Test Series: April, 2021

MOCK TEST PAPER 2

FINAL (OLD) COURSE: GROUP – II

PAPER – 7: DIRECT TAX LAWS

SOLUTIONS

Division A – Multiple Choice Questions

MCQ No.	Sub-part	Most Appropriate Answer
1.	(i)	(c)
	(ii)	(b)
	(iii)	(b)
	(iv)	(c)
	(v)	(b)
2.	(i)	(b)
	(ii)	(b)
	(iii)	(c)
	(iv)	(a)

MCQ No.	Most Appropriate Answer
3.	(b)
4.	(b)
5.	(b)
6.	(b)
7.	(d)
8.	(d)

Division B – Descriptive Questions

1. Computation of Total Income of Astha Ltd. for the A.Y.2021-22

	Particulars	Amount (Rs.)	
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 ABC 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 Rs. 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 efforts[2]. 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	3,00,000	
	[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]		
	(f) Provision for gratuity	50,00,000	
	[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 Rs. 50 lakhs (i.e., Rs. 130 lakhs – Rs. 80 lakhs) is to be added back.]		
	(h) One time licence fee paid for obtaining franchise	80,00,000	
	[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]		
	(i) Payment for interest on loan without TDS	15,00,000	
	[Since the interest payment made to non-resident without deduction of tax 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]		
			2,23,00,000
			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,		

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

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 [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"]	8,50,000	
AI(1) Conversion of unpaid interest into new loan [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 Rs. 2 lakhs has been paid in the P.Y.2020-21, the same is allowable as deduction]	2,00,000	
AI(2) Depreciation as per Income-tax Act, 1961 [Rs. 75,00,000, being normal depreciation allowable under the Income-tax Act, 1961 (+) Rs. 20,00,000, depreciation @25% on franchise, being an intangible asset put to use for more than 180 days in the year (+) Rs. 72,50,000, being additional depreciation [@17.5% on Rs. 300 lakhs = Rs. 52.50 lakhs, being the balance higher additional depreciation on plant and machinery installed in a notified backward area in the state of Telangana till 31.3.2020] + Rs. 20 lakhs, being 10% on Rs. 200 lakhs (i.e., Rs. 250 lakhs – Rs. 50 lakhs, being cost of second hand plant and machinery not eligible for additional depreciation)]	1,67,50,000	1,88,00,000
Income from manufacturing business		**2,82,00,000**
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 section 70(1), since the same is not speculative in nature		3,00,000
Profits and gains of business or profession		**2,79,00,000**
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		**2,79,00,000**
	Tax payable Rs. 2,79,00,000 @30%, since the turnover of the company for the P.Y. 2018-19 exceeds Rs. 400 crores		83,70,000
	Add: Surcharge @7% since the total income exceeds Rs. 1 crore but does not exceed Rs. 10 crores		5,85,900
			89,55,900
	Add: Health and education cess @4%		3,58,236
	Total Tax payable		93,14,136
	Total tax payable (Rounded off)		**93,14,140**

2 (a) (i) Computation of total income of Kashish Limited for the A.Y. 2021-22

Particulars	Rs.(in lacs)	
Business income before setting-off brought forward losses of Khushboo Ltd.	130.00	
Speculative profit before setting-off brought forward losses of Khushboo Ltd.	10.00	140.00
Add: Excess depreciation claimed in the scheme of amalgamation of Khushboo Limited with Kashish Limited.		
Value at which assets are transferred by Khushboo Ltd.	150	
WDV in the books of Khushboo Ltd.	100	
Excess accounted	50	
Excess depreciation claimed in computing taxable income of Kashish Ltd. [Rs.50 lacs × 15 %] [*Explanation 2* to section 43(6)]		7.50
		147.50
Set-off of brought forward business loss of Khushboo Ltd. **(See Notes 2 & 4)**		(120.00)
Set-off of unabsorbed depreciation under section 32(2) read with section 72A **(See Notes 2 & 4)**		(18.00)
Set-off of unabsorbed capital expenditure under section 35(1)(iv) read with section 35(4) **(See Note 5)**		(2.00)
Business income		7.50

Notes:

1. It is presumed that the amalgamation is within the meaning of section 72A of the Income-tax Act, 1961.
2. In the case of amalgamation of companies, the unabsorbed losses and unabsorbed depreciation of the amalgamating company shall be deemed to be the loss or unabsorbed depreciation of the amalgamated company for the previous year in which the amalgamation was effected and such business loss and unabsorbed depreciation shall be carried forward and set-off by the amalgamated company for a period of 8 years and indefinitely, respectively.
3. As per section 72A(7), the accumulated loss to be carried forward specifically excludes loss sustained in a speculative business. Therefore, speculative loss of Rs.4 lacs of Khushboo Ltd. cannot be carried forward by Kashish Ltd.
4. Section 72(2) provides that where any allowance or part thereof unabsorbed under section 32(2) (i.e., unabsorbed depreciation) or section 35(4) (i.e., unabsorbed scientific research capital expenditure) is to be carried forward, effect has to be first given to brought forward business losses under section 72.
5. Section 35(4) provides that the provisions of section 32(2) relating to unabsorbed depreciation shall apply in relation to deduction allowable under section 35(1)(iv) in respect of capital expenditure on scientific research related to the business carried on by the assessee. Therefore, unabsorbed capital expenditure on scientific research can be set-off and carried forward in the same manner as unabsorbed depreciation.
6. The restriction contained in section 73 is only regarding set-off of loss computed in respect of speculative business. Such a loss can be set-off only against profits of another speculation business and not non-speculation business. However, there is no restriction under the Income-tax Act, 1961 regarding set-off of normal business losses against speculative income. Therefore, normal business losses can be set-off against profits of a speculative business.

   Consequently, there is no loss or allowance to be carried forward by Kashish Ltd. to the F.Y. 2021-22.

(ii) Worldclass Ltd. is an eligible start-up, since –

(1) it is a company engaged in eligible business of innovation, development or improvement of new products.

(2) it is incorporated during the period 1.4.2016 to 31.3.2021.

(3) its total turnover does not exceed Rs.100 crores.

(4) it holds a certificate of eligible business from the notified IMBC

Therefore, Worldclass Ltd., being an eligible start-up, is eligible for deduction under section 80-IAC of 100% of the profits and gains derived by it from an eligible business for any three consecutive assessment years out of ten years beginning from the year in which the eligible start up is incorporated i.e., P.Y.2020-21.

In the first two years i.e., P.Y.2020-21 and P.Y. 2021-22, Worldclass Ltd. has incurred a loss. In the P.Y. 2022-23, Worldclass Ltd. has earned profits from eligible business and can hence, claim 100% of its profits as deduction for any three consecutive assessment years under section 80-IAC from the P.Y.2022-23 to P.Y.2029-30. However, for P.Y.2022-23, the profits eligible for deduction would be the profits after set-off of brought forward losses of P.Y.2020-21 and P.Y. 2021-22.

It would be beneficial for Worldclass Ltd. to claim deduction under section 80-IAC for the three consecutive assessment years from A.Y.2024-25 to A.Y.2026-27 (P.Y. 2023-24 to P.Y.2025-26)

(b) Computation of total income and tax liability of Ms Ayesha for the A.Y. 2021-22

Particulars	Rs.	Rs.
Indian Income [Income from playing chess matches in India]		21,00,000
Foreign Income		
- Income from playing chess matches in country A	14,00,000	
- Agricultural Income [taxable in India since agricultural income from agricultural lands outside India is not exempt u/s 10(1)]	3,00,000	17,00,000
Gross Total Income		**38,00,000**
Less: **Deduction under Chapter VI-A**		
Deduction under section 80C		
PPF deposit of Rs. 1,50,000 made during the previous year is within the overall limit of 1.5 lakh. Hence, fully allowable as deduction	1,50,000	
Deduction under section 80D		
Medical expenditure of Rs. 60,000 paid for her mother aged 75 years. Since her mother is a senior citizen, the deduction is allowable to a maximum of Rs. 50,000, even though she is not dependent on her. Further, deduction is allowable where payment is made by any mode other than cash. Here payment is made by credit card hence, eligible for deduction.	50,000	2,00,000
Total Income		**36,00,000**
Tax on Total Income		
Income-tax	8,92,500	
Add: Health and education cess @ 4%	35,700	9,28,200
Average rate of tax in India (i.e. Rs. 9,28,200/Rs. 36,00,000 × 100) 25.78%		
Average rate of tax in foreign country "A" (i.e. Rs. 3,00,000/Rs.14,00,000 ×100) 21.43%		
Rebate under section 91 on Rs. 14 lakh @ 21.43% (lower of average Indian-tax rate or average foreign tax rate) **[Note 2]**		3,00,000
Tax payable in India (Rs. 9,28,200 – Rs. 3,00,000)		**6,28,200**

Notes:

1. Ms Ayesha shall be allowed deduction under section 91, since the following conditions are fulfilled:-
   (a) She is a resident in India during the relevant previous year.
   (b) The income accrues or arises to her outside India during that previous year and such income is not deemed to accrue or arise in India during the previous year.
   (c) The income in question has been subjected to income-tax in the foreign country A in her hands and she has paid tax on such income in the foreign country A.

(d) There is no agreement under section 90 for the relief or avoidance of double taxation between India and country A where the income has accrued or arisen.

2. Rebate under section 91 would not be available in respect of agricultural income, since such income is exempt in country A and consequently, is not a doubly taxed income.

3. (a) As per section 115TD, the accreted income of "Needy", a charitable trust, registered under section 12AA which is merged with M/s XY Ltd., an entity not entitled for registration under section 12AA, would be chargeable to tax at maximum marginal rate @ 34.944% [30% plus surcharge @12% plus cess@4%].

Computation of accreted income and tax liability in the hands of the trust arising as a result of merger with XY Ltd. for A.Y. 2021-22

Particulars	Amount (Rs.)
Aggregate FMV of total assets as on 1.4.2020, being the specified date (date of merger) **[See Working Note 1]**	95,50,000
Less: Total liability computed in accordance with the prescribed method of valuation **[See Working Note 2]**	68,00,000
Accreted Income	**27,50,000**
Tax Liability @ 34.944% of Rs. 27,50,000	**9,60,960**
Working Notes:	
(1) Aggregate fair market value of total assets on the date of merger	
- **Land, being an immovable property**	18,00,000
[The fair market value of land would be higher of Rs. 18 lakhs i.e., price that the land would ordinarily fetch if sold in the open market and Rs. 14 lakhs, being stamp duty value as on the specified date]	
- **Quoted equity shares in Pen Ltd. [50,000 x Rs. 85 per share]**	42,50,000
[Rs. 85 per share, being the average of the lowest (Rs. 80) and highest price (Rs. 90) of such shares on the date of merger]	
- **30,000 preference shares of Z Ltd.**	
[The fair market value which it would fetch if sold in the open market on the date of merger i.e. FMV on 1.4.2020]	35,00,000
	95,50,000
(2) Total liability	
- Outside liabilities	60,00,000
- Corpus Fund of Rs. 25 lakhs [not includible]	-
- Provision for taxation Rs. 10 lakhs [not includible]	-
- Liabilities in respect of payment of various utility bills [since this liability is an ascertained liability]	8,00,000
	68,00,000

(b) (i) If an Indian company, being the borrower, incurs any expenditure by way of interest in respect of any debt issued by its non-resident associated enterprise (AE) and such interest exceeds Rs.1 crore, the interest paid or payable by such Indian company in excess of 30%

of its earnings before interest, taxes, depreciation and amortization (EBITDA) or interest paid or payable to associated enterprise, whichever is lower, shall not be allowed as deduction as per section 94B.

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

In the present case, since Yoyo Inc holds 30% of voting power i.e., more than 26% of voting power in Akash Ltd., Akash Ltd. and M/s Yoyo Inc are deemed to be associated enterprises.

Since, loan of Rs.100 crores taken by Akash Ltd., an Indian company from M/s Sarthak Inc, is guaranteed by M/s Yoyo Inc, an associated enterprise of Akash Ltd., such debt shall be deemed to have been issued by an associated enterprise and interest payable to M/s Sarthak Inc shall be considered for the purpose of limitation of interest deduction.

Computation of interest to be disallowed in the computation of income under the head profits and gains of business or profession of Akash Ltd.

Particulars		Rs.
EBITDA		10,00,00,000
Interest paid or payable by Akash Ltd.		9,00,00,000
lower of the following would be disallowed		
- Interest paid or payable in excess 30% of EBITDA	6,00,00,000	
- Interest paid or payable to non-resident AE	9,00,00,000	
Interest to be disallowed as deduction		6,00,00,000

(ii) The interest income received by Mr. Singh, a non-resident, from a notified infrastructure debt fund would be subject to a concessional tax rate of 5% under section 115A on the gross amount of such interest income. Therefore, the tax liability of Mr. Singh in respect of such income would be Rs. 20,800 (being 5% of Rs. 4 lakhs *plus* health and education cess@4%).

Under section 194LB, tax is deductible @5% (*plus* health and education cess@4%) on interest paid by such fund to a non-resident. However, since Mr. Singh is a resident of a NJA, tax would be deductible@30% (*plus* health and education cess@4%) as per section 94A, and not @5% specified under section 194LB. This is on account of the provisions of section 94A(5), which provides that "**Notwithstanding anything contained in any other provision of this Act,** where a person located in a NJA is entitled to receive any sum or income or amount on which **tax is deductible under Chapter XVII-B,** the **tax shall be deducted at the highest of the following rates**, namely–

(a) at the rate or rates in force;

(b) at the rate specified in the relevant provision of the Act;

(c) at the rate of thirty per cent."

Mr. Singh can, however, claim refund of excess tax deducted along with interest.

4. (a) (i) The *Explanation* below section 194A(1) provides that where any income by way of interest other than interest on securities is credited to any account, whether called 'interest payable account' or 'suspense account' or by any other name, in the books of account of the person liable to pay such income, such crediting shall be deemed to be credit of such income to the account of the payee and provisions of section 194A, shall, thus, apply.

However, the CBDT has, vide *Circular No.3/2010 dated 2.3.2010*, clarified that *Explanation* to section 194A will not apply in cases of banks where credit is made to provisioning account on daily/monthly basis for the purpose of macro monitoring only by the use of CBS software.

Since no constructive credit to the depositor's/ payee's account takes place while calculating interest on daily/ monthly basis in the CBS software used by banks, tax need not be deducted at source on such provisioning of interest by banks for the purposes of macro monitoring only.

In such cases, tax shall be deducted at source on accrual of interest at the end of the financial year or at periodic intervals as per practice of the bank or as per the depositor's or payee's requirement or on maturity or on encashment of time deposit, whichever event takes place earlier and wherever the aggregate amount of interest income credited or paid or likely to be credited or paid during the financial year by the bank exceeds the limits specified in section 194A i.e., Rs.40,000.

In view of the above, the action of the Assessing Officer in disallowing the interest expenditure credited in a separate account for macro monitoring purpose is not valid and consequent initiation of penalty proceedings under section 271C is not tenable in law.

(ii) I. Section 194D requires deduction of tax at source@3.75% from insurance commission, where the commission exceeds Rs.15,000.

Reinsurance is different from insurance since there is no direct contractual relationship between the person insured and the re-insurer.

In order to attract section 194D, the commission or any other payment covered under the section should be a remuneration or reward for soliciting or procuring the insurance business. The insurance companies do not procure business for the reinsurance company nor does the reinsurer pay commission or other payment for soliciting the business from the insurance companies. Therefore, section 194D has no application.

Hence, when profit commission is paid by a reinsurance company to an insurance company, after the expiry of the term of insurance, in respect of cases where there is no claim during the operation of the reinsurance treaty, tax deduction under section 194D is not attracted.

(II) Section 194J provides for deduction of tax at source @7.5% on any remuneration or fees or commission, by whatever name called, paid to a director, which is not in the nature of salary in respect of which tax is deductible at source under section 192.

Hence, tax is to be deducted at source under section 194J @7.5% by Karishma Pvt. Ltd. on the commission of Rs.3,10,000 paid to Usha, a part-time director. The tax deductible under section 194J would be Rs.23,250, being 7.5% of Rs.3,10,000.

(b) (i) Chapter VIII of the Finance Act, 2016, "Equalisation Levy", provides for an equalisation levy of 6% of the amount of consideration for specified services received or receivable by a non-resident not having permanent establishment in India, from a resident in India who carries out business or profession, or from a non-resident having permanent establishment in India.

"Specified Service" means

(1) online advertisement;

(2) any provision for digital advertising space or any other facility or service for the purpose of online advertisement and

(3) any other service as may be notified by the Central Government.

However, equalisation levy shall not be levied-

- where the non-resident providing the specified services has a permanent establishment in India and the specified service is effectively connected with such permanent establishment.
- the aggregate amount of consideration for specified service received or receivable during the previous year does not exceed Rs.1 lakh.
- where the payment for specified service is not for the purposes of carrying out business or profession

In the present case, equalisation levy @6% is chargeable on the amount of Rs.15,00,000 received by Sunshine Inc., a non-resident not having a PE in India from Master Ltd., an Indian company. Accordingly, Master Ltd. is required to deduct equalisation levy of Rs.90,000 i.e., @6% of Rs.15 lakhs, being the amount paid towards online advertisement services provided by Sunshine Inc., a non-resident having no permanent establishment in India. Non-deduction of equalisation levy would attract disallowance under section 40(a)(ib) of 100% of the amount paid while computing business income.

(ii) The statement is correct.

Under section 245U, the Authority for Advance Rulings shall have all the powers vested in the Civil Court under the Code of Civil Procedure, 1908 as are referred to in section 131.

Accordingly, the Authority for Advance Rulings shall have the same powers as are vested in a court under the Code of Civil Procedure, 1908, when trying a suit in respect of the following matters, namely -

(1) discovery and inspection;

(2) enforcing the attendance of any person, including any officer of a banking company and examining him on oath;

(3) compelling the production of books of account and other documents; and

(4) issuing commissions.

Therefore, the Authority for Advance Ruling has the powers of compelling the production of books of account.

5. (a) (i) Section 144C requires the eligible assessee, Mr. Suresh, 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. Suresh 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. Suresh 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 search[3].

(b) 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 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 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)[4].

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

As per section 9(1)(vi), income by way of royalty payable by a person who is a non-resident would be deemed to accrue or arise in India, where the royalty is payable in respect of any

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

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

right, property or information used or services utilized for the purposes of a business or profession carried on by such person in India or for the purposes of making or earning any income from any source in India.

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

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

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

(ii) The Calcutta High Court in *Indcom v. CIT (TDS)(2011) 335 ITR 485* has held that 'match referee' would not fall within the meaning of "sportsmen" to attract the provisions of section 115BBA. Therefore, although the payments made to non-resident 'match referee' are "income" which has accrued and arisen in India, the same are not taxable under the provisions of section 115BBA.

Particulars		Rs.
Tax@30% under section 115BB on winnings of Rs.25,000 from horse races		7,500
Tax on Rs.9,60,000 at the rates in force		
Upto Rs. 2,50,000	Nil	
2,50,001 – 5,00,000 @5%	12,500	
5,00,001 – 7,50,000 @ 10%	25,000	
7,50,001 – 9,60,000 @ 15%	31,500	69,000
		76,500
Add: Health and Education cess@4%		3,060
Tax payable		**79,560**

6. (a) (i) There is no violation of section 269SS at the time of acceptance of the first deposit of Rs.18,000 by bearer cheque on 10.7.2019, since it is not in excess of the threshold limit of Rs.20,000. However, violation under section 269SS is attracted at the time of acceptance of the second deposit in cash on 1st August, 2020, since as on that date, there is already an outstanding deposit of Rs.18,000 and another cash deposit of Rs.14,000 would take the aggregate to Rs.32,000, which exceeds the threshold limit of Rs.20,000. Therefore, penalty under section 271D of a sum equal to the amount of deposit taken from Mr. Deepak is attracted for failure to comply with the provisions of section 269SS.

In case of withdrawal, there is a violation of the provisions of section 269T at the time of first repayment by bearer cheque on 27th March, 2021, since on that date, the aggregate amount of deposits held by Mr. Deepak with the non-banking company (together with interest payable on such deposits) is more than Rs.20,000. Therefore, penalty under section 271E equal to the amount of deposit so repaid will be attracted for failure to comply with the provisions of section 269T.

However, the second repayment of Rs.14,600 on 28th March, 2021 in cash cannot be considered as a violation of section 269T, since neither the amount of deposit with interest thereon nor the aggregate amount of deposits held by Mr. Deepak on that date together with interest exceeds the threshold limit of Rs.20,000.

(ii) The above arrangement of splitting the investment through two subsidiaries appears to be with the intention of obtaining tax benefit under the treaty. Further, there appears to be no commercial substance in creating two subsidiaries as they do not change the economic condition of investor A Ltd. in any manner (i.e. on business risks or cash flow), and reveals a tainted element of abuse of tax laws. Hence, the arrangement can be treated as an impermissible avoidance arrangement by invoking GAAR, if the tax benefit arising in aggregate, to all the parties to the arrangement exceeds Rs. 3 crores. Consequently, treaty benefit would be denied by ignoring M Ltd. and N Ltd., the two subsidiaries, or by treating M Ltd. and N Ltd. as one and the same company for tax computation purposes.

(b) (i) Under section 245F(1), the Settlement Commission has been conferred all the powers which are vested in an income-tax authority under the Act. Under section 154, an income-tax authority has the power to amend any order passed by it in order to rectify any mistake apparent from the record. Therefore, the Settlement Commission's power to amend an order to rectify any mistake apparent from the record is embedded in section 245F(1).

Further, in order to reflect the correct intention of the legislature, section 245D(6B) specifically provides that the Settlement Commission may, at any time within a period of six months from the end of the month in which the order was passed, amend any order passed by it under section 245D(4) to rectify any mistake apparent from the record. In this case, the rectification order was passed by the Settlement Commission within six months from the end of the month in which the order was passed (i.e. by 31.8.2021)

Therefore, Mr. Ashish’s view is **<u>not</u>** correct.

(ii) In this case, the rectification has the effect of modifying the liability of Mr. Ashish. Therefore, as per the second proviso to section 245D(6B), the Settlement Commission, before passing the amended order, should have –

(1) given a notice to the applicant and the Principal Commissioner/Commissioner of its intention to make such an amendment; and

(2) allowed the applicant and the Principal Commissioner/Commissioner an opportunity of being heard.

If these conditions are fulfilled, the order amended by the Settlement Commission would be a valid order, since the amended order is passed by the Settlement Commission within the permitted time limit i.e., within six months from the end of the month in which the original order was passed.

However, if the Settlement Commission has not given notice of its intention to make such an amendment or has not allowed the applicant and the Principal Commissioner/ Commissioner an opportunity of being heard, then, the amended order passed by it will not be valid.