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SOLVED QUESTION PAPER FOR NOVEMBER 2018 EXAM (NEW SYLLABUS)

Question 1:

M/s Hind Udyog, a manufacturing partnership firm, consisting of three partners namely X, Y and Z, provides following information relating to the year ending on 31.03.2019.

Net profit of ₹ 28.75 Lakhs as per profit and loss account, was arrived at after debiting/crediting the following items:

- (i) The firm had provided amount of ₹ 2 Lakhs being sum estimated as payable to workers based on agreement to be entered with the workers union towards periodical wage revision once in three years. The provision is based on a fair estimation on wage and reasonable certainty of revision once in three years.*
- (ii) Sale proceeds of import entitlements amounting to ₹1 lakh have been credited to profit and loss account, which the firm claims as capital receipt not chargeable to income tax.*
- (iii) Goods and Service Tax demand paid includes an amount of ₹ 5,300 charged as penalty for delayed filling of returns and ₹12,750 towards interest for delay in deposit of tax.*
- (iv) A free air ticket was provided by a supplier for reaching a certain volume of purchase during the F.Y. 2018-19. The same is not credited in profit & loss account because it was encashed by the firm for ₹ 2 lakhs in April 2019.*
- (v) Interest amounting ₹ 20,000 paid to X as a Karta of HUF @ 18% per annum.*
- (vi) The firm had taken on lease an old building for the purpose of locating its business. Due to old age of building, it was demolished and a new building put up, which was used by the firm from September, 2018. The cost of new building ₹ 10 lakh was written off as revenue expenditure. The lessor permitted the firm to have an extension of the lease by another 20 years.*
- (vii) Loss incurred in transactions of purchase and sale of shares (without delivery) of various companies ₹ 3 lakhs.*
- (viii) A scheduled bank sanctioned and disbursed a term loan in the financial year 2014-15 for a sum of ₹ 50 lakhs. Interest of ₹ 8 lakhs was in arrears. The bank has converted the arrears of interest into a new loan repayable in 10 equal instalments. During the year, the company has paid 2 instalments and the amount so paid has been reduced from Funded Interest in the Balance Sheet.*

The firm furnishes following additional information relating to it:

- (1) Provision for audit fees ₹ 2.5 lakhs was made in the books for the year ended on 31.03.2018 without deducting tax at source. Such fees was paid to the auditors in September, 2018 after deducting tax under section 194J and the tax so deducted was deposited on 7th October, 2018.*

- (2) The firm had made an investment of ₹ 23 lakhs and ₹ 12 lakhs on the construction of two warehouses (excluding the cost of land), in rural areas for the purpose of storage of agricultural produce and edible oil respectively. These were made available for use from 15 September 2018. The profits from setting of these warehouses (before claiming deduction under section 35AD and 32) for Assessment year 2019-20 is ₹15 lakhs and ₹ 5 lakhs respectively.
- (3) In July, 2018 firm received a dividend of ₹ 11 lakhs from A Ltd. in which it holds 10% of shares.

Compute the total income of M/s Hind Udyog for the A.Y. 2019-20 by analysing, integrating and applying the relevant provisions of Income tax law. Explain in brief, the reasons for the treatment of each items.

Answer:

M/s Hind Udyog
Computation of Total Income for Assessment Year 2019-20

Particulars	₹	₹
Net profit as per Profit & Loss Account		28,75,000
Add: Items to be disallowed/ considered separately/ Added as income		
i. Provision for periodical wage revision. It is allowable expense since it is based on fair estimation of wages and reasonable certainty. It is also a permissible expense as per ICDS.	Nil	
ii. Sales proceeds of import entitlements. It is taxable under section 28 as business income. Since it is already credited to Profit & Loss Account, therefore, no adjustment is required.	Nil	
iii. Penalty for delayed filing of returns under GST Act. Applying the ratio of CIT v. Swadeshi Cotton Mills Co. Ltd. , penalty for infraction of law is disallowed in computing the business income. However, interest on delay in deposit of GST is an allowable expense since it is compensatory in nature. CIT v. Westend Indian State Motors (Raj)	5,300 Nil	
iv. Free air ticket for achieving the target of purchase, is perquisite in course of business, therefore, taxable under section 28 as business income. Since it is not credited to Profit & Loss Account, the same is to be added to the income.	2,00,000	
v. Interest paid to Mr. X as Karta of HUF is not disallowed under section 40(b) as per Explanation to section 40(b). It is assumed that 18% is the market rate of interest and hence, section 40A(2) is not invoked.	Nil	

vi.	As per Explanation to section 32(1), if an assessee makes capital expenditure on a building not owned by him but for which he has tenancy/lease rights, then the capital expenditure on building will be treated as deemed building. Since building is used for more than 180 days, depreciation shall be allowed at full rate. Cost of building of ₹ 10 lakhs debited to Profit & Loss Account shall be added back. However, depreciation on building @ 10% is an allowable expense. ₹ 10,00,000 minus ₹ 1,00,000 = ₹9,00,000 is adjusted.	9,00,000	
vii.	Loss on purchase and sale of shares being speculation loss shall not be allowed to be set-off and therefore added back. It is assumed that these are not in derivative segment.	3,00,000	
		14,05,300	
			42,80,300
	Less: Permissible deductions/ Items to be reduced from business income		
(a)	Instalments of funded interest allowed under section 43B as per CBDT circular.	1,60,000	
(b)	30% of audit fees would have been disallowed in previous year 31.3.2018 since TDS was not deducted during the Previous Year 31.03.2018. The same shall be allowed in current year under section 40(a)(ia) when TDS is deducted & paid.	75,000	
(c)	Dividend to be considered separately under the head Income from other sources. Assuming that it is credited to profit & loss account.	11,00,000	
(d)	Profit from warehouse for storage of agricultural produce to be treated separately under section 35AD. Assuming that it is credited to profit and loss Account.	15,00,000	
(e)	Profit from warehouse for storage of edible oil in not covered under section 35AD. Assuming that it is credited to profit & loss Account, no adjustment required. However, depreciation on its same shall be allowed @ 10%	1,20,000	
		29,55,000	
	Business Profit under Section 35AD	15,00,000	
	Less: Deduction section 35AD	23,00,000	
	Loss to be carried forward and set off against profit of specified business under section 35AD	(8,00,000)	
	Profit and Gains of Business or Profession		13,25,300

Income from Other Sources		
Dividend Income	11,00,000	
Less: Exempt under section 10(34)	10,00,000	
Income from Other Sources		1,00,000
Total Income		14,25,300

Question 2:

Red Ltd., a non-resident foreign company, had entered into a collaboration agreement, approved by the Central Government, with Blue Ltd. an Indian company on February 21, 2003 and is in receipt of following payments during the previous year ending on March 31, 2019:

- (i) Interest on 8% debentures for ₹ 40 lakhs issued by Blue Ltd. on July 1, 2018 in consideration of providing of technical know-how, manufacturing process and designs (date of payment of interest being March 31 every year).
- (ii) Service charges @ 2.5% of the value of plant and machinery for ₹ 500 lakhs leased out to Blue Ltd. payable each year before March 31.
- (iii) Apart from the above incomes, Red Ltd. received a long-term capital gain amounting to ₹ 1.90 Lakhs on sale of debentures of Green Ltd., an Indian company, subscribed in US\$.

Compute the Total Income of Red Ltd. and determine its tax liability for the assessment year 2019-20.

Answer:

Red Ltd. (Non-Resident Foreign Company)
Computation of Income and Tax Liability for Assessment Year 2019-20

Particulars	Computation of Income	Computation of Tax Thereon
Profits and Gains of Business or Profession		
(a) Know how fees for providing technical know-how, manufacturing process and designs. Taxable @ 10% under section 115A	40,00,000	4,00,000
(b) Leasing charges or rentals for plant & machinery is taxable as royalty as per the definition of royalty Taxable @ 10% under section 115A	12,50,000	1,25,000
Income under the Head Profits and Gains of Business or Profession	52,50,000	
Income from Other Sources		
Interest on debentures is not covered under section 115A since debentures have not been subscribed in foreign currency. Such interest taxable at normal rate of 40%	2,40,000	96,000
Long Term Capital Gains		
Long term capital gains on sale of debentures Taxable @ 10% under section 112 assuming debentures are unlisted	1,90,000	19,000

Total Income	56,80,000	
Tax thereon		6,40,000
Add: 4% Health & Education cess		25,600
Total Tax Liability		6,65,600

Question 3:

Anustup Chandra Flour mills Ltd., a domestic company engaged in manufacture of wheat flour furnishes the following information pertaining to the year ended 31-3-2019:

- (i) *Net profit as per the statement of Profit and Loss is ₹ 77 lakhs, after **considering the items listed in (ii) to (vi) below.***
- (ii) *The company is a member of Vishnu Foods & Co., an AOP in which the members shares are determinate and their shares in profit/loss are clearly known. The entire income of the AOP is from business activities. During the year, the company has derived share income of ₹ 9 lakhs from the AOP. The company has spent a sum of ₹ 90,000 towards earning such income.*
- (iii) *The company has provided for income-tax (including interest under sections 234B and 234C of ₹ 62,000) for ₹ 3 lakhs, and ₹ 5 lakhs towards share in loss of foreign subsidiary.*
- (iv) *Amount debited to the statement Profit and Loss towards interest to a public financial institution is ₹12 lakhs. Of this, ₹4 lakhs was paid on 12-12-2018 only.*
- (v) *The company committed breach of building norms while extending the factory building. The City Corporation initiated proceedings against the company and the company settled the issue by paying compounding fee of ₹ 1 lakh. This amount forms part of general expenses, which has been debited to the Statement of Profit and Loss.*
- (vi) *In the administrative expenses, the company has debited a sum of ₹ 70,000 towards fee for delayed filing of statement of TDS under section 234E of the Income-tax Act, 1961.*
- (vii) *The company has credited revaluation surplus of ₹ 10 lakhs on fair valuation of assets under Ind AS-16 and Ind AS-38 to other equity.*
- (viii) *The company has credited ₹ 5 lakhs to other comprehensive income on fair valuation of equity instruments in which the company has Investment.*

During the current year, the depreciation charged as per books of account of the company is the same as allowable under the IT Act, 1961 [before considering the provisions of section 32(2)]. The company proposes to adopt this practice consistently in the future years.

You are required to compute the income-tax payable by the company for the Assessment Year 2019-20. The company is an Indian Accounting Standard compliant company.

Note: *The turnover of the company for Previous Year 2016-17 was ₹ 250 crores.*

Answer:

**Anustup Chandra Flour Mills Ltd.
Assessment Year 2019-20**

Computation of Total Income as per Normal Provisions of Income Tax Act

Net Profit as per Profit & Loss Account	77,00,000
(i) <i>Share of income from AOP is exempt under section 86 since one or more member has total income which exceeds the taxable limit.</i>	-9,00,000
(ii) <i>Since share from AOP is exempt, the expenses towards earning of such income to be disallowed under section 14A.</i>	+90,000
(iii) <i>Income tax disallowed under section 40 and interest paid under Income tax Act disallowed as per Federal Bank Ltd. v. CIT</i>	+3,00,000

(iv)	Loss of foreign subsidiary shall not to be allowed in the hands of holding company.	+5,00,000
(v)	Interest to financial institution not paid till due date of filing of return disallowed under section 43B.	+8,00,000
(vi)	Compounding fees is in the nature of penalty. Penalty for infraction of any law is disallowed [Mamta Enterprises].	+1,00,000
(vii)	Fees under 234E for delayed filing of TDS returns is neither interest nor penalty and hence allowed.	–
(viii)	Revaluation surplus has no tax treatment. No adjustment required since it is not routed through Profit & Loss Account	–
(ix)	No Tax treatment on fair valuation of equity instruments No adjustment required since not routed through Profit & Loss Account	–
Total Income		85,90,000
Tax thereon @ 25%		21,47,500
Add: 4% Health & Education cess		85,900
Total Tax		22,33,400

Computation of Book Profits as per Section 115JB

Net Profit as per Profit & Loss Account		77,00,000
Add:		
(i)	Expenses on earning the share of income from AOP since share of income from AOP is exempt under section 86	90,000
(ii)	Income tax and Interest under the Income Tax Act	3,00,000
(iii)	Loss of foreign subsidiary company	5,00,000
(iv)	Revaluation surplus on fair valuation of assets to be added at the time of disposal/ realisation of assets. Hence, no adjustment required.	Nil
(v)	Gain on fair valuation of equity instruments to be added at the time of sale of equity instruments. Hence, no adjustment required.	Nil
Less: Share from AOP since it is exempt under section 86		-9,00,000
Book Profits as per Section 115JB		76,90,000
Tax thereon @ 18.5%		14,22,650
Add: 4% Health & Education cess		56,906
Tax Liability on Book profit		14,79,556

The tax liability of the company is therefore ₹22,33,400.

Notes:

- No adjustment is required in computation of book profits under section 115JB for following expenses:
 - Interest to financial institution
 - Compounding fees for breach of building laws
 - Filing fees for late filling of TDS returns
- As per Supreme Court in **Malayala Manorama Co. Ltd.**, the company can follow rates of depreciation given in Income Tax Act, while preparing Profit and Loss Account as per the Companies Act.

Question 4:

Mr. Manav, a resident, has derived certain income from a nation Q with which no DTAA exists. In Q, any income chargeable to tax is charged at a flat rate of 18%.

Mr. Manav has derived the following income from Q:

Solved Question Paper of Nov 2018 Exam (New Syllabus)

- (i) Agricultural income from lands in Q ₹ 14 lakhs
- (ii) Share income from a partnership firm in Q ₹ 18 lakhs

In nation Q, agricultural income is exempt and does not form part of total income. State with reasons, whether, Mr. Manav (assessee) can claim double taxation relief in respect of the above two items of income and also determine the quantum of double taxation relief available.

The "Indian rate of tax" may be taken as 20%.

Answer:

For the applicability of section 91(1), following conditions should be satisfied:

- (a) The assessee is a resident in India during the previous year in respect of which the income is taxable.
- (b) The income accrues or arises to him outside India.
- (c) The income is not deemed to accrue or arise in India during the previous year.
- (d) The income in question has been subjected to income-tax in the foreign country in the hands of the assessee.
- (e) The assessee has paid tax on the income in the foreign country.
- (f) There is no agreement for relief from double taxation between India and the other country where the income has accrued or arisen.

If there is a country with which India does not have a Double Taxation Avoidance Agreement, and the assessee in respect of income arising outside India, pays income tax in foreign country and also in India, **then he shall be entitled to deduct the lower of the following amount from Income tax payable by him in India in respect of such doubly taxed income.**

- (i) Tax on such doubly taxed income at the rates applicable in India which shall be computed as under:

$$\frac{\text{Tax on Total Income in India}}{\text{Total Income in India}} \times \text{Such doubly taxed income}$$

- (ii) Tax on such doubly taxed income at the rates applicable in foreign country which shall be computed as under:

$$\frac{\text{Tax paid in foreign country}}{\text{Total income assessed in foreign country}} \times \text{Such doubly taxed income}$$

As per Indian Income tax Act, both the incomes earned in country Q by Mr. Manav are taxable in India since he is resident in India. Therefore, following incomes shall be included in income tax return of Mr. Manav, to be filed in India, for previous year 31.3.2019.

Agricultural income from lands in nation Q	₹ 14 lakh
Share of income from partnership firm in nation Q	₹ 18 lakh
Total Income	₹ 32 lakh

However, doubly taxed income is only ₹ 18 lakhs since agricultural income is exempt in nation Q. Therefore, double taxation relief under section 91 shall be on ₹18 Lakhs, which shall be lower of:

(i)	18% of ₹ 18 lakhs	=	₹ 3,24,000
(ii)	20% of ₹ 18 lakhs	=	₹ 3,60,000
	Relief under section 91	=	₹ 3,24,000

Question 5:

Eden Fabs Private Ltd. went into liquidation on 31.07.2018. The company was seized and possessed of the following funds prior to the distribution of assets to the shareholders:

	(₹)
Share capital (issued on 01.04.2012)	8,00,000
Reserves prior to 31.07.2018	4,00,000
Excess realization in the course of liquidation	<u>6,00,000</u>
Total	<u>18,00,000</u>

There are 8 shareholders, each of whom received ₹ 2,25,000 from the liquidator in full settlement. You are required to examine the various issues and advise the shareholders about their liability to Income tax.

Answer:

As per Section 2(22)(c), DIVIDEND INCLUDES any distribution to its shareholders by a company on its liquidation, **to the extent to which the company possesses accumulated profits immediately before its liquidation, whether capitalised or not.**

Section 46(2) provides that where a shareholder on the liquidation of a company receives any money or other assets from the company, then he shall be chargeable to income-tax under the head capital gains and the sales consideration for the purposes of section 48 shall be as under:

Moneys Received

Add: Market value of the assets received as on the date of distribution

Less: Amount assessed as dividend under section 2(22)(c)

Sales consideration for the shares in the liquidating company

In the present case, the implications shall be as under:

- Accumulated profits, whether capitalised or not, up to the date of liquidation is ₹4,00,000. Post liquidation profits shall not be included in “accumulated profits” for the purpose of section 2(22)(c).
- Therefore, amount distributed to the shareholders shall be deemed as dividend under section 2(22)(c) to the extent of ₹ 4,00,000. Out of total distribution of ₹18,00,000, ₹4,00,000 is deemed dividend under section 2(22)(c).
- The company shall pay DDT under section 115-O on ₹4,00,000 @ 20.555%. In hands of each shareholder, deemed dividend is ₹ 50,000. The same is exempt in the hands of each shareholder under section 10(34).
- As per section 46A, the sale price of the shares of liquidating company in the hands of each shareholder shall be:

Money Received	2,25,000
Less: Deemed dividend section 2(22)(c)	50,000
Sale Consideration	1,75,000

(e) Computation of capital gains in the hands of each shareholder shall be:

Sale Consideration	1,75,000
Cost of Acquisition (subject to indexation)	1,00,000
Long term Capital Gains	75,000

(f) The shareholders can claim exemption under section 54EE on the above long-term capital gains.

Question 6:

Mani foundations, a charitable trust registered under section 12AA of the Income tax Act run schools for primary and secondary education. The following particulars pertaining to the previous year 2018-19 are furnished to you by the trust:

S. No.	Particulars	₹ (in lakhs)
(i)	Gross receipts from students towards tuition fees, development fees, laboratory fees, etc.	200
(ii)	Voluntary contributions received from public (including anonymous donation ₹ 5 lakhs)	25
(iii)	Government grants	8
(iv)	Donation given towards corpus to a trust registered u/s 10(23C)	2
(v)	Amount applied for the purpose of schools	90
(vi)	Included in (v) above, a sum of ₹ 5 lakhs, being the amount applied for the benefit of the founder of the trust.	
(vii)	The trust set apart ₹55 lakhs for acquiring a building to expand its schools. But the amount was paid in December 2019 when the sale deed was registered in its name.	25
(viii)	Excess of expenditure over income in the Previous Year 2017-18	25

Compute the total income of the trust for the assessment year 2019-20 in order to avail maximum benefits within the four corners of law.

Answer:

Mani Foundations
Computation of Total Income for Assessment Year 2019-20

Particulars	₹ in Lakhs
Gross Receipt	
(i) From students towards tuition fees etc.	200
(ii) Voluntary contributions from public (excluding anonymous donations)	20
(iii) Government Grants	8
Total Receipts	228
Less: 15% set apart or accumulated as per section 11(1)	34.20
Balance Income	193.80
Less: Application of income as per section 11(1)	

(a) Donations towards corpus of trust not treated as application of income	Nil
(b) Applied for purpose of schools	90
(c) Assuming that agreement to purchase the building was entered into in previous year 31.3.2019, ₹ 55 lakhs shall be treated as application of income. It is immaterial that sale deed was registered in next previous year and payment was made in next previous year	55
(d) Excess of expenditure over income of previous year 2017-18 treated as application of income as per judgement of Matriseva Trust	25
Income of the trust	23.80
Add: Anonymous donation taxable as per section 115BBC	5
Add: Amount applied for founder of trust deemed on income as per section 12	5
Total Income	33.80

For the purpose of section 115BBC,

- (i) 5% of total donations of ₹ 33 Lakh, i.e. ₹ 1,65,000; or
- (ii) ₹ 1,00,000

whichever is higher, is not treated as anonymous donation.

In the present case, ₹ 1,65,000 shall not be treated as anonymous donation.

Computation of Tax Liability

Tax on ₹ 30.45 Lakh at normal rates	₹ 7,26,000
Tax on ₹ 3.35 Lakh @ 30% as per section 115BBC	₹ 1,00,500
Total Tax	₹ 8,26,500
Add: 4% Health & Education Cess	₹ 33,060
Total Tax Liability	₹ 8,59,560

Question 7:

State with reasons, whether Netlon LLC., (Incorporated in Singapore) and Briggs Ltd., a domestic company, are/can be deemed to be associated enterprises for the transfer pricing regulations (Each situation is independent of the others):

- (i) Netlon LLC., has advanced a loan of ₹ 53 crores to Briggs Ltd. on 12-1-2019. The total book value of assets of Briggs Ltd is ₹ 100 crores. The market value of the assets, however, is ₹ 150 crores. Briggs. Ltd repaid ₹ 10 crores before 31-3-2019.
- (ii) Netlon LLC., has the power to appoint 2 of the directors of Briggs Ltd. whose total number of directors in the Board is 4.
- (iii) Total value of raw materials and consumables of Briggs Ltd. is ₹ 900 crores. Of this, Netlon LLC. supplies to the tune of ₹ 820 crores, at prices mutually agreed upon once in six months and depending upon the market conditions.

Answer:

Section 92A provides that two enterprises shall be deemed to be associated enterprises, if, **at any time during the previous year:**

- (i) Loan advanced by one enterprise to other enterprise constitute not less than 51% of the **book value** of the total assets of the other enterprise; or
- (ii) More than half of the board of directors of one enterprise are **appointed** by the other enterprise; or

- (iii) 90% or more of the raw materials and consumables required for the manufacture or processing of goods or articles carried out by one enterprise, are supplied by the other enterprise.

In view of the provisions of section 92A, the answer is as under:

- (i) Netlon LLC. and Briggs Ltd. are associated enterprise since Loan advanced by Netlon LLC. ₹53 Crore (at any time during the previous year) is 53% of book value of assets of Briggs Ltd. (market value of asset is not relevant).
- (ii) Netlon LLC. and Briggs Ltd. are not associated enterprises since:
- (a) More than half of the board of directors of Briggs Ltd. is not appointed by Netlon LLC.
- (b) Actual appointment of directors is considered rather than the power to appoint.
- (iii) Total value of raw materials & consumables ₹900 crore
Value of Raw Material & consumables supplied by Netlon LLC. ₹820 crore
Percentage of total supplies 91.11%

Since the conditions of section 92A were met, therefore, Netlon LLC. and Briggs Ltd. are considered as associated enterprises.

Question 8:

Tulsi Private Ltd., a company engaged in ship breaking activity, sold some old and used plates, wood etc., in respect of which it did not collect tax from the buyer. The company claimed that such items are usable as such. Hence these are not 'scrap' to attract the provisions for collection of tax at source. The Assessing Officer treated such items in the nature of 'scrap' and raised a demand under section 201(1) and interest under section 201(1A).

Is the action of the Assessing Officer in treating such items as 'scrap' tenable in law? Discuss.

Answers:

The facts of this case are similar to the judgement in case of **Priya Blue Industries (P) Ltd. (Guj.)**

The assessee-company, engaged in ship breaking activity, sold old and used plates, wood etc. It did not produce any document or papers to show collection of tax at source on sale of such items and payment thereof to the credit of the Central Government. The Assessing Officer observed that such items were in the nature of scrap and therefore, the assessee was under an obligation to collect tax at source from the buyers of scrap. **The assessee claimed that such items are usable as such, and are hence not 'scrap' to attract the provisions for collection of tax at source.**

The Court held that the waste and scrap must be from manufacture or mechanical working of material which is definitely not usable as such because of breakage, cutting up, wear and other reasons. Since the assessee is engaged in ship breaking activity, these items/products are finished products obtained from such activity which are usable as such and hence, are not 'waste and scrap' though commercially known as scrap.

The High Court held that any material which is usable as such would not fall within the ambit of the expression 'scrap' as defined in Explanation to section 206C and therefore, no TCS is required to be collected on the same.

Therefore, in view of the above-mentioned judgement, the action of Assessing Officer in treating the item as scrap is INCORRECT. The demand under section 201(1) and 201(1A) are, therefore, not correct.

Question 9:

Discuss whether liability to deduct tax at source arises in the undermentioned (independent) situations in respect of following payments made by residents in India:

- (i) Dindayal & Co., a partnership firm, has credited a sum of ₹ 67,000 and ₹ 4,000 respectively, as interest to partners L (Resident in India) and M (non-resident) respectively.
- (ii) Lumnous Pvt. Ltd., whose accumulated profits are ₹ 20 lakhs, wants to disburse a loan of ₹ 25 lakhs to Mrs. Nisha, a resident shareholder holding 20% of the equity shareholding in the company. Can the entire amount of loan be disbursed to the shareholder, keeping in mind the provisions of the Income-tax Act, 1961? The Finance Manager feels that this being a pure loan transaction, there is no bar for disbursing the entire amount. Is his view correct?
- (iii) Payment of ₹ 5 lakhs made by Shiv & Company (partnership firm) to Jyoti & Company Ltd. for organising debate competition on the subject 'Rural Heritage of Rajasthan'.

Answer:

The liability to deduct tax at source is discussed as under:

- (i) Dindayal & Co. shall not deduct tax at source on interest paid to partner L (Resident in India) of ₹ 67,000. The interest so paid is treated as business income and therefore, deduction of tax at source was not required. However, tax shall be deducted under section 195, on interest payment to Non-Resident Partner Mr. M.
- (ii) Dividend includes:
 - any payment by a company not being a company in which public are substantially interested
 - of any sum by way of loan or advance to
 - (a) a shareholder being the beneficial owner of shares
 - (b) holding not less than 10% of voting power

} Deemed as dividend in the hands of the shareholder.

to the extent to which the company possesses accumulated profits.

Prior to amendment by Finance Act, 2018, Dividend distribution tax was not payable on deemed dividend under section 2(22)(e). But the shareholder receiving the dividend was required to pay the tax thereon. Now, after amendment, dividend distribution tax is payable under section 115-O @ 30% on deemed dividend under section 2(22)(e) and the same is exempt in the hands of the shareholder under section 10(34).

Accordingly, the Loan of ₹ 25 Lakhs to the extent of ₹ 20 Lakhs shall be deemed on dividend. As per Finance Act, 2018, ₹20 Lakhs deemed dividend section 2(22)(e) is exempt in hands of Nisha under section 10(34). Section 115BBDA in not applicable to deemed dividend section 2(22)(e). As per Finance Act, 2018, the

company Luminous Pvt. Ltd. shall pay DDT under section 115-O on the deemed dividend of ₹20 Lakhs @ 34.944%.

- (iii) The services of Event Managers in relation to sports activities only have been notified by the CBDT as “professional services” for the purpose of section 194J. In the present case, payment of ₹5 lakhs has been made to an event management company for organization of a debate competition. Hence, the TDS provisions under section 194J will not be attracted.

However, TDS provisions under section 194C relating to payment to contractors will be attracted and consequently, tax has to be deducted @ 2% under section 194C by Shiv & Company while making payment to Jyoti & Company Ltd. The tax deductible under section 194C would be ₹10,000, being 2% of ₹5 lakhs.

Question 10:

“Every jurisdiction, in the domestic law, prescribes the mechanism to determine residential status of a person. In case, a person is considered to be resident to both contracting states, it becomes necessary to apply the tie-breaker rule.”

Discuss the manner for application of the tie-breaker rule.

Answer:

DTAA provides that certain incomes are taxable in the hands of recipient in the country of which he is a resident.

Every jurisdiction, in its domestic tax law, prescribes the mechanism to determine residential status of a person. If a person is considered to be resident of both the Contracting States, a series of tie-breaker rules are provided in Model Convention to determine single state of residence for an individual.

The tie-breaker rule would be applied in the following manner:

- (i) The first test is based on where the individual has a permanent home. Therefore, he shall be deemed to be resident of the state in which he has a permanent home available to him. Permanent home would mean a dwelling place available to him at all times continuously and not occasionally and includes place taken on rent for a prolonged period of time. Any place taken for a short duration of stay or for temporary purpose, may be for reasons such as short business travel, or a short holiday etc. is not regarded as a permanent home.
- (ii) If that test is inconclusive for the reason that the individual has permanent home available to him in both Contracting States, he will be considered a resident of the Contracting State where his personal and economic relations are closer (centre of vital interests). Thus, preference is given to family and social relations, occupation, place of business, place of administration of his properties, political, cultural and other activities of the individual.
- (iii) In case,
 - where the individual has a permanent home available to him in both Contracting States and it is not possible to determine in which State he has his centre of vital interests; or
 - where the individual has no permanent home available to him in both the Contracting State.

preference is given to the Contracting State where the individual has an habitual abode.

- (iv) If the individual has habitual abode in both Contracting States or in neither of them, he shall be treated as a resident of the Contracting State of which he is a national.

If the individual is a national of both or neither of the Contracting States, the matter is left to be considered by the competent authorities of the respective Contracting States.

Question 11:

The business premise of Mr. Rajneesh was subjected to a survey under section 133A of the Act. There were some indiscriminating materials found at the time of survey. The assessee apprehends reopening of assessments of the earlier years. He wants to know whether he can approach the Settlement Commission.

Explain briefly the basic conditions to be satisfied and the benefits that may accrue to Mr. Rajneesh by approaching the Settlement Commission.

Answer:

An assessee may, at any stage of a case relating to him, make an application in the prescribed form and manner to the Settlement Commission under section 245C. "Case" means any proceeding for assessment which may be pending before an Assessing Officer on the date on which such application is made. Thus, the basic condition for making an application before the Settlement Commission under section 245C is that there must be a proceeding for assessment pending under section 143(3)/144/147/ 153A before an Assessing Officer on the date on which the application is made.

A proceeding for assessment or reassessment under section 147 shall be deemed to have commenced from the date on which a notice under section 148 is issued.

In this case, Mr. Rajneesh cannot approach the Settlement Commission merely due to his apprehension that assessment of earlier years may be reopened, since there is no case pending before an Assessing Officer under section 143(3)/144/147/153A.

Therefore, he has to wait for the Assessing Officer to issue notice under section 148. Thereafter, he can make an application to the Settlement Commission under section 245C, since there would be a "case pending" before the Assessing Officer on that date.

Another basic condition to be satisfied for making an application is that the additional amount of income-tax payable on the income disclosed in the application should exceed ₹10 lakh, and such tax and interest thereon which would have been paid had the income disclosed in the application been declared in the return of income should be paid on or before the date of making the application and proof of such payment should be attached with the application.

If the Settlement Commission is satisfied that Mr. Rajneesh has co-operated in the proceedings and made true and full disclosure of his income and the manner in which it has been derived, it may, subject to such conditions as it may think fit to impose, grant to Mr. Rajneesh –

- immunity from prosecution for any offence under the Income-tax Act, 1961; and
- immunity from imposition of penalty under the Income-tax Act, 1961, either wholly or in part, with respect to the case covered by the settlement

This is the benefit that may accrue to Mr. Rajneesh, if he approaches the Settlement Commission.

Question 12:

The assessment of Foundation Bank Ltd. for Assessment Year 2015-16 was made under section 143(3) on 30th November, 2016 allowing deduction u/s 36(1)(vii) and deduction in respect of foreign exchange rate difference as claimed in the return of income. Subsequently, two notices of reassessment were issued u/s 148 and an order of reassessment was passed u/s 147 on 31st December, 2018 which did not deal with the above deductions. Later the Principal Commissioner after examining the records of assessment, initiated revisionary proceeding u/s 263 on 31st May, 2019 for disallowing deduction u/s 36(1)(vii) and deduction in respect of foreign exchange rate difference. The bank claims that the order passed by the Principal Commissioner u/s 263 is barred by limitation.

Is the claim made by Foundation Bank tenable in law?

Answer:

The facts of the case are similar to judgement of **CIT v. ICICI Bank Ltd. (Bom.)** which is discussed below:

In the present case, an order of assessment for Assessment Year 2015-16 was passed under section 143(3) on 30.11.2016 allowing the deductions under section 36(1)(vii), and foreign exchange rate difference. Further, notice of reassessment was issued under section 148 and an order of reassessment was passed under section 147 on 31.12.2018 which did not deal with the above deductions. Certain incomes not shown by assessee were assessed under section 147.

Later, the Commissioner passed an order under section 263 on 31-5-2019 for disallowing the deduction under section 36(1)(vii), and in respect of foreign exchange rate difference which have not been taken up in the reassessment proceedings under section 147 but which was decided in the original order of assessment passed under section 143(3).

Held, period of limitation in respect of the order of Commissioner under section 263 in respect of a matter which does not form the subject matter of reassessment shall be reckoned from the date of the original order under section 143(3) and not from the date of the reassessment order under section 147. Therefore, Commissioner of Income-tax could have passed the order under section 263 upto 31.3.2019 and order passed by Commissioner of Income-tax on 31.5.2019 is time barred and invalid.

The facts of the present case are similar to Bombay High Court Judgement in case of ICICI Bank Ltd.

In the present case, in view of the above judgement, the order of Principal Commissioner under 263 is time barred and invalid and it could have been passed till 31.3.2019.

Question 13:

State with brief reason, whether the following statements are true or false:

(No mark will be awarded for answers without reason.)

- (i) *Where a notice under section 143(2) is issued to the assessee, it is not required to process under section 143(1), the return of income filed by the assessee.*
- (ii) *Even without rejecting the books of account, if any, maintained by the assessee, the Assessing Officer can make a reference to the Valuation Officer u/s 142A for estimating the cost of construction of an immovable property.*

- (iii) *Expenses of special audit conducted under section 142 shall be paid by the Central Government.*
- (iv) *Only an individual can be regarded as a Tax Return Preparer under section 139B.*

Answer:

- (i) **The statement is False.** As per Finance Act, 2017, processing of return shall be done under section 143(1) even if case is selected for scrutiny under section 143(2).

Therefore, refund shall be granted under section 143(1) even if case is selected for scrutiny. But Assessing Officer has been given:

- **power to withhold the refund**
 - **upto the date on which assessment is made under section 143(3)**
 - **only in cases where Assessing Officer is of the opinion that the grant of refund is likely to adversely affect the interest of revenue (e.g. massive tax evasion detected or assessee is a habitual tax offender).**
 - **But in this case Assessing Officer has to take previous approval of CIT and has to record reasons as to how the grant of refund will affect the interest of revenue.**
- (ii) **The statement is True.** Section 142A provides that Assessing officer can make reference to Valuation Officer whether or not he is satisfied about the correctness or completeness of accounts of the assessee.
 - (iii) **The statement is True.** As per section 142(2A), the expenses of special audit and remuneration of the auditor (Accountant) shall be determined by the Commissioner or Chief Commissioner and expenses and remuneration so determined shall be paid by Central Government
 - (iv) **The statement is True.** Section 139B defines “Tax Return Preparer” means an individual who has been authorised to act as Tax Return preparer under the notified scheme.

Question 14:

In the course of search operation under section 132 of the Income Tax Act 1961, in the month of July, 2019, Mr. Khemka has made a declaration under 132(4) to the Income Tax authorities on the earning of his income not disclosed in respect of previous year 2018-19. Can that statement save Mr. Khemka from a levy of penalty, if he is yet to file his return of income for assessment year 2019-20?

Answer:

As per Section 271AAB, the Assessing Officer may, notwithstanding anything contained in any other provisions of this Act, direct that, in a case where search has been initiated under section 132, the assessee shall pay by way of penalty, in addition to tax, if any, payable by him,—

- (a) **a sum computed at the rate of 30% of the undisclosed income of the specified previous year, if such assessee—**
 - (i) **in the course of the search, in a statement under sub-section (4) of section 132, admits the undisclosed income and specifies the manner in which such income has been derived;**
 - (ii) **substantiates the manner in which the undisclosed income was derived;**
- and**

- (iii) on or before the specified date—
- (A) pays the tax, together with interest, if any, in respect of the undisclosed income; and
 - (B) furnishes the return of income for the specified previous year declaring such undisclosed income therein;

(b) a sum computed at the rate of 60% of the undisclosed income of the specified previous year, if it is not covered by clause (a) above.

Explanation.— For the purposes of this section,—

"specified previous year" means the previous year—

- (i) which has ended before the date of search, but the date of furnishing the return of income under sub-section (1) of section 139 for such year has not expired before the date of search and the assessee has not furnished the return of income for the previous year before the date of search; or
- (ii) in which search was conducted;

Since the due date of filling of return for previous 31.3.2019 has not expired on the date of search, previous year 31.3.2019 is "Specified previous year" as per section 271AAB,

Therefore, Mr. Khemka has to pay a penalty of 30% of the undisclosed income as per section 271AAB even if he makes the statement under section 132.

Question 15:

John Butler Tax. Inc., is a company incorporated in Colombo, Sri Lanka. 60% of its shares are held by I Pvt. Ltd., a domestic company. John Butler Tax. Inc. has its presence in India also. The data relating to John Butler Tax. Inc., are under:

Particulars	India	Sri Lanka
<i>Fixed assets at depreciated values for tax purposes (₹ in crores)</i>	90	70
<i>Intangible assets (₹ in crores)</i>	40	180
<i>Other assets (₹ in crores)</i>	30	90
<i>Income from trading operations (₹ in crores)</i>	15	42
<i>Income from investments (₹ in crores)</i>	30	13
<i>Number of employees (Residents in respective countries)</i>	40	60

For POEM purposes, state whether,

- (i) *The company shall be said to be engaged in 'active business outside India'.*
- (ii) *Because of increased operations in India, more manpower is needed. 30 more employees may be required in this regard. The company can either take these employees directly in its roll or can outsource the increased operation to an external agency which will engage the 15 employees in its roll and finish the work for the company. Which choice will be better?*

Note: *If for any test, average figures are needed, the same may be ignored and the data as given above to the applicant may be used.*

Answer:

A company is said to be engaged in "ACTIVE BUSINESS OUTSIDE INDIA" and hence its POEM is outside India

If it satisfies all the following conditions				
Passive income is 50% or less of its Total Income ¹	Less than 50% of total assets situated in India [†]	Less than 50% of total employees situated in India or are resident in India [†]	Payroll expenses of employees situated in India or resident in India is less than 50% of total payroll expenditure [†]	Majority meetings of Board of Directors are held outside India

- Note 1:** The value of assets shall be
- Depreciable assets** – Average of its value for tax purposes at the beginning and end of Previous Year.
 - Other assets** – Value as per books of account
- Note 2:** Number of Employees shall be average of number of employees at the beginning and end of the previous year. Employees shall include persons who are not directly employed but performs functions similar to employees e.g. contractual persons.
- Note 3:** Passive income shall be aggregate of
- Income from transactions where both the purchase and sale of goods is from/to its associated enterprises and
 - Income by way of royalty, dividend, capital gains, interest and rental income whether derived from associated or non-associated enterprises.

Now, as per the information given in the question:

- The percentage of total assets in India viz-a-viz total assets all over the world is computed as under:
 Total Assets worldwide = 90+70+40+180+30+90= ₹ 500 crore
 Total Assets in India = 90+40+30= ₹160 crore

 Assets situated in India: Total Assets = 160: 500
 = 160/ 500 x 100=32%
- The percentage of passive income viz-a-viz total income worldwide is computed below:
 Passive Income = ₹43 Crore
 Total Income = ₹100 Crore
 Passive Income: Total Income = 43%
- Number of Employees in India: Total Employees worldwide = 40 : 100 = 40%.

Therefore, the answers are as under:

- All conditions of “ACTIVE BUSINESS OUTSIDE INDIA” are satisfied and therefore the POEM of John Butler Tax Inc. shall be outside India
- As per POEM Rules, Employees shall include persons who are not directly employed but performs functions similar to employees e.g. contractual persons. If 30 employees are employed in India, then,

Number of Employees in India: Total Employee = 70:130 = 53.84%

Then company shall not be said to have "ACTIVE BUSINESS OUTSIDE INDIA".

If outsourcing of work is done to an external agency which will engage 15 employees then number of Employees in India: Total Employee = 55:115 = 47.82%

The company shall be said to have "ACTIVE BUSINESS OUTSIDE INDIA":

Therefore, the choice of outsourcing is better.

Question 16:

Mr. B proposes to purchase for his business, certain raw materials from Mr. S. In view of the scarcity of the products, S insists on cash payments for the purchases, to which B agrees. On 27-3-2019, the purchases are effected through a cash invoice for ₹ 3,20,000.

In respect of the above transactions, will there be any detrimental effect in the hands of B and S under the provisions of the Income-Tax Act, 1961? Explain briefly.

Will your answer be different, if the cash purchases are effected by the buyer B on two different dates for different raw materials for ₹ 1,80,000 and ₹ 1,40,000 respectively?

Answer:

Section 40A(3): Where the assessee incurs **any expenditure** in respect of which a payment or aggregate of payments **made to a person in a day, otherwise than by an account payee cheque drawn on a bank or account payee bank draft or use of electronic clearing system through a bank account, exceeds ₹10,000**, no deduction shall be allowed in respect of such expenditure.

Section 269ST:

No person shall receive an amount of two lakh rupees or more—

- (a) in aggregate from a person in a day; or**
- (b) in respect of a single transaction; or**
- (c) in respect of transactions relating to one event or occasion from a person, otherwise than by an account payee cheque or an account payee bank draft or use of electronic clearing system through a bank account.**

Section 271DA:

If a person receives any sum in contravention of the provisions of section 269ST, he shall be liable to pay, by way of penalty, a sum equal to the amount of such receipt.

In view of the above-said provisions, in the present question, the tax implication of the transactions shall be as under:

- (i) ₹ 3,20,000 shall be disallowed under section 40A(3), in hands of Mr. B since the payment exceeds the threshold limit of ₹ 10,000 per invoice per day.
- (ii) Mr. S shall be liable to a penalty of ₹ 3,20,000 under section 271DA since he contravened the provisions of section 269ST i.e., the purchases are made in cash, in excess of ₹ 2,00,000.

The answer will be changed, if buyer make purchases on two different dates for ₹ 1,80,000 and ₹ 1,40,000 respectively, then:

- (i) ₹3,20,000 shall be disallowed under section 40A(3), in hands of Mr. B since the payment exceeds the threshold limit of ₹10,000 per invoice per day.
- (ii) Section 269ST and section 271DA shall not be attracted in hands of Mr. S since each transaction is less than ₹2,00,000.

Question 17:

Mr. Sarthak a software engineer wants to commence a business in manufacture of solar powered car. He provides the following information:

- (i) *The project cost is estimated at ₹5 Crores.*
- (ii) *He has a residential house in Surat since 2010 which could be sold for ₹3 Crores.*
- (iii) *And the balance ₹2 Crores could be financed through bank borrowings at a cost of 13% per annum.*
- (iv) *He has another option Viz. his friend Miss Juhi who is willing to contribute ₹2 Crores and become a co-promoter.*

The indexed cost of acquisition of the residential house (Computed) is ₹70 lakhs.

Mr. Sarthak seeks your guidance on the project finance taking into account any tax incentives available under Income Tax Law besides the funding of project through bank finance or accepting Miss Juhi as Co-Promoter.

You are requested to advise Mr. Sarthak, on Income tax aspects to avail tax benefits within the four corners of law.

Answer:

1. If Mr. Sarthak forms a company which is an Eligible Start-up and invests the sale proceeds of ₹3 crores in equity shares of the company and the company buys new plant & machinery within one year of subscription of shares, then Long Term Capital Gains of ₹2.30 crores shall be exempt under section 54GB.

If Miss. Juhi becomes a shareholder in the company and contributes ₹2 crores as share capital, then also deduction under section 54GB shall be available to Mr Sarthak as he owns more than 50% of the equity share capital of the company.

2. The company being an Eligible Start-up is entitled deduction under section 80IAC. 100% of profits of the company shall be allowed as deduction under section 80IAC for 3 consecutive assessment years out of 7 consecutive assessment years beginning with the year, the company is incorporated.
3. If Mr. Sarthak takes a Loan of ₹2 crores @ 13% p.a., then interest of ₹26 Lakhs per annum shall be allowed to the company as deduction under section 36(1)(iii).

Question 18:

T, Inc., a non-resident entity incorporated in Mauritius, has Permanent Establishment (PE) in India. The PE filed its return of income for the assessment year 2018-19 disclosing income ₹100 lakhs and paid tax at the rate applicable to the domestic company i.e. 30% plus applicable surcharge and cess on the basis of paragraph 2 of Article 24 of Double Tax Avoidance Agreement (non-discrimination) between India and Mauritius, which reads as follow:

“The taxation on PE which an enterprise of a contracting state has in the other contracting state shall not be less favourably levied in that other state than the taxation levied on enterprise of that other state carrying on the same activities in the same circumstances,”

However, the Assessing Officer computed the Tax on the PE at the rate applicable to a foreign company (40%). Is the action of AO in accordance with law?

Answer:

Under section 90(2), where the Central Government has entered into an agreement for avoidance of double taxation with the Government of any country outside India or specified territory outside India, as the case may be, then, in relation to the assessee to whom such agreement applies, the provisions of the Income-tax Act, 1961 shall apply to the extent they are more beneficial to the assessee. Thus, in view of paragraph 2 of the Article 24 (Non-discrimination of the Double Taxation Avoidance Agreement (DTAA)), it appears that the Indian PE of T, Inc., incorporated in Mauritius, is liable to tax in India at the rate applicable to domestic company (30%), which is lower than the rate of tax applicable to a foreign company (40%).

However, Explanation 1 to section 90 clarifies that the charge of tax in respect of a foreign company at a rate higher than the rate at which a domestic company is chargeable, shall not be regarded as less favourable charge or levy of tax in respect of such foreign company. Therefore, in view of this Explanation, the action of the Assessing Officer in levying tax @ 40% (plus surcharge, if any, plus 4% health & education cess) on the Indian PE of Mauritius Company is in accordance with law.

Question 19:

Alpha Inc., a non-resident company has an IT enabled business process outsourcing Unit in India (BPO) and it provides certain outsourcing services to a resident Indian entity.

Discuss, the tax implications, in the hand of Alpha Inc. due to presence of BPO unit in India.

Answer:

Article 7 of Double Taxation Avoidance Agreements provides that if a foreign enterprise carries on business in another country through a Permanent Establishment situated therein, **the profits of the enterprise may be taxed in the other country but only so much of them as is attributable to the Permanent Establishment.**

Article 7 also provides that in determining the profits of a Permanent Establishment **there shall be allowed as deductions expenses which are incurred for the purposes of the Permanent Establishment** including executive and general administrative expenses so incurred, whether in the State in which the Permanent Establishment is situated or elsewhere. **What are the expenses that are deductible would have to be determined in accordance with the accepted principles of accountancy and the provisions of the Income-tax Act, 1961.**

Article 7 also contains the central directive on which the **allocation of profits to a Permanent Establishment** is intended to be based. The paragraph incorporates the view that the profits to be attributed to a Permanent Establishment are those which that Permanent Establishment would have made if, instead of dealing with its Head Office, it had been dealing with an entirely separate enterprise under conditions and at prices prevailing in the ordinary market. This corresponds to the "arm's length principle".