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NOVEMBER, 2020 EXAMINATION

Question 1:

MP Ltd. is engaged in the manufacture of textile since 01.05.2010. Its Statement of Profit and Loss for the financial year ended 31st March, 2022 shows a profit of ₹ 560 lakhs after debiting or crediting the followings items:

- (a) *Depreciation charged on the basis of useful life of assets as per Companies Act is ₹ 52 lakhs.*
- (b) *Industrial power tariff concession of ₹ 5.40 lakhs, received from Madhya Pradesh Government was credited to Statement of Profit and Loss.*
- (c) *Contribution of ₹ 2.50 lakhs to a scientific laboratory functioning at the national level with a specific direction for use of the amount for scientific research programme approved by the prescribed authority.*
- (d) *Profit of ₹ 8 lakhs on sale of a plot of land to AVM Limited, a domestic company, the entire shares of which are held by the assessee company. The plot was acquired by MP Ltd. on 30th June, 2020.*
- (e) *Payment of ₹ 3.50 lakhs towards transportation of various materials procured by one of its units to M/s Bansal Transport, a partnership firm, without deduction of tax at source. The firm opts for presumptive taxation under section 44AE and has furnished a declaration to this effect. It also furnished its Permanent Account Number in the tender document.*
- (f) *Bonus paid to staff includes an amount of ₹ 1.50 lakhs which was provided for in the books on 31.03.2021 but has been paid in August 2021.*
- (g) *Interest of 15 lakhs paid on loans taken specifically for purchase of plant and machinery. Out of this ₹ 5 lakhs is for upto the period till such machinery was commissioned.*
- (h) *A debtor who owed the company an amount of ₹ 20 lakhs was declared insolvent and hence, was written off by debiting the Statement of Profit and Loss.*
- (i) *₹ 5 lakhs, being the additional compensation received from the State Government pursuant to an interim order of Court in respect of land acquired by the State Government in the previous year 2014-15.*
- (j) *In order to expand its overseas business, the company planned online advertisement campaign for which it engaged Fastex Inc., a London based company not having any PE in India, and paid ₹ 5 lakhs for services availed. No tax/TDS was deducted by the company*
- (k) *₹ 2 lakhs paid to consultant for expert opinion on new business set-up.*

Additional Information:

- (i) Normal depreciation computed as per Income-tax Rules on the book assets is ₹ 71 lakhs.
- (ii) Debenture of face value of 1500 lakhs having 5 years tenure were issued at a discount of 3% and were subscribed in full.
- (iii) The company received a bill for ₹ 3 lakhs on 31st March, 2022 from a supplier of cotton for supply made in March, 2022. The bill was omitted to be recorded in the books in March, 2022. Payment against the bill was made in April, 2022 and necessary entry was made in the books then. The same has been considered in closing inventory valuation during physical verification conducted on 31.03.2022.
- (iv) The company has purchased 1000 bales of cotton at ₹ 5,000 per bale from Enpee LLP, a firm in which majority of the directors are partners. The normal selling price in the market for the same material is ₹ 4,600 per bale.

Compute total business income of the company for A.Y. 2022-23 giving a brief explanation to each item of addition or deletion. Ignore MAT provisions and the provisions of section 115BAA.

[NOVEMBER 2020]

Answer:

Computation of Business Income of MP Ltd. for the A.Y. 2022-23			
Particulars		Amount (₹)	
Profits and gains of business and profession			
Net profit as per the statement of profit and loss			5,60,00,000
Add:	Items debited but to be considered separately or to be disallowed		
(a)	Depreciation as per Companies Act	52,00,000	
(e)	Payment to transporter		
	[No tax is required to be deducted at source u/s 194C on payment to a transporter declaring income under section 44AE, who has furnished a declaration to that effect along with PAN. Therefore, disallowance @ 30% of payment for non-deduction at source u/s 40(a)(ia) would not be attracted in respect of payment of ₹ 3.50 lakhs to M/s. Bansal Transport]		
(f)	Bonus paid to staff in respect of P.Y. 2020-21	1,50,000	
	[Bonus for P.Y. 2020-21 is stated to have been provided in the books of account of that year. It is also allowable as deduction under the Income-tax Act, 1961 in that year since the same has been paid in August, 2021 i.e., on or before the due date u/s 139(1). Since the bonus for the earlier previous year has once again been debited to statement of profit and loss of this year, the same is required to be added back while computing business income, as it is not allowable as deduction again in the P.Y. 2021-22)		
(g)	Interest on loan for purchase of plant and machinery	5,00,000	
	[Interest on loan taken for purchase of plant and machinery for use in business is allowable as deduction u/s 36(1)(iii) for the period after the date the asset is first put to use. Hence, such interest		

	for the period upto the date the asset is first put to use is not allowable as deduction. Accordingly, out of ₹ 15 lakhs paid towards such interest, only ₹ 10 lakhs is allowable as deduction. ₹ 5 lakhs, being interest paid upto the the date till such machinery was commissioned has to be added back while computing business income]		
(h)	Bad debts written off		
	[No adjustment is required in respect of debt of ₹ 20 lakhs written off owing to insolvency of the debtor, since bad debts written off in the books of account is fully allowable as deduction u/s 36(1)(vii). Since the said amount has already been debited to the statement of profit and loss, no further adjustment is required]		
(j)	Payment for online advertisement services	5,00,000	
	[Since the payment for online advertisement services is made to a non-resident not having PE in India, equalization levy @ 6% has to be deducted. Since the same has not been deducted, disallowance @ 100% of the payment would be attracted u/s 40(a)(ib)]		
(k)	Payment to Consultant for opinion on new business	2,00,000	
	[Payment to consultant for expert opinion on new business is capital in nature. Hence, the same is not allowable as deduction u/s 37. Since the amount has been debited to the statement of profit and loss, the same has to be added back]		
(iv)	Purchase of cotton at a price higher than the FMV	4,00,000	
	[Since the purchase is from a related party, a firm in which majority of the directors of the company are partners, at a price higher than the fair market value, the difference between the purchase price (₹ 5,000 per bale) and the fair market value (₹ 4,600 per bale) multiplied by the quantity purchased (1000 bales) has to be added back]		69,50,000
			6,29,50,000
Less:	Items credited to statement of profit and loss, but not includible in business income/ permissible expenditure and allowances		
(b)	Industrial power tariff concession received from State Government		
	[Any assistance in the form of, Inter alia, concession received from the Central or State Government would be treated as income. Since the same has been credited to statement of profit and loss, no adjustment is required]		

(c)	Contribution to National Laboratory	NIL	
	[Contribution to National laboratory for scientific research qualifies for deduction @ 100% u/s 35(2AA). Since 100% has been debited to the statement of profit and loss, no further treatment is required while computing business income]		
(d)	Profit on sale of plot of land	8,00,000	
	[Short-term capital gains arise on sale of plot of land held for less than 24 months. However, in this case, since the transfer is to a 100% subsidiary company, which is an Indian company, the same would not constitute a transfer for levy of capital gains tax as per section 47(iv). Since the same has been credited to the statement of profit and loss, the same has to be reduced while computing business income]		
(i)	Additional compensation received from State Government in respect of land	5,00,000	
	[Since the additional compensation has been received pursuant to an interim order of the Court, the same would be deemed as income chargeable to tax under the head “ Capital Gains ” in the year of final order as per section 45(5). Since the compensation has been credited to the statement of profit and loss, the same has to be deducted while computing business income]		
A(i)	Depreciation as per Income-tax Rules, 1961	71,75,000	
	[₹ 71,00,000, being normal depreciation on book assets + ₹ 75,000, i.e., 15% of ₹ 5,00,000, being the interest on loan taken for acquiring plant and machinery upto the date of commissioning, assuming that the same has been put to use for more than 180 days in the P.Y. 2021-22]		
A(ii)	Discount on issue of debentures	9,00,000	
	[Allowable as deduction over the tenure of debentures i.e., 5 years. Hence, 1/5 th allowable as deduction in P.Y. 2021-22 (1/5 th of ₹ 45 lakhs, being 3% of ₹ 1500 lakhs)]		
A(iii)	Purchases omitted to be recorded in the books of account	3,00,000	
	Since the purchase is made in March, 2022 (i.e., P.Y. 2021-22), in respect of which bill of ₹ 3 lakhs received in March, 2022, which has been omitted to be recorded in the books in this year, it has to be deducted to compute the business income. It is logical to assume that the company is following mercantile system of accounting		96,75,000
Profits and gains from business and profession			5,32,75,000

Question 2:

(a) *Asma Rani Public Charitable Trust runs a hospital cum Rehabilitation Centre to treat patients suffering from leprosy. The trust is registered ups 12AB and following cash system of accounting, furnishes the following information:*

- *Gross Receipts from Hospital* ₹ 560 Lakhs
- *Gross Receipts from Rehabilitation* ₹ 220 Lakhs
- *Fees not realized from patients as at 31.3.2022* ₹ 36 Lakhs
- *Administration Expenses paid for hospital* ₹ 335 Lakhs
- *Administration Expenses paid for Rehab. Centre* ₹ 138 Lakhs
- *Acquired a building for ₹ 150 lakhs on 1.5.2021 for expansion of Rehab. centre (Cost of land included therein ₹ 85 lakhs). Stamp duty value of Land & Building on the date of registration Was ₹ 185 lakhs.*
- *Grant received from State Govt. ₹ 7.50 lakhs*
- *Administration expense includes payments of ₹ 12 lakhs to resident doctors & contractors on which TDS is required to be deducted U/s 192 & 194C but such TDS has not been deducted.*
- *Voluntary contributions (including Corpus Donations for ₹ 10 lakhs) is ₹ 20 Lakhs. These contributions are included in Gross Receipts of hospital.*
- *Anonymous donations received ₹ 8 Lakhs.*
- *Amount donated to Jan Kalyan Trust registered under section 12AB running similar hospital in Bihar (includes Corpus donation of ₹ 5 Lakhs from hospital receipts) – ₹11 Lakhs.*
- *Repayment of loan taken earlier for construction of Rehab. Centre – ₹ 6.65 Lakhs.*
- *The trust set apart ₹ 25 lakhs for acquiring another table & equipment for OT but the amount was spent in October 2022. Form 10 was filed and A.O. was duly informed as required u/s 11(2). Investment made in the units of UTI (mode prescribed u/s 11(5)) of ₹ 15 lakhs upto 31.03.2022.*

Compute the Total Income of the trust and its I.T. Liability for the A.Y. 2022-23.

(b) *Answer any one out of the following two questions:*

- (i) *M/s Kashdash (P) Ltd. an Indian company in the business of event management throughout India withdraws ₹ 10 lakhs in cash on 7th day of each month during the financial year 2021-22 from its current account with Union Bank, for local payments and for payment of wages and incentives to temporary employees engaged by it for different events. It did not make any single payment of ₹ 10,000 or more to any person in a day. Examine the liability for tax deduction at source in the present case.*
- (ii) *Mis TQ Inc., a foreign company, seconded some employees to its collaborator M/s Tekwel Ltd., an Indian company, for working on a turnkey project for setting up a pharmaceutical factory. These employees worked with M/s Tekwel Ltd., throughout the P. Y. 2021-22. The employees were in receipt of salary from M/s Tekwel Ltd. They were also in receipt of special allowance directly from M/s TQ Inc. in foreign currency outside India. M/s Tekwel Ltd. deducted tax under section 192, on the component of salary paid by it, without taking into account the special allowance paid abroad by M/s TQ Inc. in foreign currency to these employees.*

For this reason, the Revenue authorities treated M/s Tekwel Ltd. as an 'assessee in-default' under Section 201 for non-deduction of tax at source on the "special allowance" component of salary paid by M/s TQ Inc. under section 192. Is such treatment by the Revenue Authorities and the consequent levy of interest and penalty justified?

[NOVEMBER 2020]

Answer:

(a) **Computation of total income of Asma Rani Public Charitable Trust for the A.Y. 2022-23**

Particulars	₹ in lakhs	
Gross receipts from Hospital (other than voluntary contribution of ₹ 20 lakhs)		540.000
Gross receipts from Rehabilitation Centre		220.000
Grant received from State Govt. [See Note 3 below]		7.500
Fees not realized from patients as at 31.3.2022 (not includible, since trust follows cash system of accounting)		-
		767.500
Add: Voluntary contributions other than corpus donations of ₹ 10 lakhs [See Note 4]		10.000
		777.500
Add: Anonymous donations [to the extent not chargeable to tax @ 30% u/s 115BBC(1)(i)] [See Notes 1 & 2 below]		1.400
		778.900
Less: 15% of income eligible for being set apart without any conditions		116.835
		662.065
Less: Amount applied for charitable purposes		
- On revenue account – Administrative expenses: For Hospital (Out of ₹ 335 lakhs, ₹ 3.6 lakhs, being 30% of 12 lakhs, would be disallowed, since tax is not deducted u/s 192 & 194C on such amount paid to resident doctors & contractors)	331.40	
For Rehabilitation Centre	138.00	
- On capital account – Land & Building	150.00	
[Section 56(2)(x) is not attracted in respect of value of property received by a trust or institution registered u/s 12AB]		
- Donation to Jan Kalyan Trust registered u/s 12AB		
[allowable since the same is out of current year income of the trust, even though the objects of the trust are different. Only corpus donations are not permissible to other trusts registered u/s 12AB. Thus, out of ₹ 11 lakhs, ₹ 5 lakhs towards corpus are not allowable as deduction.]	6.00	
- Repayment of loan taken earlier for construction of Rehab. Centre [See Note 3]	6.65	632.050
		30.015
Less: Amount set apart for acquiring another table & equipment for OT ₹ 25 lakhs would be treated as application for the previous year 2021-22 to the		15.000

extent of ₹ 15 lakhs, being the amount of investment made in units of UTI, a mode prescribed u/s 11(5)		
Total income [other than anonymous donation taxable @ 30% under section 115BBC(1)(i)]		15.015
Add: Anonymous donation taxable @ 30% u/s 115BBC(1)(i) [See Note 2 below]		6.600
Total Income of the trust (including anonymous donation taxable @ 30%)		21.615

Computation of tax liability of the trust for the A.Y. 2022-23	
Particulars	₹
Tax on total income [Excluding anonymous donations] ₹ 5,01,500 × 30% + ₹ 1,12,500]	2,62,950
Tax on anonymous donations taxable @ 30% [₹ 6,60,000 × 30%]	1,98,000
	4,60,950
Add: Health and education cess @ 4%	18,438
Total tax liability	4,79,388
Total tax liability (rounded off)	4,79,390

Note:

(1) As per section 115BBC(1)(i), the anonymous donations in excess of the higher of the following would be subject to tax @ 30%;

- ₹ 1.40 lakh, being 5% of the total donations received i.e., 5% of ₹ 28 lakh [Voluntary contributions including Corpus donations ₹ 20 lakhs (+) Anonymous donations ₹ 8 lakhs]; or
- ₹ 1 lakhs

Therefore, anonymous donations of ₹ 6.60 lakh (₹ 8 lakh – ₹ 1.4 lakh) would be subject to tax @ 30% under section 115BBC(1)(i).

Such anonymous donations which are subject to tax @ 30% are not eligible for the benefit of exclusion from total income under sections 11 and 12.

(2) Grants of ₹ 7.50 lakhs received from State Govt. are not included in the total donations, in the above solution, while computing the limit of 5% of total donations u/s 115BBC(1). This view is taken since Govt. grants are generally given subject to stipulated conditions. However, in Income-tax Form ITR-7, Government grants are included in the total donations for the purpose of computing limit of 5% of total donations u/s 115BBC(1). Hence, the solution should be worked out by including government grants in total donations for computing the limit of 5% of total donations.

(3) As per Finance Act, 2021, no deduction/ exemption is allowed for the amount spent out of the proceeds of any loan or borrowing. However, the deduction is allowed when the amount is repaid to the lender. In the given question, it is assumed that the capital expenditure for expansion of rehab centre done in earlier years was not claimed as application of income in earlier years.

- (4) As per Finance Act, 2021, corpus donations are exempt only if the amount is kept invested in the modes specified u/s 11(5). In the given case, accordingly it is assumed that the amount received as corpus is kept invested in the modes specified u/s 11(5) and the same is not used for the expenditure of the trust.
- (b) (i) Section 194N provides that a banking company, who is responsible for paying, in cash, any sum or aggregate of sums exceeding ₹ 1 crore during the previous year to any person from one or more accounts maintained by such recipient-person with it, shall deduct tax at source @ 2% of such sum.

In the present case, M/s Kashdash (P) Ltd. an Indian company has withdrawn ₹ 10,00,000 in cash on 7th of each month from the current account with Union Bank, which is totaling to ₹ 1.20 crores in aggregate during the previous year 2021-22.

Thus, Union Bank is required deducted tax at source of ₹ 2,20,000 [i.e., 2% of ₹ 1.10 crores] from the withdrawal of ₹ 10 lakhs in the month of Feb, 2022 i.e., 7th Feb, 2022 and 2% of ₹ 10 lakhs i.e., ₹ 20,000 from the withdrawal of ₹ 10 lakhs in the month of March 2022 i.e., on 7th March, 2022. It is assumed that M/s Kashdash (P) Ltd. is a regular filer of return & first proviso to section 194N is not applicable.

- (ii) Section 9(1)(ii) provides that any income which falls under the head “Salaries” is deemed to accrue or arise in India, if it is earned in India. The Explanation thereto further clarifies that income payable for services rendered in India shall be regarded as income earned in India.

Section 192(1) requires the person responsible for paying any income chargeable under the head “Salaries” to deduct income-tax, at the time of payment, at the average rate of income-tax computed on the basis of the rates in force for the financial year on the amount payable.

Since the TDS provisions relating to payment of income chargeable under the head “Salaries” form an integrated code along with the charging and computation provisions under the Act, section 192(1) has to be read with section 9(1)(ii) and the Explanation thereto. Therefore, if any payment under the head “Salaries” falls within section 9(1)(ii), then TDS provisions under section 192 gets attracted. Consequently, the Indian tax deductor-assessee is duty bound to deduct, from the portion of salary paid by it, tax at source under section 192(1) on the entire salary paid to the employee, including special allowance paid abroad to the employee by the foreign company. It was so held in **CIT, New Delhi v. Eli Lilly & Co. (India) P. Ltd. (2009) 312 ITR 225 (SC)**.

In this case, all the employees are resident in India, since they have worked with the Indian collaborator throughout the previous year 2021-22. If the tax due on special allowance received from the foreign company is paid by the recipient-employees, then, the Indian collaborator would not be treated as an assessee-in-default under section 201(1), if these resident-employees have furnished a return of income under section 139, disclosing such income, and have also furnished a certificate to this effect from an accountant in the prescribed form. However, interest under section 201(1A) @ 1% per month or part of month shall be payable by the Indian collaborator from the date on which such tax was deductible to the date of furnishing of return by such resident employee.

In cases where the tax has not been paid by the recipient employee, the Assessing Officer can proceed under section 201(1) to recover the shortfall in payment of tax and interest thereon under section 201(1A) from M/s Tekwel Ltd.

However, no penalty under section 271C would be attracted, if the Indian company was under the genuine and bona fide belief that it was not under any obligation to deduct tax at source from the special allowance paid by the foreign company. This is provided for under section 273B.

Question 3:

(a) *The net result of the business carried on by a branch of a foreign company in India for the financial year ended 31.03.2022 was a profit of ₹ 20 lakhs after charge of the following expenses:*

- i. *Depreciation for the current financial year of ₹ 15 lakhs.*
- ii. *Unabsorbed depreciation for previous financial year of ₹ 17 lakhs.*
- iii. *Capital Expenditure incurred for promoting family planning amongst its employees of ₹ 7 lakhs. ₹ 7 Lakhs is one fifth of the total expenditure incurred on promoting family planning.*
- iv. *Expenditure incurred for Scientific research ₹ 11 lakhs.*
- v. *Business loss brought forward for A.Y. 2021-22 of ₹ 25 lakhs.*
- vi. *Deductions under Chapter VI-A of ₹ 20 lakhs.*
- vi. *Head Office expenses of ₹ 125 lakhs allocated to the branch.*

Compute income to be declared by the branch in its return for the Assessment Year 2022-23.

(b) *Explain in brief whether the transaction - Interest of ₹ 5,00,000 paid on money borrowed by Mr. Smith (a Non-resident) for the purpose of doing business of garments at Mumbai to Mr. John (who is also a Non-resident) attracts income-tax in India in the hands of recipient in the Assessment Year 2022-23.*

(c) *KVS Ltd., the assessee, has sold goods on 12.01.2022 to L Ltd., located in notified jurisdictional area (NJA), for ₹ 10.50 crores. During the current financial year, KVS Ltd. charged ₹ 11.50 crores from AJ of New York and ₹ 12 crores from KP of London for sale of identical goods and both of which are neither associated enterprise of KVS Ltd. nor they are situated in any NJA. While sales to AJ and KP were on CIF basis, the sale to L Ltd., was on FOB basis, which paid ocean freight and insurance amounting to ₹ 20 lakhs on purchases from KVS Ltd.*

India has a Double Taxation Avoidance Agreement with the U.S.A. and U.K. The assessee has a policy of providing after sales support service to the tune of ₹ 14 lakhs to all customers except L Ltd. which procured the same locally at a cost of ₹ 18 lakhs.

Compute the ALP for the sales made to L Ltd., and the amount of consequent increase, if any, in the profit of the assessee-company.

[NOVEMBER 2020]

Answer:

(a) Computation of income to be declared by the branch in its return of income

Computation Head Office expenses allowable u/s 44C:		
Particulars	₹	₹
Net profit of the branch		20,00,000
Add: Head office expenditure debited to profit and loss	1,25,00,000	

Unabsorbed depreciation	17,00,000	
Capital expenditure on family planning	7,00,000	
Brought forward business loss	25,00,000	
Deductions under Chapter VI-A	20,00,000	
		1,94,00,000
Adjusted total income		2,14,00,000

Note: Depreciation for the current financial year and expenditure incurred for scientific research are not required to be added back for computing adjusted total income.

Head office expenses allowable u/s 44C = ₹ 10,70,000

Being the lower of –

- (i) 5% of ₹ 2,14,00,000 = ₹ 10,70,000
- (ii) Actual Head Office expenses allocated to the branch = ₹ 1,25,00,000

Income to be declared by the branch for A.Y. 2022-23	
Particulars	₹
Net profit of the branch	20,00,000
Add: Head office expenditure debited to profit and loss	1,25,00,000
	1,45,00,000
Less: Head office expenses allowable u/s 44C	10,70,000
Income to be declared by the branch	1,34,30,000

- (b) Income by way of interest payable by a person who is a non-resident would be deemed to accrue or arise in India, where the interest is payable in respect of any money borrowed and used for the purposes of a business or profession carried on by such person in India.

Accordingly, interest income arising to Mr. John, a non-resident, would be deemed to accrue or arise in India since it is in respect of money borrowed by Mr. Smith, a non-resident, for the purpose of business of garments at Mumbai in India. Hence, it would attract income-tax in India in the hands of Mr. John, even though he is a non-resident.

- (c) A transaction where one of the parties thereto is a person located in a NJA would be deemed to be an international transaction and all parties to the transaction would be deemed as associated enterprises. Accordingly, all the provisions of transfer pricing would be attracted in case of such a transaction.

Hence, the transactions between KVS Ltd, an Indian company and L Ltd., located in NJA, would be deemed to be international transactions between associated enterprises.

The transactions of KVS Ltd. with AJ of New York and KP of London for sale of identical goods are comparable uncontrolled international transactions, since they are neither associated enterprises of KVS Ltd. nor are they situated in NJA. Hence, Comparable Uncontrolled Price (CUP) method can be used to determine ALP.

Where more than one price is determined by the most appropriate method, CUP method in this case, then, the arithmetic mean has to be taken in cases where the number of entries in the dataset is less than 6 (in this case it is only 2). However, the benefit of permissible variation between the ALP and the transfer price based on the rate notified by the Central Government (i.e., maximum of 3% of transaction price) would not be available in respect of such transaction in NJA.

Computation of ALP using CUP method		
Particulars	AJ	KP
	₹ in crores	₹ in crores
Price charged by KVS Ltd. (on CIF basis)	11.50	12.00
Less: Ocean freight and insurance, has to be reduced since the price charged to L Ltd. is on FOB basis	0.20	0.20
	11.30	11.30
Less: Cost of after-sales support service (has to be reduced, since such services are being provided to AJ and KP but not to L Ltd.)	0.14	0.14
Arm's Length Price	11.16	11.16
Arithmetic mean of the above prices [(₹ 11.16 crores + ₹ 11.66 crores)/2]		11.41
Less: Price at which goods were sold to L Ltd.		10.50
Arm's length adjustment [increase in profit of KVS Ltd.]		0.91

Question 4:

(a) Mahadev & Sons Ltd. is a Public Company whose accounts have been prepared in accordance with provisions of Schedule III of Company's Act. Its P&L for the year ended 31st March, 2022 shows a Net Profit of ₹ 27 Lakhs. The Company informs the following debit/credits have been made in the P& LA/c before arriving at the above stated Net Profit.

	Credits to the P&L A/c		Debits to the P&L A/c
1	Net Agricultural income in India – 11 Lakhs	1	Expenses relating to section 10AA undertaking – 16 Lakhs
2	Profits of industrial undertaking covered & qualified for deduction u/s 10AA – 30 Lakhs	2	Depreciation relating to P.Y. 2020-21 b/f 13 Lakhs
3	Amount withdrawn from reserve created in P.Y. 2020-21 (Book profit was not increased by the amount transferred to the reserve in the year 2020-21) – 4 Lakhs	3	Business Loss relating to P.Y. 2020-21 b/f 10 lakhs
4	LTCG on sale of equity shares on which STT paid - 3.50 lakhs	4	Current year Depreciation – 12 lakhs
5	Amount withdrawn from Revaluation Reserve – 10 lakhs	5	Interest to bank not paid upto filing of ROI – 5 Lakhs
		6	Provision for unascertained liability – 3 lakhs
		7	Income-tax – 6 lakhs
		8	Penalty for infraction of Law – 2 lakhs

Further Information:

- Depreciation for current year includes ₹ 5 Lakhs towards revaluation of assets.

Compute the book profits of the Company for the year ended 31.03.2022 liable to tax under MAT.

- (b) Explain the expression "Round Trip Financing" in relation to Impermissible Avoidance Agreement (IAA).
- (c) M/s Manish & Co., a proprietary concern of Mr. Manish, failed to furnish its Return of Income (ROI) for A.Y. 2020-21 within the due date under section 139(1). The A.O. in turn lodged a complaint against the proprietor under section 276CC. The tax payable on assessed income as reduced by the tax deducted at source, advance tax paid and self-assessment tax paid was ₹ 1,65,000. Mr. Manish filed an appeal before CIT(A) against the order of assessment and got part relief. Accordingly, A.O. passed an order giving effect to the order of CIT(A). The tax payable as per said order of A.O. was ₹ 18,500. The A.O. accepted the order of CIT(A) and did not prefer an appeal against it to ITAT.

M/s Manish & Co. seeks your advice on the maintainability of proceedings under section 276CC.

Also, briefly mention would your answer be different if Manish and Co. is a private limited company.

[NOVEMBER 2020]

Answer:

- (a) **Computation of "Book Profit" for levy of MAT under section 115JB for the year ended 31.3.2022**

Particulars	₹	₹
Net Profit as per Statement of Profit and Loss		27,00,000
Add: Net profit to be increased by the following amounts as per Explanation 1 to section 115JB:		
• Current year depreciation as per books of account	12,00,000	
• Provision for unascertained liability	3,00,000	
• Income-tax	6,00,000	
		21,00,000
		48,00,000
Less: Net profit to be decreased by the following amounts as per Explanation 1 to section 115JB:		
• Net agricultural income [since the same is exempt u/s 10(1)]	11,00,000	
• Depreciation other than depreciation on revaluation of assets (₹ 12,00,000 – ₹ 5,00,000)	7,00,000	
• Unabsorbed depreciation or brought forward business loss, whichever is less, as per the books of account.	10,00,000	
[Lower of unabsorbed depreciation ₹ 13,00,000 and brought forward business loss ₹ 10,00,000 as per books of accounts has to be reduced while computing the book profit]		

• Amount withdrawn from revaluation reserve [to the extent of depreciation on revaluation]	5,00,000	33,00,000
Book Profit for levy of MAT		15,00,000

Notes:

1. The profits from unit established in special economic zone cannot be excluded while computing the book profit as per proviso to section 115JB(6), and hence, such income would be liable for MAT. Hence, no adjustment is required in respect of credits or debits to P & L in respect of income and expenditure relating to SEZ.
 2. Long-term capital gains exceeding Rs.1 lakh on sale of equity shares on which STT is paid is taxable u/s 112A. The same is not deductible while computing book profit for levy of MAT.
 3. Amount withdrawn from reserve created in P.Y. 2020-21 cannot be reduced to compute book profit, since the book profit was not increased by the amount transferred to the reserve in the year 2020-21.
 4. It is only the specific items mentioned under Explanation 1 to section 115JB, which can be adjusted from 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 thereunder, the same cannot be adjusted for computing book profit:
 - Interest to bank (unpaid before filing of return) and
 - Penalty for infraction of law
- (b) An arrangement which lacks commercial substance or is deemed to lack commercial substance would be an impermissible avoidance agreement where the main purpose or one of the main purposes of the arrangement is to obtain a **tax benefit**. Accordingly, GAAR provisions would be attracted in respect of such impermissible avoidance agreement.

An arrangement, which involves or includes round tripping of funds, is deemed to lack commercial substance.

Round trip financing includes any arrangement in which, through a series of transactions—

- (a) funds are transferred among the parties to the arrangement; and
- (b) such transactions do not have any substantial commercial purpose other than obtaining the tax benefit,

without having any regard to—

- (A) whether or not the funds involved in the round trip financing can be traced to any funds transferred to, or received by, any party in connection with the arrangement;
- (B) the time, or sequence, in which the funds involved in the round trip financing are transferred or received; or
- (C) the means by, or manner in, or mode through, which funds involved in the round trip financing are transferred or received

- (c) (i) 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, prosecution shall not be there if M/s Manish & Co. files the return before the end of relevant assessment year.

In a case where the return of income is not filed within the due date and is filed after the end of the assessment year prosecution proceedings will not be attracted if the tax payable by a person, other than a company, on the total income determined on regular assessment, as reduced by the advance tax or self-assessment tax, if any, paid and any tax deducted at source, does not exceed ₹ 10,000.

In this case, not only did the tax liability of M/s. Manish & Co., proprietary concern, for A.Y. 2020-21 as per the original order of assessment exceed ₹ 10,000, but the reduced tax liability of ₹ 18,500 as a result of the order of the Commissioner (Appeals) also exceeds ₹ 10,000. Therefore, since the tax liability of the proprietary concern on final assessment for A.Y. 2020-21 was determined at ₹ 18,500, which exceeds ₹ 10,000, the prosecution proceedings are maintainable.

- (ii) In case of a company also, the answer would be the same and prosecution proceedings would be maintainable. However, in case of a company, prosecution will always be there if return is filed after the end of relevant assessment year. Amount of tax has no relevance.

Question 5:

- (a) *Mr. Lal Singh created Lal Singh Welfare Trust in June 2021 by duly executing in writing a trust deed. He appointed Ms. Vinita as the trustee. The trust was created to take care of his old parents and his 2 uncles (both being older brothers of his father) where all are dependent on Mr. Lal Singh and continue to live together in their native village in Rajasthan. The income arising out of assets of the trust is to be allocated amongst the beneficiaries each year as per the sole discretion of Ms. Vinita. The beneficiaries to the trust have no other source of income. The income of the trust during P.Y. 2021-22 was ₹ 10 lakhs. Calculate the tax liability of the trust for A.Y. 2022-23. Would your answer differ if father of Mr. Lal Singh was receiving a monthly pension of ₹ 25,000 apart from the trust?*
- (b) *During the Previous Year 2021-22, Ms. Sujata, a citizen of India is a resident of both India and a foreign country with which India has a Double Taxation Avoidance Agreement (DTAA), which provides that "the income would be taxable in country where it is earned and not in other country but would be included for computation of tax rate in such other country."*

Her income is ₹ 5,75,000 from business in India and ₹ 14,00,000 from business in foreign country. In foreign country, the rate of tax is 20%. During the year, she paid a premium of ₹ 35,000 to insure the health of her mother, a non-resident, aged 83 years, through her credit card. You are required to compute the tax payable by Ms. Sujata in India for the A.Y. 2022-23. Also, show the tax payable by Ms. Sujata in India, had there been no DTAA with such foreign country. Ignore provisions of section 115BAC.

[NOVEMBER 2020]

Answer:

- (a) (i) Lal Singh Welfare Trust is created by Mr. Lal Singh to take care his old parents and his two uncles, being relatives dependent on him for support and maintenance. It is created by duly executing in writing a trust deed and Ms. Vinita, being a trustee, is given the discretionary power to decide the allocation of the income each year. Lal Singh Welfare trust can, therefore, be regarded as a discretionary trust.

A discretionary trust will be liable to tax at the maximum marginal rate of income-tax on its entire income. However, where none of the beneficiaries have any other income chargeable to tax exceeding the basic exemption limit in the case of an AOP and none of the beneficiaries is a beneficiary under any other trust, the income would be chargeable to tax at the rate applicable to the income of an individual.

Since the beneficiaries of the trust have no other source of income, the income of ₹ 10 lakh of the trust is taxable applying the normal slab rates. Thus, the tax liability would be ₹ 1,17,000 (₹ 1,12,500 plus health and education cess @ 4%).

- (ii) Tax liability would remain same i.e., ₹ 1,17,000 even if father of Mr. Lal Singh is receiving monthly pension of ₹ 25,000 apart from the trust, since his total income i.e., ₹ 2,50,000 [₹ 3,00,000 (₹ 25,000 × 12) less standard deduction u/s 16(ia) of 50,000] would not exceed the maximum amount not chargeable to tax i.e., ₹ 2,50,000.

(b) (i) Computation of tax payable in case where there is a DTAA with the foreign country

The DTAA with the foreign country provides that the income would be taxable in country where it is earned and not in other country, but it would be included for computation of tax rate in such other country.

Thus, business income of ₹ 14,00,000 in foreign country would not be taxable in India in the hands of Ms. Sujata; however, such income has to be included in the total income to determine the effective rate of tax applicable on Indian income chargeable to tax in India.

Computation of tax liability of Ms. Sujata for A.Y. 2022-23	
Particulars	₹
Business Income	
- Foreign country	14,00,000
- In India	5,75,000
Gross Total Income	19,75,000
Less: Deduction under Chapter VI-A	
Section 80D – Medical insurance premium of ₹ 35,000 allowable to the extent of ₹ 25,000 [Since her mother aged 83 years is a non-resident]	25,000
Total Income	19,50,000
Tax on total income [30% of ₹ 9,50,000 + ₹ 1,12,500]	3,97,500
Add: Health and education cess @ 4%	15,900
Tax Liability	4,13,400
Tax rate [₹ 4,13,400 / ₹ 19,50,000 × 100]	21.2%
Tax payable = 21.2% × ₹ 5,50,000 [₹ 5,75,000 – ₹ 25,000]	1,16,600

(ii) Computation of tax payable in case where there is no DTAA with the foreign country

In such case, Ms. Sujata would be allowed deduction under section 91, since she has satisfied the following conditions: -

- She is a resident in India during the relevant previous year i.e., P.Y. 2021-22.
- The business income of ₹ 14,00,000 accrues or arises to her outside India and such income is not deemed to accrue or arise in India during the previous year.
- Such business income has been subjected to tax in the foreign country @ 20%

Computation of tax liability of Ms. Sujata for A.Y. 2022-23	
Particulars	₹
Tax Liability (computed above would remain same)	4,13,400
Less: Rebate under section 91 [See Working Note below]	2,80,000
Tax Payable	1,33,400
Working Note: Calculation of Rebate under section 91	
Average rate of tax in India [$\frac{₹ 4,13,400}{₹ 19,50,000} \times 100$]	21.2%
Average rate of tax in Foreign Country	20%
Doubly taxed income (Business income in foreign country)	14,00,000
Rebate u/s 91 on ₹ 14,00,000 @ 20% [being the lower of average Indian tax rate (21.2%) and foreign tax rate (20%)]	2,80,000

Question 6:

- Simran (P) Ltd. holds 55% of shares in AI Kuber Ltd., a Company incorporated in Dubai. AI Kuber Ltd. has its offices in India also.*

Details relating to AI Kuber Ltd. for year ended March 2022 are as stated below:

Particulars	Amount in (₹ crores)	
	India	Dubai
• Fixed Assets after considering Depreciation for tax purposes	1500	650
• Intangible Assets	225	1075
• Other Assets (value as per books of account)	800	1900
• Income from trading operations.	730	1370
The above figure includes:		
a. Income from transactions where sales are to AE	20	40
b. Income from transactions where purchases are from AE	30	55
c. Income from transactions where sales/purchases are to/from AE	45	80
• Interest & Dividend from investments	560	320
• No. of employees	70	90
✓ Unskilled employees out of the above mentioned total employees (resident in respective countries)	5	30

• Payroll expenses on employees	940	1250
✓ Payroll expenses on Unskilled employees out of the above mentioned total Payroll expenses	100	415
• No. of Board Meetings held	3	4

Determine the Residential Status of AI Kuber Ltd. for A.Y. 2022-23.

- (b) Mr. Anand, a resident of Bangalore, has 2 house properties, one situated in Bangalore and the other in Jaipur. The house property at Jaipur was purchased in April 1998 and the Bangalore house was purchased during May 2008. Mr. Anand transferred his house property at Jaipur in the name of his son, Prateek, on his 10th birthday in July 2002.

In September 2021, TRO has served a notice on Mr. Anand for recovering outstanding tax arrears of ₹ 150 lakhs relating to A.Y. 2016-17 in respect of his proprietorship business. TRO simultaneously attached both houses for recovering the tax arrears along with interest.

Mr. Prateek has been staying in the house property at Jaipur with his wife for last 4 years after he got separated from his father. The current value of house at Jaipur is ₹ 45 lakhs and Bangalore is ₹ 90 lakhs.

Mr. Prateek seeks your advice on the validity of action taken by TRO in attaching the Jaipur property.

- (c) ND Ltd., an Indian Company, has borrowed ₹ 90 crores on 01.04.2021 from M/s. TM Inc, a company incorporated in London, at an interest rate of 10% p.a. The said loan is repayable over a period of 5 years. Further, this loan is guaranteed by M/s TY Inc. incorporated in UK. M/s. TD Inc, a non-resident, holds shares carrying 40% of voting power both in M/s ND Ltd. and M/s TY Inc.

Net profit of M/s. ND Ltd. for P.Y. 2021-22 was ₹ 11 crores after debiting the above interest, depreciation of ₹ 5 crores and income-tax of ₹ 4 crores.

Calculate the amount of interest to be allowed to be claimed under the head "Profits and gains of business or profession" in the computation of M/s ND Ltd. giving appropriate reasons. Also explain allowability of such disallowed interest, if any.

[NOVEMBER 2020]

Answer:

- (a) AI Kuber Ltd., a company incorporated in Dubai, would be resident in India in the P.Y. 2021-22, if its place of effective management is in India in that year.

For determining the POEM of AI Kuber Ltd., the important criteria is whether the company is engaged in active business outside India or not.

A company would be said to be engaged in "Active Business Outside India" (ABOI) for POEM, if -

- its passive income is not more than 50% of its total income; and
- less than 50% of its total assets are situated in India; and
- less than 50% of total number of employees are situated in India or are resident in India; and

- the payroll expenses incurred on such employees is less than 50% of its total payroll expenditure.

AI Kuber Ltd. would be regarded as a company engaged in active business outside India for P.Y. 2021-22 for POEM purpose only if it satisfies all the four conditions cumulatively.

Condition 1: The passive income of AI Kuber Ltd. should not be more than 50% of its total income.

Total income of AI Kuber Ltd. during the P.Y. 2021-22 is ₹ 2,980 crores.

Passive income is the aggregate of, -

- (i) income from the transactions where both the purchase and sale of goods is from/to its associated enterprises i.e., ₹ 125 crores; and
- (ii) income by way of, inter alia, interest and dividend i.e., ₹ 880 crores;

Passive Income of AI Kuber Ltd. is ₹ 1,005 crores (i.e., ₹ 125 crores + ₹ 880 crores)

Percentage of passive income to total income = $\frac{\text{₹ 1,005 crore}}{\text{₹ 2,980 crores}} \times 100 = 33.72\%$

Since passive income of AI Kuber Ltd. i.e., 33.72% is **not** more than 50% of its total income, the first condition is satisfied.

Condition 2: AI Kuber Ltd. should have less than 50% of its total assets situated in India

Value of total assets of AI Kuber Ltd. is ₹ 6,150 crores [₹ 1,500 crore + ₹ 225 crores + ₹ 800 crores + ₹ 650 crores + ₹ 1,075 crores + ₹ 1900 crores].

Value of total assets of AI Kuber Ltd. in India is ₹ 2,525 crores [₹ 1,500 crores + ₹ 225 crores + ₹ 800 crores]

Percentage of assets situated in India to total assets = $\frac{\text{₹ 2,525 crores}}{\text{₹ 6150 crores}} \times 100 = 41.06\%$

Since the value of assets of AI Kuber Ltd. situated in India is less than 50% of its total assets, the second condition for ABOI test is satisfied.

Condition 3: Less than 50% of the total number of employees of AI Kuber Ltd. should be situated in India or should be resident in India

Number of employees working in India is 70.

Total number of employees of AI Kuber Ltd. is 160 [70 + 90].

Percentage of employees working in India to total number of employees is $70 \times \frac{100}{160} = 43.75\%$

Since the number of employees of AI Kuber Ltd. working in India is less than 50% of its total number of employees, the third condition for ABOI test is satisfied.

Condition 4: The payroll expenses incurred on employees situated in India or resident in India should be less than 50% of its total payroll expenditure

Payroll expenditure on employees in India is ₹ 940 crores

Total payroll expenditure of AI Kuber Ltd. is ₹ 2190 crores [₹ 940 crore + ₹ 1250 crores].

Percentage of payroll expenditure on employees in India to total payroll expenditure is 42.92%, being ₹ 940 crores × 100 / ₹ 2190 crores.

Since payroll expenditure on employees of AI Kuber Ltd. in India is less than 50% of its total payroll expenditure, the fourth condition for ABOI test is satisfied.

Since AI Kuber Ltd. satisfies all the above four conditions cumulatively, AI Kuber Ltd. has passed the Active Business Outside India (ABOI) test.

POEM of a company engaged in active business outside India shall be presumed to be outside India, if the majority of the board meetings are held outside India.

Since AI Kuber Ltd. is engaged in active business outside India in P.Y. 2021-22 and majority of its board meetings i.e., 4 out of 7, were held outside India, POEM of AI Kuber Ltd. would be outside India.

Therefore, AI Kuber Ltd. would be non-resident in India for the P.Y. 2021-22.

- (b) When an assessee is in default or is deemed to be in default in making a payment of tax, the TRO may draw up under his signature, a statement in the prescribed form specifying the amount of arrears due from the assessee and shall proceed to recover from such assessee, the amount specified in the certificate by *inter alia* attachment and sale of the assessee's immovable property.

The assessee's immovable property shall include any property which has been transferred, directly or indirectly, by the assessee *inter alia* to his minor child, otherwise than for adequate consideration, and which is held by, or stands in the name of minor son. Immovable property so transferred to his minor child shall, even after the date of attainment of majority by such minor child, continue to be included in the assessee's immovable property for recovering any arrears due from the assessee in respect of any period prior to such date.

In the present case, Mr. Anand has transferred his Jaipur house property in July 2002, when his son is 10 years old. He attained majority in July 2010. TRO has served a notice on Mr. Anand for recovering outstanding tax arrears of ₹ 150 lakhs relating to A.Y. 2016-17 in respect of his proprietorship business. The immovable property transferred to minor son continues to be includible in the assessee's immovable property for recovering any arrears due from the assessee, so far as the same is in respect of the period prior to the date of attainment of majority by such minor son.

However, in the present case, since Anand's minor son Prateek attained the age of majority in the year 2010, the action taken by TRO in attaching Jaipur property, for recovering arrears relating to A.Y. 2016-17, which falls after the date of attainment of majority, is not valid.

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

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

In the present case, since M/s TD Inc holds 40% of voting power i.e., more than 26% of voting power in both ND Ltd and M/s TY Inc, ND Ltd. and M/s TY Inc are deemed to be associated enterprises.

Since loan of ₹ 90 crores taken by ND Ltd., an Indian company from M/s TM Inc, is guaranteed by M/s TY Inc, an associated enterprise of ND Ltd., such debt shall be deemed to have been issued by an associated enterprise and interest payable to M/s TM Inc shall be considered for the purpose of limitation of interest deduction u/s 94B.

Computation of interest to be allowed as per section 94B in the computation of income under the head profits and gains of business or profession of ND Ltd.	
Particulars	₹ (in crores)
Net profit	11.00
Add: Interest already debited (₹ 90 crores × 10%)	9.00
Depreciation	5.00
Income-tax	4.00
EBITDA	29.00
Interest paid or payable by ND Ltd.	9.00
Lower of the following would be disallowed	
- Total interest paid or payable in excess of 30% of EBITDA (₹ 9,00,00,000 – ₹ 8,70,00,000) = ₹ 30 lakhs	0.30
- Interest paid or payable to non-resident AE	9.00
Interest to be disallowed as deduction	0.30
Interest allowable as deduction under the head “Profits and Gains from Business or Profession” (₹ 9,00,00,000 – ₹ 30,00,000)	8.70

Disallowed interest of ₹ 30 lakhs can be carried forward to the subsequent assessment year and it would be allowed as deduction against profits and gains, to the extent of allowable interest expenditure u/s 94B.