

PAPER – 7: DIRECT TAX LAWS

Question No.1 is compulsory.

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

Working notes should form part of the respective answers.

All questions relate to Assessment Year 2020-21, unless stated otherwise in the question.

Question 1

Tulsi Ltd., engaged in manufacturing activity shows a net profit of ₹ 2,47,00,000/- for the financial year ended on 31st March, 2020 after the debit/credit of following items:

- (a) ₹ 45 lakhs paid to X Ltd. towards feasibility study conducted for examining proposals for technological advancement relating to the existing business, where the project was abandoned without creating a new asset.
- (b) Depreciation charged during the year amounted to ₹ 72 lakhs.
- (c) It incurred ₹ 3 lakhs as expenditure for public issue of shares. The public issue could not materialize due to non-clearance by SEBI.
- (d) Profit of ₹ 10 lakhs on sale of plot of land to S Ltd., a domestic company, the entire shares of which are held by the assessee company. The plot was acquired by Tulsi Ltd. on 30.09.2018.
- (e) Loss of ₹ 3 lakhs incurred by way of trading in futures and options (derivatives) in stocks in a recognized stock exchange.
- (f) Provision for gratuity based on actuarial valuation was ₹ 130 lakhs. Actual gratuity paid was ₹ 80 lakhs.
- (g) ₹ 8.50 lakhs, being the additional compensation received from the State Government pursuant to an interim order of the Court in respect of land acquired by the State Government in the previous year 2014-15.
- (h) One time license fee of ₹ 80 lakhs paid to a foreign company for obtaining franchise on 01.10.2019.
- (i) Payment of ₹ 15 lakhs towards purchase of software from a non-resident meant for subsequent resale in the Indian market (no tax deducted at source), was ultimately sold at a profit during financial year 2019-20.

Additional Information:

- (1) As a corporate debt restructuring, the bank has converted unpaid interest of ₹ 10 lakhs upto 31st March, 2019 into a new loan account repayable in five equal annual installments.

The Suggested Answers for Paper 7: Direct Tax Laws are based on the provisions of Income-tax law as amended by the Finance Act, 2019, Finance (No.2) Act, 2019 and Taxation Laws (Amendment) Act, 2019, which are relevant for November, 2020 examination. The relevant Assessment Year is A.Y.2020-21.

The first installment of ₹ 2 lakhs was paid in March, 2020 by debiting new loan account.

- (2) Depreciation allowable as per Income-tax Act, 1961 is ₹ 75 lakhs.
- (3) The company has installed a new plant and machinery worth ₹ 300 lakhs on 01.06.2019 in the notified backward area in the state of Telangana. Further, it invested ₹ 250 lakhs in the plant and machinery on 01.11.2019 out of which machinery worth ₹ 50 lakhs was second hand. Additional depreciation and Investment allowance on this machinery was not considered while calculating depreciation as per Income-tax Act.

Compute the total income of M/s. Tulsi Ltd. for the A.Y. 2020-21 by analyzing, integrating and applying the relevant provisions of Income-tax Act, 1961 (ignoring MAT and the provisions of section 115BAA). Explain in brief, the reasons for the treatment of each item. **(14 Marks)**

Answer

(a) Computation of Total Income of Tulsi Ltd. for the A.Y.2020-21

	Particulars	Amount (₹)	
I	Profits and gains of business and profession		
	Net profit as per the Statement of Profit and Loss		2,47,00,000
	Add: Items debited but to be considered separately or to be disallowed		
	(a) Payment towards feasibility study	-	
	¹ Since the feasibility study was conducted by X Ltd. for the existing business and the study was abandoned without creating a new asset, the expenses were of revenue nature		
	Since the expenditure of ₹ 45 lakhs is already debited to the statement of profit and loss, no further adjustment is required]		
	(b) Depreciation as per books of account	72,00,000	
	(c) Expenditure on public issue of shares	3,00,000	
	[Share issue expenses incurred by the company constitutes capital expenditure, even though it could not go in for the public issue on account of non-clearance by		

¹ CIT v. Priya Village Roadshows Ltd. (2011) 332 ITR 594 (Delhi)

	SEBI. Though the efforts were aborted, the fact remains that the expenditure incurred was only for the purpose of expansion of the capital base. The capital nature of the expenditure would not be lost on account of the abortive efforts². Since the share issue expenses have been debited to statement of profit and loss of this year, the same is required to added back while computing business income]	
(e)	Loss incurred in trading in futures and options [Loss incurred by way of trading in futures and options cannot be allowed as deduction while computing profit from the manufacturing activity, since it is not a loss in relation to such business. Since the said amount has been debited to the statement of profit and loss, it has to be added back for computing profit from manufacturing activity]	3,00,000
(f)	Provision for gratuity [As per section 40A(7), any provision made for payment of gratuity to employees is disallowed. However, actual gratuity paid during the year is allowable as deduction. Hence, the balance provision of ₹ 50 lakhs (i.e., ₹ 130 lakhs – ₹ 80 lakhs) is to be added back.]	50,00,000
(h)	One time licence fee paid for obtaining franchise [Franchise is an intangible asset and the licence fee paid to obtain franchise is a capital expenditure eligible for depreciation. Since the licence fee paid has been debited to the statement of profit and loss, the same has to be added back]	80,00,000

² Mascon Technical Services Ltd. v. CIT (2013) 358 ITR 545 (Mad.)

(i) Payment for purchase of software without TDS	15,00,000	<u>2,23,00,000</u>
[Since the payment made for purchase of software constitutes royalty on which tax is deductible at source, 100% disallowance under section 40(a)(i), of the amount paid, is attracted for non-deduction of tax at source, since the payment is made to a non-resident]		4,70,00,000
Less: Items credited to statement of profit and loss, but not includible in business income/ permissible expenditure and allowances		
(d) Profit on sale of plot of land	10,00,000	
[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 by virtue of 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]		
(g) Additional compensation received from State Government in respect of land	8,50,000	
[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 by virtue of 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"]		

AI(1) Conversion of unpaid interest into new loan	2,00,000	
[Conversion of unpaid interest into loan shall not be construed as payment of interest for the purpose of section 43B. The amount of unpaid interest converted into a new loan will be allowable as deduction only in the year in which such converted loan is actually paid. Since ₹ 2 lakhs has been paid in the P.Y.2019-20, the same is allowable as deduction]		
AI(2) Depreciation as per Income-tax Act, 1961	2,35,00,000	
[₹ 75,00,000, being normal depreciation allowable under the Income-tax Act, 1961		
(+) ₹ 20,00,000, depreciation @25% on franchise, being an intangible asset put to use for more than 180 days in the year		
(+) ₹ 1,40,00,000, being additional depreciation		
[@35% on ₹ 300 lakhs = ₹ 105 lakhs + ₹ 35 lakhs being 17.5% on ₹ 200 lakhs (i.e., ₹ 250 lakhs – ₹ 50 lakhs, being cost of second hand plant and machinery not eligible for additional depreciation), since the plant and machinery has been installed in a notified backward area in the state of Telangana so entitled for higher rate of additional depreciation@35%]		
AI(3) Deduction under section 32AD	75,00,000	
[15% of ₹ 500 lakhs (₹ 300 lakhs + ₹ 250 lakhs – ₹ 50 lakhs, being cost of second hand plant and machinery) would be eligible for deduction u/s 32AD]		
Income from manufacturing business		<u>3,30,50,000</u>
Less: Set-off of loss from trading in futures and options (derivatives) in stocks in recognized stock exchange against income from manufacturing business is allowable as per		1,39,50,000

section 70(1), since the same is not speculative in nature		<u>3,00,000</u>
Profits and gains of business or profession		1,36,50,000
Capital Gains		-
(d) Profit on sale of plot of land [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 by virtue of section 47(iv)].	-	
(g) Additional compensation received from State Government in respect of land [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" only in the year of final order as per section 45(5)].	-	
Total Income		1,36,50,000

Question 2

(a)

		(₹) in lakhs
(1)	Gross receipts from students towards admission fees, tuition fees, development fees, etc.	145.00
(2)	Dividend received on units of mutual funds specified in section 10(23D)	12.00
(3)	Donations received (including anonymous donation ₹ 2.50 lakhs)	11.50
(4)	Government Grant	9.50
(5)	Amount applied for the purposes of schools. This includes ₹ 15 lakhs paid to resident teachers and contractors on which TDS is required to be deducted under section 192 and 194C and TDS has not been deducted	92.25
(6)	Purchase of computers and laboratory equipment	18.50
(7)	Donation given towards corpus to a trust registered under	3.00

	section 10(23C)	
(8)	The institution has accumulated ₹ 35 lakhs under section 11(2) in the previous year 2016-17 for a period of two years for acquiring and developing a plot of land for construction of a new school. Only land was purchased for ₹ 22 lakhs and no development was made during the two years	
(9)	Excess of expenditure over income in the previous year 2018-19	28.00
(10)	Repayment of loan taken earlier for the construction of school building	10.00

Compute total income of the trust and tax payable by it for the Assessment Year 2020-21.

(8 Marks)

- (b) Mr. Suresh, an individual resident in India aged 60 years, furnishes you the following particulars of income earned in India, Country "X" and Country "Y" for the previous year 2019-20. India has not entered into double taxation avoidance agreement with Country X and has a double taxation avoidance agreement with country Y.

Particulars	₹
Income from profession carried on in India	8,00,000
Agricultural income in Country "X" (gross)	60,000
Dividend received from a company incorporated in Country "Y" (gross)	1,50,000
Royalty income from a literary book from Country "X" (gross)	6,00,000
Expenses incurred for earning royalty	1,00,000
Business loss in Country "Y" (Proprietary business)	65,000
Rent from a house situated in Country "Y" (gross)	2,40,000
Municipal tax paid in respect of the above house in Country "Y" (not allowed as deduction in Country "Y")	10,000

Note: Business loss in Country "Y" not eligible for set off against other incomes as per law of that country. Royalty income brought in India in May, 2020. The rates of tax in Country "X" and Country "Y" are 10% and 15%, respectively. Compute total income and tax payable by Mr. Suresh in India for Assessment Year 2020-21.

(6 Marks)

Answer

- (a) **Computation of total income of Trust for the A.Y.2020-21**

Particulars	₹ in lakhs	₹ in lakhs
Gross receipts from students towards admission fees, tuition fees, development fees etc.		145.000

Dividend received on units of mutual funds [would not be exempt since trust registered under section 12AA by virtue of section 11(7)]		12.000
Government Grant – [See Note 3]		9.500
Donations other than anonymous donations of ₹ 2.5 lakhs		<u>9.000</u>
		175.500
Add: Anonymous donations [to the extent not chargeable to tax @30% under section 115BBC(1)(i)] [See Note 1 & 2]		<u>1.000</u>
		176.500
Less: 15% of income eligible for being set apart without any condition ³		<u>26.475</u>
		150.025
Less: Amount applied for charitable purposes		
- <u>On revenue account</u> – Administrative expenses:	87.75	
For schools (Out of ₹ 92.25 lakhs, ₹ 4.5 lakhs, being 30% of ₹ 15 lakhs, would be disallowed, since tax is not deducted u/s 192 & 194C on such amount paid to resident doctors & contractors)		
- <u>On capital account</u> – Purchase of computer and laboratory equipment	18.50	
- Corpus donations to a trust registered under section 10(23C) out of current year income are permissible.	3.00	
- Repayment of loan taken earlier for construction of school building	<u>10.00</u>	<u>119.25</u>
		30.775
Add: ₹ 13 lakhs remaining unutilized out of accumulated income would be deemed as income of the current previous year [i.e., ₹ 35 lakhs, being the amount set apart for acquiring		

³ As per the Supreme Court ruling in CIT v. Programme for Community Organisation (2001) 116 Taxman 608, 15% of gross receipts would be eligible for accumulation under section 11(1)(a). Alternatively, 15% of income can be set apart without any condition, as per the plain reading of section 11(1).

and developing a plot of land for construction of a new school for a period of 2 years less ₹ 22 lakhs utilised on acquisition of land]	<u>13.000</u>
	43.775
Less: Excess of expenditure over income in the P.Y. 2018-19 allowable as application for the current previous year	<u>28.000</u>
Total income [other than anonymous donation taxable@30% u/s 115BBC(1)(i)]	15.775
Add: Anonymous donation taxable @30% u/s 115BBC(1)(i) [See Note 1 & 2]	<u>1.500</u>
Total Income of the trust (including anonymous donation taxable@30%)	<u>17.275</u>

Computation of tax liability of the trust for the A.Y. 2020-21

Particulars	₹
Tax on total income [Excluding anonymous donations] [₹ 5,77,500 x 30% + ₹ 1,12,500]	2,85,750
Tax on anonymous donations taxable@30% [₹ 1,50,000 x 30%]	<u>45,000</u>
	3,30,750
Add: Health and Education cess @4%	<u>13,230</u>
Total tax liability	<u>3,43,980</u>

Notes:

- As per section 115BBC(1)(i), the anonymous donations in excess of the higher of the following would be subject to tax@30%;
 - ₹ 0.575 lakh, being 5% of the total donations received i.e., 5% of ₹ 11.5 lakh [Donations ₹ 9 lakhs (+) Anonymous donations ₹ 2.5 lakhs]; or
 - ₹ 1 lakh

Therefore, anonymous donations of ₹ 1.5 lakh (₹ 2.5 lakh – ₹ 1.0 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
- A plain reading of section 13(7) gives rise to the view that the entire anonymous donations may not be eligible for benefit of exclusion from total income under sections 11 and 12. If this view is taken, then ₹ 1.00 lakh should not be added to ₹ 175.50 lakhs for 15% unconditional exemption. Accordingly, ₹ 26.325 lakhs, being

15% of ₹ 175.50 lakhs would be the income eligible for accumulation without any condition. Computation of total income and tax liability would, accordingly, change.

- (3) Government Grant of ₹ 9.50 lakhs are not included in the total donations, in the above solution, while computing the limit of 5% of total donations under section 115BBC(1). This view is taken, since Government 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 under section 115BBC(1). Hence, the solution can be worked out by including government grants in total donations for computing the limit of 5% of total donations.

(b) **Computation of total income of Mr. Suresh for A.Y.2020-21**

Particulars	₹	₹
Income from House Property [House situated in Country Y]		
Gross Annual Value ⁴	2,40,000	
Less: Municipal taxes paid in Country Y	<u>10,000</u>	
Net Annual Value	2,30,000	
Less: Deduction under section 24 – 30% of NAV	<u>69,000</u>	1,61,000
Profits and Gains of Business or Profession		
Income from profession carried on in India	8,00,000	
Less: Business loss in Country “Y” from proprietary business	<u>65,000</u>	
	7,35,000	
Royalty income ⁵ from a literary book from Country X (after deducting expenses of ₹ 1,00,000)	<u>5,00,000</u>	12,35,000
Income from Other Sources		
Agricultural income in Country X [Not exempt]	60,000	
Dividend received from a company in Country Y	<u>1,50,000</u>	<u>2,10,000</u>
Gross Total Income		16,06,000

⁴Rental income has been taken as GAV in the absence of other information relating to fair rent, municipal value etc.

⁵ Alternatively, royalty income can be taxable under the head “Income from other sources”.

Less: Deduction under Chapter VI-A		
Under section 80QQB – Royalty income of a resident from literary book allowable as deduction since the amount has been brought into India within six months from the end of the previous year		<u>3,00,000</u>
Total Income		13,06,000
Note – Since adjusted total income (i.e., ₹ 16,06,000) does not exceed ₹ 20 lakhs, AMT would not be attracted in this case.		
Computation of tax liability of Mr. Suresh for A.Y.2020-21		
Tax on total income [30% of ₹ 3,06,000 + ₹ 1,10,000, since Mr. Suresh is a senior citizen, he is eligible for higher basic exemption limit of ₹ 3,00,000]		2,01,800
Add: Health and education cess @4%		<u>8,072</u>
		2,09,872
Less: Deduction under section 90 (See Working Note 1)		39,532
Less: Deduction under section 91 (See Working Note 2)		<u>26,000</u>
Tax Payable		1,44,340

Working Note 1

Calculation of deduction under section 90: Deduction under section 90 is available in respect of Country Y with which India has a DTAA.		
	₹	₹
Foreign tax paid in Country Y on Rental income of ₹ 2,40,000 plus Dividend income of ₹ 1,50,000 @ 15% [Business loss is not allowable as deduction in Country Y and no deduction is available in respect of municipal tax]	58,500	
Income pertaining to Country Y forming part of total income in India		
Income from house property	1,61,000	
Dividend	<u>1,50,000</u>	
	3,11,000	
Less: Loss from business set-off against other business income	<u>65,000</u>	
	2,46,000	
Average rate of tax in India [i.e., ₹ 2,09,870 / ₹ 13,06,000 x 100]	16.070%	
Tax payable in India on the income forming part of total		

income @16.070% on ₹ 2,46,000	39,532	
As per Rule 128, lower of tax paid in Country Y and tax payable in India is allowable as deduction		39,532

Working Note 2

Calculation of deduction under section 91: Deduction under section 91 is available in respect of Country X with which India has no DTAA		
		₹
Average rate of tax in India [i.e., ₹ 2,09,870 / ₹ 13,06,000 x 100]	16.070%	
Average rate of tax in Country X	10%	
Doubly taxed income pertaining to Country X⁶	₹	
Agricultural Income	60,000	
Royalty Income [₹ 6,00,000 – ₹ 1,00,000 (Expenses) – ₹ 3,00,000 (deduction under section 80QBB)]	<u>2,00,000</u>	
	2,60,000	
Deduction under section 91 on ₹ 2,60,000 @10% [being the lower of average Indian tax rate (16.070%) and Country X tax rate (10%)]		26,000

Question 3

- (a) Examine the liability for tax deduction at source in the following cases, which have taken place during the year ended 31st March, 2020:
- Sartaj Hotels Ltd. paid tips to his employees, received from its customers (who made payments through credit card). Examine whether tips distributed to the employees would fall within the meaning of "Salaries" to attract tax deduction at source under section 192?
 - Skyhigh Airlines Ltd. has paid amount of ₹ 22 lakhs during the year ended 31.3.2020 to Airports Authority of India towards landing and parking charges.
 - Paras Hospitals Pvt. Ltd. has recently accorded recognition by several insurance companies to admit and treat patients on cashless hospitalization basis. Payment to the assessee hospital will be made by Third Party Administrators (TPA) who will process the claims of the patients admitted and make payments to the various hospitals including the assessee. All TPAs are corporate entities. The assessee wants to know whether the TPAs are bound to deduct tax at source under section 194J or under section 194C.

⁶Doubly taxed income includes only that part of income which is included in the assessee's total income. The amount deducted under Chapter VIA is not doubly taxed and hence, no relief is allowable in respect of such amount – CIT v. Dr. R.N. Jhanji (1990) 185 ITR 586 (Raj.).

- (iv) *Beta Ltd., an event management company, organized a concert of international artists in India. In this connection, it engaged the services of an overseas agent Mr. Mike from UK to bring artists to India. He contacted the artists and negotiated with them for performance in India in terms of the authority given by the company. He did not take part in event organized in India. The company made a payment of commission equivalent to ₹ 2 lakhs to the overseas agent.* **(8 Marks)**
- (b) *Michael, a foreign national and a cricketer came to India as a member of Australian cricket team in the year ended 31st March, 2020. He received ₹ 6 lakhs for participation in matches in India. He also received ₹ 1 lakh for an advertisement of a product on TV. He contributed articles in newspaper for which he received ₹ 10,000/-. When he stayed in India, he also won a prize of ₹ 50,000/- from horse racing in Mumbai. He has no other income in India during the year.*
- (i) *Compute tax liability of Michael for Assessment Year 2020-21.*
- (ii) *Are the income specified above subject to deduction of tax at source?*
- (iii) *Is he liable to file his return of income for Assessment Year 2020-21?* **(6 Marks)**

Answer

- (a) (i) In respect of tips collected by the company from the customers and distributed to the employees, the person responsible for paying the employee was not the employer at all, but a third person, namely the customer.
- The payments of collected tips included and paid by way of a credit card by a customer, would not be payments made "by or on behalf of" an employer. The contract of employment not being the proximate cause for the receipt of tips by the employee from a customer, such payments would be outside the scope of sections 15 and 17.
- As income from tips would be chargeable in the hands of the employees as "Income from Other Sources", on account of such tips being received from customers and not from the employer, section 192 would not get attracted at all.⁷
- (ii) The landing and parking charges which are fixed by the Airports Authority of India are not merely for the "use of the land". These charges are also for services and facilities offered in connection with the aircraft operation at the airport which include providing of air traffic services, ground safety services, aeronautical communication facilities, installation and maintenance of navigational aids and meteorological services at the airport⁸.
- Hence, tax of ₹ 44,000 is deductible at source under section 194C (contract payment) by the airline company, Skyhigh Airlines Ltd., being @2% on payment of

⁷ ITC Ltd v. CIT (2016) 384 ITR 14 (SC)

⁸ Japan Airlines Co. Ltd. v. CIT / CIT v. Singapore Airlines Ltd. (2015) 377 ITR 372 (SC)

₹ 22 lakhs made towards landing and parking charges to the Airports Authority of India for the previous year 2019-20.

- (iii) "Professional services" includes services rendered by a person in the course of carrying on medical profession as per clause (a) of *Explanation* to section 194J. The services rendered by hospitals to various patients are primarily medical services and, therefore, the provisions of section 194J are applicable on payments made by TPAs to hospitals etc. Further, for invoking provisions of section 194J, there is no stipulation that the professional services have to be necessarily rendered to the person who makes payment to hospital.

Therefore, TPAs who are making payment on behalf of insurance companies to hospitals for settlement of medical/ insurance claims etc. under various schemes including Cashless Schemes are liable to deduct tax at source under section 194J on all such payments to hospitals etc.

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

Commission of ₹ 2 lakhs payable to Mr. Mike, a non-resident, who remains outside India, for contacting and negotiating with artists outside India, is not subject to tax in India. Consequently, there is no liability to deduct of tax at source. It is assumed that the commission equivalent to ₹ 2 lakh was remitted to Mr. Mike outside India.

(b)

(i)	Computation of tax liability of Michael for the A.Y.2020-21		
	Particulars	₹	₹
	Income taxable under section 115BBA		
	Income from participation in matches in India	6,00,000	
	Advertisement of product on TV	1,00,000	
	Contribution of articles in newspaper	10,000	
	Income taxable under section 115BB		
	Income from horse races	<u>50,000</u>	
	Total income	7,60,000	
	Tax@ 20% under section 115BBA on ₹ 7,10,000		1,42,000
	Tax@ 30% under section 115BB on income of ₹ 50,000 from horse races		<u>15,000</u>
			1,57,000

	Add: Health and Education cess@4%		<u>6,280</u>
	Total tax liability of Michael for the A.Y.2020-21		<u>1,63,280</u>
(ii)	Yes, the above income is subject to tax deduction at source. Income referred to in section 115BBA (i.e., ₹ 7,10,000, in this case) is subject to tax deduction at source@ 20% under section 194E. Income referred to in section 115BB (i.e., ₹ 50,000, in this case) is subject to tax deduction at source@30% under section 194BB. Since Michael is a non-resident, the amount of tax to be deducted calculated at the prescribed rates mentioned above, would be increased by health and education cess@4%.		
(iii)	Section 115BBA provides that if the total income of the non-resident sportsman comprises of only income referred to in that section and tax deductible at source has been fully deducted, it shall not be necessary for him to file his return of income. However, in this case, Michael has income from horse races as well. Therefore, he cannot avail the benefit of exemption from filing of return of income as contained in section 115BBA. Hence, he would be liable to file his return of income for A.Y. 2020-21.		

Question 4

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

- (i) Mr. Rakesh received the draft order from the Assessing Officer as per section 144C of the Income-tax Act, 1961 due to variations determined by the Transfer Pricing Officer in the arm's length price. But Mr. Rakesh did not prefer to file the objection against the draft order before the Dispute Resolution Panel, instead, he prefer to do appeal before the CIT appeals under section 246A against the final order received from the Assessing Officer.

You are required to advise Mr. Rakesh, whether his contentions are tenable? Discuss the issue with reference to provisions of section 144C of the Income-tax Act, 1961.

- (ii) During search conducted on premises of assessee, some gold bars were seized by the department from lockers of assessee. Assessee voluntarily disclosed some income during course of search. Assessee moved an application before Assessing Officer, for adjustment of tax liability on income surrendered during search by sale of seized gold bars. However said application was turned down by the Assessing Officer. Explain whether action of the AO is justified, in light of relevant case laws?

- (iii) *In the case of Mr. Vinod, a summary assessment was made under section 143(1) for Assessment Year 2016-17 without calling him. Thereafter, Mr. Vinod has received a notice under section 148 on 6th April, 2019 for reopening of assessment. Can Mr. Vinod challenge the legality of the notice on the ground of change of opinion?* **(2 x 4 = 8 Marks)**
- (b) *Examine with reasons, whether the following transaction attract income tax in India, in the hands of recipients under section 9 of Income-tax Act, 1961:*
- (i) *A firm of solicitors in New Delhi engaged a barrister in UK for arguing a case before Hon'ble Supreme Court of India. A payment of 5000 pounds was made as per terms of professional engagement.*
- (ii) *A non-resident German company, which did not have a permanent establishment in India, entered into an agreement for execution of electrical work in India. Separate payments were made to the German Company towards drawing & designs, which were described as "Engineering Fee". The assessee contended that such business profit should be taxable in Germany as there is no business connection within the meaning of section 9(1)(i) of the Income tax Act, 1961.*
- (iii) *Ekta Engineering, a non-resident foreign company entered into a collaboration agreement on 25.06.2019, with an Indian company and was in receipt of interest on 8% debentures of ₹ 10 lakhs, issued by Indian company, in consideration of providing technical know-how utilised in its business in Mumbai during previous year 2019-20.* **(6 Marks)**

Answer

- (a) (i) Section 144C requires the eligible assessee, Mr. Rakesh, to file his objections within 30 days of the receipt of draft assessment order from the Assessing Officer with the DRP and the Assessing Officer

If he fails to do so, the Assessing Officer will proceed to complete the assessment on the basis of the draft order.

The CBDT has clarified that the assessee has a choice whether to file an objection before the DRP against the draft assessment order or not to exercise this option and file an appeal later before CIT (Appeals) against the final assessment order passed by the Assessing Officer.

Therefore, Mr. Rakesh can choose to file an appeal before Commissioner (Appeals) against the final assessment order instead of filing objection before the DRP against the draft assessment order passed by the Assessing Officer.

In case Mr. Rakesh files objection before the DRP, then, he has the right to appeal to Appellate Tribunal, if he is aggrieved by the final order passed by the Assessing Officer in pursuance of the directions of the DRP.

- (ii) As per section 132B, the amount of existing liability under the Income-tax Act and the amount of liability determined on completion of assessment under section 153A may be recovered out of assets seized under section 132. The words “existing liability” postulates a liability that is crystallized by adjudication.

Likewise, “a liability is determined” only on completion of the assessment. Until the assessment is complete, it cannot be postulated that a liability has been crystallized.

It is only when the liability is determined on the completion of assessment that it would stand crystallized and in pursuance of which a demand can be raised and recovery can be initiated. Accordingly, the assessee may make an application to the Assessing Officer within 30 days from the end of the month in which the asset was seized, for release of the assets seized.

However, in the present case, the assessee moved an application before the Assessing Officer for adjustment of tax liability on income surrendered during search by sale of seized gold bars.

In this case, assessment is not complete and the liability has not been crystallised.

Therefore, the action of the Assessing Officer in turning down the application of the assessee is in order, since the assets seized cannot be adjusted against tax liability on income surrendered during search⁹.

- (iii) Under section 143(1) the total income or loss shall be computed after making the following adjustments viz.
- any arithmetical error in the return,
 - incorrect claim which is apparent from any information in the return,
 - disallowance of loss claimed where return of income for set-off of loss is claimed was filed beyond the due date under section 139(1),
 - disallowance of expenditure indicated in the audit report but not taken into account in computing total income in the return and
 - disallowance of deduction claimed under section 10AA, sections 80-IA to 80-IE, where return is furnished beyond due date,

In short, what is permissible is only correction of errors apparent on the basis of the of the return and tax audit report filed.

Therefore, the intimation given under section 143(1) is only a preliminary assessment, commonly referred to as a summary assessment without calling the assessee. The same cannot be treated as an order of assessment under section

⁹ It was so held in *Hemant Kumar Sindhi & Another v. CIT* (2014) 364 ITR 555 (All)

143(3). Since there has been no assessment under section 143(3) in this case, the question of change of opinion does not arise.

Therefore, Mr. Vinod cannot challenge the legality of the notice issued under section 148 for reopening of assessment on the ground of change of opinion in a case where no assessment is made under section 143(3)¹⁰.

- (b) (i) As per section 9(1)(i), all income accruing or arising, whether directly or indirectly, through or from any business connection in India is deemed to accrue or arise in India.

In this case, there was a professional connection between the firm of solicitors in New Delhi and the barrister in UK.

The expression “business” includes not only trade and manufacture; it includes, within its scope, “profession” as well.

Therefore, the existence of professional connection amounts to existence of “business connection” under section 9(1)(i)¹¹.

Hence, the amount of 5,000 pounds paid to the barrister in UK as per the terms of the professional engagement constitutes income which is deemed to accrue or arise in India under section 9(1)(i). Hence, it is taxable in India.

- (ii) Fees for technical services is taxable under section 9(1)(vii). In this case, the separate payments made towards drawings and designs (described as “engineering fee”) are in the nature of fee for technical services and, therefore, it is taxable in India by virtue of section 9(1)(vii), since the services are utilized for execution of electrical work in India¹².

As per *Explanation* below section 9(2), where income is deemed to accrue or arise in India under section 9(1)(vii), such income shall be included in the total income of the non-resident German company, regardless of whether it has a residence or place of business or business connection in India.

- (iii) ₹ 10 lakhs, being the value of debentures issued by an Indian company in consideration of providing technical know-how for use in its business in India, is in the nature of fee for technical services, deemed to accrue or arise in India to Ekta Engineering, a non-resident foreign company, under section 9(1)(vii). Hence, it is taxable in India.

Interest on debentures: Further, as per section 9(1)(v), income by way of interest payable by a person who is a resident of India is deemed to accrue or arise in

¹⁰ Supreme Court ruling in *ACIT vs. Rajesh Jhaveri Stock Brokers P. Ltd.* (2007) 291 ITR 500.

¹¹ It was so held by the Supreme Court in *Barendra Prasad Roy v. ITO* (1981) 129 ITR 295.

¹² *Aeg Aktiengesellschaft v. CIT* (2004) 267 ITR 209 (Kar.)

India¹³. It is utilized for a business in Mumbai. Therefore, interest income from debentures of an Indian company is deemed to accrue or arise in India in the hands of Ekta Engineering by virtue of section 9(1)(v). Hence, it is taxable in India.

Question 5

- (a) (i) Cash of ₹ 50 lakhs was seized on 12.9.2019 in a search conducted as per section 132 of the Act. The assessee moved an application on 27.10.2019 to release such cash after explaining the sources thereof, which was turned down by the department.

The assessee seeks your opinion, on the following issues:

- (1) Can the department withhold the explained money?
 - (2) If yes, then to what extent and up to what period?
- (ii) The Assessing Officer has initiated the penalty proceedings under section 270A for under reporting of income and launched prosecution proceedings under section 276C for willful evasion of tax at the time of completion of Re-assessment of Mr. Pradeep under section 147 of Income tax Act, 1961.

Mr. Pradeep filed an application for the immunity from imposition of penalty and prosecution before the Assessing Officer. Is he entitled to file application for immunity from penalty and prosecution under section 270A and 276C, respectively before the Assessing Officer? **(2 x 4 = 8 Marks)**

- (b) ABC Ltd., an Indian company declared income of ₹ 150 crores computed in accordance with Chapter IV-D before making any adjustments in respect of the following transaction for the year ended on 31.03.2020:

Unisea Ltd., a Swedish company advanced a loan of Euro 500 crores carrying interest @ 8% per annum during the F.Y. 2019-20 to ABC Ltd. The total Book Value of assets of ABC Ltd. on 31.03.2020 was ₹ 70,000 crores. The said Swedish Co. also advanced a loan of similar nature & amount to another Indian Co. @ 6% per annum during the F.Y. 2019-20. The total interest paid for the year was 40 crores Euros.

- (i) You are required to make primary adjustments, if any, to the above income keeping in mind transfer pricing provisions contained in section 92 of Income-tax Act, 1961 for filing return of income for the A.Y. 2020-21.
- (ii) You have to elaborate on secondary adjustments required to be made if any, under said provisions of Income-tax Act, 1961.
- (iii) If ABC Ltd. opts for additional tax instead of repatriation of excess money by Unisea Ltd., calculate additional tax liability required to be made.

Value for 1 Euro was ₹ 85, throughout the year.

(6 Marks)

¹³ since the debt incurred is not utilized for a business outside India or for earning income from a source outside India

Answer

- (a) (i) As per the proviso to section 132B(1)(i), where the assessee makes an application to the Assessing Officer within 30 days from the end of the month in which the asset was seized, for release of cash seized in a search conducted as per section 132, and the nature and source of acquisition of such cash is explained to the satisfaction of the Assessing Officer, then, the Assessing Officer may, with the prior approval of the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner, release the asset after recovering the existing liability under the Income-tax Act, 1961, etc. out of such asset.

'Existing liability', however, does not include advance tax payable.

Such cash or portion thereof has to be released within 120 days from the date on which the last of the authorizations for search under section 132 was executed.

In this case, since the application was made to the Assessing Officer before 30th October, 2019, i.e., within the 30 days period from the end of the month in which cash was seized, the amount of existing liability may be recovered out of such cash and the balance may be released within 120 days from the date on which the last of the authorizations for search under section 132 was executed.

Note: If the application was turned down by the Department due to the reason that it was not satisfied with the explanation given by the assessee as to the nature and source of acquisition of the asset, then, the asset (in this case, cash) cannot be released, since the condition mentioned above is not satisfied.

- (ii) Section 270AA empowers an assessee to make an application to the Assessing Officer for grant of immunity from imposition of penalty under section 270A and initiation of proceedings under section 276C, if he -
- (i) pays the tax and interest payable as per the order of reassessment under section 147, within the period specified in such notice of demand; and
 - (ii) does not prefer an appeal against such reassessment order.

Therefore, Mr. Pradeep is entitled to file an application for immunity from penalty under section 270A and prosecution under section 276C before the Assessing Officer.

He has to do so within one month from the end of the month in which the order of reassessment is received.

However, immunity shall be granted by the Assessing Officer only if the penalty proceedings under section 270A have not been initiated on account of the following, namely -

- (a) misrepresentation or suppression of facts;
- (b) failure to record investments in the books of account;

- (c) claim of expenditure not substantiated by any evidence;
 - (d) recording of any false entry in the books of account;
 - (e) failure to record any receipt in books of account having a bearing on total income; or
 - (f) failure to report any international transaction or any transaction deemed to be an international transaction or any specified domestic transaction to which the provisions of Chapter X apply.
- (b) ABC Ltd., an Indian company and Unisea Ltd., a Swedish company are deemed to be associated enterprises since the latter has advanced a loan to the former which constitutes 60.71% of the book value of total assets of the former. Since the loan advanced by Unisea Ltd. is not less than 51% of the book value of the total assets of ABC Ltd., the two companies are deemed to be associated enterprises.

A loan transaction between two enterprises, one of whom is a non-resident (Unisea Ltd., Sweden, in this case), would be an international transaction. Accordingly, transfer pricing provisions would be attracted in this case.

- (i) The interest rate charged by Unisea Ltd on loan advanced to ABC Ltd. is 8% p.a whereas the arm's length interest charged in a comparable uncontrolled transaction (with another Indian company) by Unisea Ltd. is 6% p.a. Therefore, the arm's length adjustment (primary adjustment) to be made is = $8\% - 6\% = 2\%$ of ₹ 42,500 crores (Euro 500 crores x ₹ 85, being the value of 1 Euro) = ₹ 850 crores

Note - Alternatively, the calculation can also be shown as – Euro 40 crores x ₹ 85 x $\frac{2}{8} = ₹ 850$ crores

The total income (after primary adjustment) of ABC Ltd for P.Y.2019-20 = ₹ 150 crores + primary adjustments of ₹ 850 crores = ₹ 1000 crores.

- (ii) Assuming that the primary adjustment has been made by ABC Ltd. *suo moto* while filing its return of income for A.Y.2020-21, ABC Ltd. has to carry out secondary adjustment.

The excess money (i.e., ₹ 850 crores) lying with Unisea Ltd. has to be repatriated within 90 days from 30.11.2020, being the due date for filing return of income.

If the excess money is not repatriated on or before 28th February, 2021, it would be deemed as an advance made by ABC Ltd. to Unisea Ltd. and interest would be chargeable from 30.11.2020 at six month LIBOR as on 30th September, 2020 + 3%, since the loan is denominated in Euros. Such interest would be included in the total income of ABC Ltd.

- (iii) If ABC Ltd. opts for payment of additional income-tax, it has to pay ₹ 178.2144 crores [i.e., 20.9664% (tax@18% + surcharge@12% + cess@4%) of ₹ 850 crores].

Question 6

- (a) Describe procedures to be followed by Authority of Advance ruling on receipt of application under section 245R and the circumstances in which it should not allow it.

(6 Marks)

- (b) Specify with reasons, whether the following acts can be considered as (i) Tax planning; or (ii) Tax evasion; or (iii) Tax management?

- (1) PQR Ltd. established a manufacturing unit in Karimnagar in the state of Telangana, a notified backward area, so as to claim additional depreciation u/s 32AD?
- (2) A company installed a refrigerator costing ₹ 75,000/- at the residence of a director as per terms of his appointment but treats it is fitted in quality control section in the factory. This is with the objective to treat it as plant for the purpose of computing depreciation.
- (3) RR Ltd. fictitiously gave salary of ₹ 2,40,000/- to Mr. X. The purpose is to build income of Mr. X, who is unemployed otherwise and reduce the income of RR Ltd. by ₹ 2,40,000.
- (4) A company remitted provident fund contribution of both its own contribution and employees' contribution on monthly basis before due date.

(4 Marks)

- (c) Mr. Piyush, an individual resident in India bought 2,000 equity shares of ₹ 10/- each of Delta Ltd. at ₹ 40/- per share on May 30th, 2019. He sold 1,500 equity shares at ₹ 30/- per share on September 30th, 2019 and the remaining 500 shares at ₹ 20/- per share on December 20th, 2019. Delta Ltd. declared a dividend of 50%, the record date being August 10th, 2019. Piyush sold on February 1st, 2020 a house from which he derived a long-term capital gain of ₹ 80,000/-

Discuss the provision involved and compute the amount of capital gain arising to Piyush for the A.Y. 2020-21.

(4 Marks)**Answer**

- (a) The Authority for Advance Rulings (AAR), on receipt of an application from the applicant, will send a copy to the Principal Commissioner or Commissioner concerned.

Wherever the AAR considers necessary, it may also call upon the Principal Commissioner or Commissioner (PCIT/CIT) to furnish relevant records. Such records have to be returned to the PCIT/CIT as soon as possible.

The AAR may, after examining the application and the records called for, by order, either allow or reject the application.

However, the AAR shall not allow an application where the question raised in the application is:

- (i) already pending before any income-tax authority, or Appellate Tribunal¹⁴ or any court.
- (ii) involves the determination of the fair market value of any property
- (iii) relates to a transaction or issue which is designed *prima facie* for avoidance of income-tax¹⁵.

However, no application shall be rejected unless an opportunity has been given to the applicant of being heard. Further, where an application is rejected, the reasons for rejection shall be given in the order. A copy of every order shall be sent to the applicant and to the PCIT/CIT.

Where an application is allowed, the AAR would pronounce its advance ruling on that question specified in the application, after examining such further material as may be placed before it by the applicant or obtained by the AAR.

On a request received from the applicant, the AAR shall, before pronouncing its advance ruling, provide an opportunity to the applicant of being heard, either in person or through a duly authorised representative.

The AAR will pronounce the advance ruling in writing within 6 months of the receipt of application. A copy of advance ruling pronounced by the AAR, duly signed by the Members and certified in the prescribed manner, shall be sent to the applicant and to the PCIT/CIT, as soon as may be, after such pronouncement.

(b) Tax Planning / Tax Management / Tax Evasion

	Answer	Reason
1.	Tax planning	Establishing a manufacturing unit in a notified backward area to claim higher additional depreciation and deduction u/s 32AD is in line with the legislative intent of encouraging setting up of new manufacturing units in backward areas. Therefore, setting up of a new manufacturing unit in a notified backward area to avail the benefit of allowances and enhanced depreciation to reduce tax liability, would constitute tax planning.
2.	Tax evasion	A refrigerator costing ₹ 75,000 installed at the residence of a

¹⁴ However, a resident falling within any class or category of persons as notified by the Central Government i.e., a public sector undertaking can seek for advance ruling even if question raised is pending before the Appellate Tribunal.

¹⁵ (except in case of a resident applicant falling within any class or category of persons as notified by the Central Government i.e., a public sector undertaking or in the case of resident or a non-resident for determination of whether an arrangement, which is proposed to be undertaken is an impermissible avoidance arrangement)

		director as per the terms of his appointment would be a furniture qualifying for depreciation @10%, whereas a refrigerator fitted in a factory would be a plant qualifying for a higher depreciation @15%. The wrong treatment unjustifiably increases the amount of depreciation and consequently, reduces profit and consequent tax liability of the company. Thus, treatment of refrigerator fitted at the residence of a director as a plant fitted at the factory would tantamount to furnishing of false particulars with an attempt to evade tax.
3.	Tax evasion	The company is liable to tax at a flat rate of 30%/25%, as the case may be, whereas Mr. X would not be liable to pay any tax, since his total income of ₹ 2,40,000 does not exceed the basic exemption limit of ₹ 2,50,000, as he does not have any other source of income. Thus, paying fictitious salary of ₹ 2,40,000 to Mr. X in order to correspondingly reduce the company's total income and tax liability would tantamount to tax evasion.
4.	Tax management	Remitting of own contribution to provident fund and employees' contribution to provident fund on a monthly basis before due date is proper compliance of the statutory obligations.

(c) As per section 94(7), in case a person

- acquires any securities within a period of three months prior to the record date;
- sells such securities within a period of three months after such date;

the dividend on such securities received by such person is exempt, then, the loss, if any, arising to him on account of such purchase and sale of securities to the extent of the amount of exempt dividend shall be ignored for the purposes of computing his income chargeable to tax.

In the present case, Mr. Piyush has acquired 2000 shares of Delta Ltd. on 30.5.2019 i.e., within three months prior to the record date i.e., 10.8.2019. He sold 1500 shares within a period of 3 months i.e., 30.9.2019 from the record date and 500 shares on 20.12.2019 after 3 months from the record date.

Thus, loss arising on sale of 1500 shares to the extent of dividend received in respect of such shares not to be considered for the purpose of set-off against other source of income. Accordingly, the capital gains arising in the hands of Mr. Piyush would be computed in the following manner:

Computation of capital gains of Mr. Piyush for the A.Y. 2020-21

Particulars	₹	₹
Long-term capital gain on sale of house		80,000
Less: Short-term capital loss on sale of shares (Can be set-off against LTCG) [See Working Note below]		
1500 shares	7,500	
500 shares	<u>10,000</u>	<u>17,500</u>
Taxable long-term capital gains		62,500

Working Note**Computation of capital gain on sale of shares of Delta Ltd. by Mr. Piyush**

Date of purchase of shares		30.5.2019
Purchase price per share		₹ 40
Record date		10.8.2019
Date of sale of shares	30.9.2019	20.12.2019
Number of shares sold	1500	500
Sale price per share	₹ 30	₹ 20

Particulars	₹	₹
Sale consideration	45,000	10,000
Less: Cost of acquisition	<u>60,000</u>	<u>20,000</u>
	(15,000)	(10,000)
Less: Dividend income to reduced from short term capital loss as per section 94(7) [1500 × ₹ 10 × 50%]	7,500	
[However, dividend income of ₹ 2,500 [500 × ₹ 10 × 50%] should not be deducted from the loss of ₹ 10,000. Such dividend would be exempt under section 10(34)]		-
Short-term capital loss on sale of shares	(7,500)	(10,000)