the nature of specified agreement under section 45(5A), which involves cash consideration as well, TDS@10% on ₹ 25,00,000, being the cash component payable to A, is deductible under section 194-IC. Assuming that only ₹ 15,00,000, being the amount paid to A on 30.3.2018, has actually been credited to the account of A in the books of B in the P.Y.2017-18, the TDS liability would be ₹ 1,50,000, being 10% of ₹ 15,00,000.

**Note** – *If it is assumed that ₹ 25,00,000 has been credited to the account of A in the books of B in the P.Y.2017-18, even though only ₹ 15,00,000 has been actually paid in that year, then, tax has to be deducted@10% on ₹ 25,00,000, being the amount credited to the account of A. TDS liability would be ₹ 2,50,000, being 10% of ₹ 25,00,000.*

- (ii) (1) Since Mr. Shrikanth pays rent exceeding ₹ 50,000 per month in the F.Y. 2017-18, he is liable to deduct tax at source @5% under section 194-IB on such rent for F.Y. 2017-18.

However, since Mr. Ashok does not provide his PAN to Mr. Shrikanth, tax would be deductible@20%, instead of 5%.

Tax has to be deducted from rent payable for the last month of the P.Y.2017-18. However, since he vacated the premises in February, 2018, tax has to be deducted from rent paid on 1.2.2018 for the month of February, 2018.

Tax of ₹ 96,000 [₹ 60,000 x 20% x 8] has to be deducted but the same has to be restricted to ₹ 60,000, being rent for February, 2018.

- (2) If Mr. Ashok furnished his PAN to Shrikanth, tax would be deductible@5%.

Tax of ₹ 24,000 [₹ 60,000 x 5% x 8] has to be deducted from rent paid on 1.2.2018 for the month of February, 2018.

- (iii) Shooting of Tele Episode for B-TV as per the storyline, contents and specifications of B-TV falls within the scope of “work” under section 194C. Since the amount credited exceeds the specified limit of ₹ 30,000, TDS@2% under section 194C is attracted on ₹ 19,50,000 credited to the account of Digitec Studios, a partnership firm.

TDS liability would be ₹ 39,000 [being 2% of ₹19,50,000]

### Question 6

- (a) *Examine and state the correctness or otherwise of each of the following statements in the context of provisions contained under the Income-tax Act, 1961 and answer by giving brief reasons/contents thereof:*
- (i) *Tax Avoidance is not defined in taxing statute. It is the outcome of actions taken by the assessee, none of which or no combination of which is illegal or forbidden by the law as such. The international literature tends to describe the tax avoidance in many ways. If yes, state briefly ways of tax avoidance.*
  - (ii) *The double taxation avoidance treaties entered into by the Government of India do not override the domestic law.*
  - (iii) *The contents of a business transaction done through e-commerce are not different from that of a business transaction carried out through traditional means. Which are the distinct means/methods for doing e-business?*
  - (iv) *Rakesh is resident in India during the previous year ended 31.03.18 and had agricultural income of ₹ 20 lakhs from the lands located in Pakistan. He had paid tax on such agricultural income in Pakistan for which he is not entitled for a deduction from the tax payable in India.*
  - (v) *Rose N. LLP of UK carried business in India against which a demand of ₹ 50 lakhs for A.Y. 2016-17 is outstanding. The LLP does not have any assets in India and has also closed the business. The tax recovery officer (TRO) cannot recover such demand by having attachment on the assets of Rose N. LLP located in UK.*
  - (vi) *A non-resident Indian despite having during the year ended on 31.3.18 income in India from the investment and long term capital gains is not required to file the return of income for A.Y. 2018-19.*

**(12 Marks)**

(b) *During the pendency of reassessment proceedings, the Assessing Officer has provisionally attached the property of the assessee, Mr. Malhotra in accordance with powers vested under section 281B of the Income-tax Act, 1961 on 21<sup>st</sup> December, 2017. The fair market value of the said property is ₹ 90 lakhs. Mr. Malhotra proposes to furnish bank guarantee to the tune of ₹ 90 lakhs in lieu of provisional attachment of property and approached the AO to revoke the attachment. AO refused such proposal. Answer the following issues in the context of relevant provisions of the Act :-*

- (i) *Whether AO can refuse to accept bank guarantee, if not, is it mandatory on his part to pass revocation order for the provisional attachment of property?*
- (ii) *Specify circumstances under which the AO is empowered to invoke the bank guarantee.*

### Answer

(a) (i) The statement is correct.

It is the outcome of action taken by the taxpayer, none of which or combination of which, is illegal or forbidden by law.

International literature on the subject tends to describe it in the following ways:

- ◆ Tax avoidance involves the legal exploitation of tax laws to one's own advantage.
- ◆ Every attempt by legal means to prevent or reduce tax liability which would otherwise be incurred, by taking advantage of some provisions or lack of provisions in the law.
- ◆ An arrangement entered into solely or primarily for the purpose of obtaining a tax advantage.

Taxpayers consider it their legitimate right to arrange their affairs in a manner as to pay the least tax possible.

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

Section 90(2) provides that where a double taxation avoidance treaty is entered into by the Government, the provisions of the Income-tax Act, 1961 would apply to the extent they are more beneficial to the assessee.

In case of any conflict between the provisions of the double taxation avoidance agreement and the Income-tax Act, 1961, the provisions of the DTA would prevail over the Act in view of the provisions of section 90(2), to the extent they are more beneficial to the assessee<sup>3</sup>.

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<sup>3</sup>CIT v. P.V.A.L. Kulandagan Chettiar (2004) 267 ITR 654 (SC)

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

The content of business transaction done through e-commerce is not the same as the content of a business transaction carried out through traditional means. The taxation of e-commerce transactions pose a stiffer challenge as compared to taxation of traditional business transactions.

In e-commerce, there are three distinct means of doing business:

- (1) electronic advertising,
- (2) electronic sales; and
- (3) electronic delivery.

The presence of anyone or more of these is sufficient to characterize the business as e-commerce.

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

Agricultural income from lands located outside India would not be exempt from income-tax in India under section 10(1) in the hands of a resident but would be chargeable to tax in his hands in India.

However, while computing Rakesh's income-tax liability in India, he would be entitled for a deduction in respect of tax paid on agricultural income in Pakistan under any law for the time being in force in that country from the income-tax payable by him in India.

**(v) The statement is correct.**

Where an assessee is in default or is deemed to be in default in making a payment of tax, the TRO may, if the assessee has property in a country outside India (being a country with which India has an agreement for the recovery of income-tax under this Act and the corresponding law in force in that country), forward to the CBDT a certificate drawn up by him under section 222 and the CBDT may take such action thereon as it may deem appropriate having regard to the terms of the agreement with such country.

Accordingly, since India has an agreement with UK, the Tax Recovery Officer (TRO) cannot recover such demand by having attachment on the assets of Rose N. LLP located in UK, but has to forward to the CBDT, a certificate drawn up by him under section 222.

**(vi) The statement is correct/partially correct.**

A non-resident Indian need not furnish a return of income u/s 139(1), if he satisfies both of the following conditions:-

- (a) His total income consists only of investment income or income by way of long-term capital gains or both; and

- (b) Tax deductible at source under the provisions of Chapter XVII-B has been deducted from such income.

**Note:** The statement would be correct only if both the above conditions are satisfied.

- (b) (i) Since Mr. Malhotra proposes to furnish a bank guarantee from a scheduled bank for an amount equal to the fair value of the property, the Assessing Officer has to revoke provisional attachment of property.

In such situation, as per section 281B, the Assessing Officer cannot refuse to accept bank guarantee, and has to mandatorily pass an order in writing revoking the provisional attachment of property.

- (ii) The Assessing Officer can invoke the bank guarantee in the following two circumstances –

- (1) **Failure to pay** - Where a notice of demand specifying a sum payable is served upon Mr. Malhotra, and he fails to pay such sum within the time specified in the notice of demand;
- (2) **Failure to renew** - Where Mr. Malhotra fails to renew the bank guarantee or fails to furnish a new guarantee from a scheduled bank for an equal amount 15 days before the expiry of such guarantee.

#### Question 7

- (a) Pranab, a non-resident Indian (aged 41) has furnished the following particulars of income relating to financial year 2017-18:

<b>Particulars</b>	<b>₹</b>
Loss from house property located in India	2,50,000
Income from business carried on in India	7,50,000
Income from mutual funds specified in section 10(23D)	65,000
Interest on debentures of Indian company subscribed in US\$	1,50,000
Interest on loan taken for purchase of above debentures	20,000
Long-term capital gains on sale of debentures subscribed in US \$ in the year 2008-09 for ₹ 5,00,000 and sold in the year 2017-18 for ₹ 8,00,000. (Cost Inflation Index- Financial Year 2008-09: 137; Financial Year 2017 -18: 272)	
Brokerage on sale of debentures	12,000

Compute tax payable by Pranab for Assessment Year 2018-19, assuming that he opts for provisions of Chapter XII-A of the Income- tax Act, 1961. **(6 Marks)**

- (b) Ashoke's assessment was made under section 143(3) of the Income-tax Act, 1961 for A.Y. 2015-16. Being aggrieved with certain additions, he preferred an appeal to the Commissioner (Appeals), which is pending at present and not being adjudicated.

In the above situation, give your opinion on the following issues in the context of provisions contained under the Income-tax Act, 1961:

- (i) There is new information that certain income for the same assessment year had escaped assessment. Is it possible for the Assessing Officer to issue notice under section 148? **(2 Marks)**
- (ii) Certain mistake in respect of issue which is not subject matter of appeal is noticed by the Assessing Officer. Can he pass an order under section 154 for rectifying the mistake? **(1 Mark)**
- (iii) If Ashoke files petition for revision under section 264 for a matter not being subject matter of appeal, will such petition be maintainable? **(2 Marks)**
- (c) SG Securities Private Ltd. is engaged in the business of trading in shares and securities. The details of shares held by it as stock-in-trade as on 31<sup>st</sup> March, 2018 are given below:

Shares	Cost per share (₹)	Net realisable value per share (₹)
500 shares of P. Ltd	50	65
200 shares of Q. Ltd	35	32
300 shares of R. Ltd	125	110
250 shares of S. Ltd	25	40

The company values its year-end stock-in-trade in accordance with Accounting Standard (AS) 13 - "Accounting for investments of the Companies (Accounting Standards) Rules, 2006".

Determine the amount of adjustments, if any, required to be made in computation of income for Assessment Year 2018-19. **(5 Marks)**

**Answer**

- (a) **Computation of tax payable by Mr. Pranab for A.Y. 2018-19**

Particulars	₹	₹
<b>Profit and gains of business or profession</b>		
Income from business carried on in India	7,50,000	
Less: Loss from house property of ₹ 2,50,000, restricted to ₹ 2,00,000 by virtue of section 71(3A)	<u>2,00,000</u>	5,50,000
Balance loss of ₹ 50,000 [₹ 2,50,000 – ₹ 2,00,000] from house property to be carried forward to A.Y.2019-20.		

<b>Capital Gains</b>		
<b>Long term capital gains</b>		
Sale Consideration	8,00,000	
Less: Brokerage on sale of debentures	<u>12,000</u>	
Net sale consideration	7,88,000	
Less: Cost of acquisition [Indexation benefit would not be available for calculating cost of acquisition while computing long term capital gains under Chapter XII-A]	<u>5,00,000</u>	2,88,000
<b>Income from Other Sources</b>		
Income from mutual fund specified in section 10(23D) [Exempt under section 10(35)]	Nil	
Interest on debentures of Indian company <sup>4</sup> [No deduction is allowed under any provision of the Act in respect of any expenditure or allowance while computing the interest on debentures applying the provisions under Chapter XII-A. Therefore, interest on loan taken for purchase of debentures is not deductible].	1,50,000	1,50,000
<b>Gross Total Income/ Total Income</b>		<b>9,88,000</b>
<b>Tax liability [as per provisions of Chapter XII-A]</b>		
Tax on long term capital gains (₹ 2,88,000 x 10%)	28,800	
Tax on interest on debentures, being investment income (₹ 1,50,000 x 20%)	30,000	
Tax on balance income of ₹ 5,50,000 as per the normal provisions of the Act		
Upto ₹ 2,50,000	Nil	
₹ 2,50,001 – ₹ 5,00,000 @5%	12,500	
₹ 5,00,001 – ₹ 5,50,000@20%	<u>10,000</u>	
	<u>22,500</u>	81,300
Add: Education cess and SHEC@3%		2,439
<b>Tax liability</b>		<b>83,739</b>
<b>Tax liability (rounded off)</b>		<b>83,740</b>

<sup>4</sup>It is assumed that the Indian company is not a private company.

- (b) (i) Yes, it is possible for the Assessing Officer to issue notice under section 148.

The Assessing Officer may assess or reassess such income, other than the income involving matters which are the subject matters of any appeal, reference or revision, which is chargeable to tax and has escaped assessment.

Therefore, even when an appeal is pending before Commissioner (Appeals), the Assessing Officer can issue notice u/s 148 in respect of income chargeable to tax which has escaped assessment, if such income is not the subject matter of the appeal before the Commissioner (Appeals).

- (ii) Yes, the Assessing Officer is empowered to pass an order u/s 154.

Section 154 provides that where any matter had been considered and decided in any proceeding by way of appeal, rectification of such matter cannot be done by the Assessing Officer. However, in respect of the matter which has not been considered and decided in the appeal, the order of the Assessing Officer can be rectified under section 154.

In this case, since the mistake is in respect of a matter which is not the subject matter of appeal, the Assessing Officer can pass an order under section 154 for rectifying the mistake, provided the same is a mistake apparent on the record.

- (iii) No, the Commissioner cannot invoke jurisdiction u/s 264.

As per section 264(4), the Commissioner shall not revise any order under section 264, where such order has been made the subject of an appeal to the Commissioner (Appeals).

Therefore, under section 264, the Commissioner cannot revise an order which is pending before the Commissioner (Appeals), even if the revision pertains to a matter, other than the matter(s) covered in the appeal. Accordingly, in the present case, petition filed by Mr. Ashok for revision under section 264 is not maintainable.

- (c) Shares held as stock-in-trade are accounted and disclosed in the financial statements in the same manner as in respect of current investment.

As per Accounting Standard (AS) 13, current investments are carried in the financial statements at the lower of cost and fair value determined either on an individual investment basis or by category of investment. However, the more prudent and appropriate method is to carry investments individually at the lower of cost and fair value. Net realizable value (NRV) can be taken as fair value, in this case.

Since the company values its year end stock-in-trade in accordance with the AS 13, it would have valued the shares at the lower of cost and fair value on individual investment basis.



**Valuation of shares held as stock in trade as per AS 13**

Security	Cost (₹)	NRV (₹)	Lower of cost or NRV
500 shares of P. Ltd.	25,000 (500 x 50)	32,500 (500 x 65)	₹ 25,000
200 shares of Q. Ltd.	7,000 (200 x 35)	6,400 (200 x 32)	₹ 6,400
300 shares of R. Ltd.	37,500 (300 x 125)	33,000 (300 x 110)	₹ 33,000
250 shares of S. Ltd.	6,250 (250 x 25)	10,000 (250 x 40)	₹ 6,250
<b>Value of stock-in-trade as per AS 13</b>			<b>₹ 70,650</b>

<sup>5</sup>ICDS-VIII on securities requires securities held as stock-in-trade to be valued at actual cost initially recognised or net realisable value (NRV) at the end of that previous year, whichever is lower. It also requires the comparison of actual cost initially recognised and net realisable value to be done category wise and not for each individual security.

**Valuation of shares held as stock in trade as per ICDS VIII**

Security	Cost (₹)	NRV (₹)	Lower of cost or NRV
500 shares of P. Ltd.	25,000 (500 x 50)	32,500 (500 x 65)	
200 shares of Q. Ltd.	7,000 (200 x 35)	6,400 (200 x 32)	
300 shares of R. Ltd.	37,500 (300 x 125)	33,000 (300 x 110)	
250 shares of S. Ltd.	6,250 (250 x 25)	10,000 (250 x 40)	
<b>Value of stock-in-trade as per ICDS</b>	<b>75,750</b>	<b>81,900</b>	<b>₹ 75,750</b>

SG Securities Pvt. Ltd. is required to value its shares held as stock in trade at ₹ 75,750 as per ICDS VIII for income-tax purpose. Accordingly, its income would be increased by ₹ 5,100 (₹ 75,750 – ₹ 70,650).

**Note** – AS 13 also permits valuation of shares on category of investment basis, in which case, there would be no increase in total income under the Income-tax Act, 1961.

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<sup>5</sup>Para 9 of ICDS VIII