

MOCK TEST PAPER 1
FINAL (NEW) COURSE: GROUP – II
PAPER – 7: DIRECT TAX LAWS & INTERNATIONAL TAXATION
SOLUTIONS

Division A – Multiple Choice Questions

MCQ No.	Most Appropriate Answer	MCQ No.	Most Appropriate Answer
1.	(d)	9.	(d)
2.	(b)	10.	(b)
3.	(a)	11.	(a)
4.	(b)	12.	(b)
5.	(a)	13.	(b)
6.	(d)	14.	(a)
7.	(d)	15.	(c)
8.	(b)	16.	(b)

Division B – Descriptive Questions

1. (a) **Computation of Total Income of Pure Ltd. for the A.Y. 2021-22**

Particulars	Amount (₹)
Profits and Gains from Business and Profession	
Net profit as per profit and loss account	4,50,00,000
Add: Items debited but to be considered separately or to be disallowed/	
- Depreciation provided on straight line basis (Note 1)	30,00,000
- Disallowance under section 40A(3) for payment exceeding ₹ 10,000 made in cash for purchases and expenditure (Note 2)	18,00,000
- Disallowance under section 40A(3) for cash payment exceeding ₹ 35,000 in a day to transport operators for hiring of lorry (Note 3)	1,10,000
- Expenditure on scientific research on in-house approved research and development facility (considered separately for weighted deduction) (Note 4)	-
- Expenditure on earning dividend from foreign company not deductible (Note 5)	50,000
- GST component of professional charges paid to consultant on which tax has not been deducted (Note 6)	-
- Disallowance under section 40A(2) for excess payment to related person (Note 7)	5,00,000

- Employer's contribution to EPF (Note 8)	-	
- Donations to electoral trust and registered political party (Note 10)	<u>2,00,000</u>	<u>56,60,000</u>
		5,06,60,000
Less: Items credited but to be considered separately or to be allowed/ permissible expenditure and allowances		
- Depreciation allowable under the Income-tax Act, 1961 (Note 1)	48,00,000	
- Dividend received from foreign company to be considered under the head "Income from other sources" (Note 5)	<u>6,00,000</u>	<u>54,00,000</u>
		4,52,60,000
Add: Recovery of bad debts credited in reserve but chargeable under section 41(4) (Note 9)		<u>1,50,000</u>
Profits and gains from business and profession		4,54,10,000
Income from Other Sources		
Dividend from foreign company (Note 5)	<u>6,00,000</u>	<u>6,00,000</u>
Gross Total Income		4,60,10,000
Less: Deduction under Chapter VI-A		
Under section 80GGB [Donation to registered political party] (Note 10)		<u>1,25,000</u>
Total Income		<u>4,58,85,000</u>

Computation of tax liability of Pure Ltd. for the A.Y. 2021-22

Particulars	Amount (₹)
Tax on dividend income received from foreign company @15% [Rs. 6,00,000 x 15%]	90,000
Tax on total income other than dividend [₹ 4,52,85,000 @ 25%, since turnover for the P.Y. 2018-19 does not exceed ₹ 400 crores]	<u>1,13,21,250</u>
	1,14,11,250
Add: Surcharge @7%, since total income exceed ₹ 1 crore but does not exceed ₹ 10 crore	<u>7,98,788</u>
	1,22,10,038
Add: Health and education cess @4%	<u>4,88,401</u>
Tax liability	<u>1,26,98,439</u>
Tax liability (rounded off)	1,26,98,440

Notes:

- (1) Depreciation provided in the accounts on straight line basis (i.e., ₹ 30 lakhs) has to be added back and depreciation calculated as per Income-tax Rules, 1962 (i.e. ₹ 48 lakhs) is allowable as deduction under section 32.

As per second proviso to section 43(1), the expenditure for acquisition of asset, in respect of which payment to a person in a day exceeds ₹ 10,000 has to be ignored for computing actual cost, if such payment is made otherwise than by way of A/c payee cheque/ bank draft/ECS or any other prescribed mode. Accordingly, depreciation on second hand machinery purchased on 23.10.2020 is not allowable since the payment is made by bearer cheque to a person in a day. No adjustment is required to be made since depreciation in respect of such plant and machinery is not included in the depreciation given.

- (2) Cash payments exceeding ₹ 10,000 in a day attracts disallowance under section 40A(3). However, Rule 6DD provides for certain exceptions, which includes, *inter alia*, payments made for the purchase of agricultural produce. Therefore, cash payment of ₹ 5.5 lakhs for the purchase of agricultural produce would not attract disallowance under section 40A(3). Cash payment of Rs. 12 lakhs on 1.4.2020 on account of bank holiday and ₹ 6 lakhs made on 17-01-2021 due to demand of supplier would attract disallowance under section 40A(3), since the same is not covered under any of the exceptions laid out in Rule 6DD.
- (3) In respect of cash payments to transport operators, a higher limit of ₹ 35,000 per day is permissible. Therefore, cash payment of ₹ 25,000 on 10-6-2020 would not attract disallowance under section 40A(3). However, cash payments of ₹ 70,000 and ₹ 40,000 on 25.8.2020 and 10.02.2021, respectively, would attract disallowance under section 40A(3) since the same exceeds ₹ 35,000 per day.
- (4) 100% of expenditure incurred on scientific research on in-house research and development facility approved under section 35(2AB) by a company engaged in the business of manufacturing qualifies deduction. Since such amount is debited to profit and loss A/c, no adjustment is required.
- (5) Under section 115BBD, dividend received by an Indian company from a foreign company in which it holds 26% or more in nominal value of the equity share capital of the company, would be subject to a concessional tax rate of 15%. This rate of 15% would be applied on gross dividend, in the sense, that no expenditure would be allowable in respect of such dividend.

Therefore, dividend of ₹ 6 lakhs received by Pure Ltd. from a foreign company, in which it holds 30% in nominal value of equity share capital of the company, would be subject to tax@15% under section 115BBD. Such dividend would be taxable under the head "Income from other sources". No deduction is allowable in respect of ₹ 50,000 expended on earning this income.

Since such dividend has been credited to the profit and loss account, the same has to be reduced for computing income under the head "Profits and gains of business or profession. Likewise, ₹ 50,000, representing expenditure for earning dividend income, which has been debited to profit and loss account, should be added back for computing business income.

- (6) Professional charges have been debited to profit and loss account. It is stated that tax has not been deducted on the GST component of professional charges.

In respect of professional charges, *CBDT Circular No.23/2017 dated 19.7.2017* clarifies that if in terms of the agreement/contract between the payer and the payee, the GST component comprised in the amount payable to a resident is indicated separately, tax shall be deducted at source on the amount paid/payable without including such GST component.

In this case, the GST component is indicated separately in the agreement/contract between the company and the consultant, tax is required to be deducted at source on the professional charges without including such GST component. Therefore, no disallowance is attracted for non-deduction of tax at source on the GST component.

- (7) ABC Ltd. is a related person under section 40A(2), since the directors of the Pure Ltd. have substantial interest in ABC Ltd. Therefore, excess payment of ₹ 5 lakh to ABC Ltd. for purchase of goods would attract disallowance under section 40A(2).
- (8) As per section 43B, employers' contribution to EPF is allowable as deduction since the same has been deposited on or before the 'due date' of filing of return under section 139(1). Since the same has been debited to profit and loss account, no further adjustment is necessary.
- (9) Recovery of a debt which was earlier written off under section 36(1)(vii) and was allowed as deduction is chargeable to tax under section 41(4) in the year of such recovery. Accordingly,

the amount of ₹ 1.5 lakhs has to be added to income despite the fact that the same was credited by the company in a reserve account.

- (10) Donation to an electoral trust and a registered political party is not an allowable expenditure under section 37 since it is not laid out wholly or exclusively for the purposes of business or profession. Hence, the same has to be added back while computing business income.

However, donation made by a company to an electoral trust or registered political party is allowable deduction under section 80GGB from gross total income, subject to the condition that payment is made otherwise than by way of cash. Since the donation to electoral trust is made in cash, the same does not qualify for deduction under section 80GGB. However, donation of ₹ 1.25 lakh by cheque to a registered political party would be eligible for deduction under section 80GGB.

2. (a) **Computation of book profit for levy of MAT under section 115JB for A.Y. 2021-22**

Particulars	₹	₹
Net Profit as per Statement of Profit and Loss		95,00,000
Add: Net Profit to be increased by the followings amounts as per <i>Explanation 1</i> below section 115JB(2)		
- Depreciation	10,00,000	
- Provision for doubtful debts i.e. provision for diminution in value of asset i.e. debtors	2,00,000	
- Reserve for currency fluctuation reserve	<u>1,25,000</u>	
		13,25,000
		1,08,25,000
Less: Net Profit to be decreased by the followings amounts as per <i>Explanation 1</i> below section 115JB(2)		
- Net agricultural income	5,00,000	
Net agricultural income is to be reduced, since it is exempt under section 10(1)]		
- Depreciation other than deprecation on revaluation of assets is to be reduced while computing book profit [10,00,000 – 1,90,000]	<u>8,10,000</u>	
		13,10,000
Book profit under section 115JB		95,15,000

Computation of Minimum Alternate Tax under section 115JB

Particulars	₹
15% of book profit (₹ 95,15,000 x 15%)	14,27,250
Add: Health & Education cess@4%	57,090
Minimum Alternate Tax under section 115JB	14,84,340

Notes:

- (1) Only the specified items mentioned under *Explanation 1* below section 115JB(2) can be added back or deducted to the net profit as per the Statement of Profit and Loss prepared as per the Companies Act for computing book profit for levy of MAT. Since the following items are not specified in the said *Explanation 1*, the same cannot be added back or deducted for computing book profit:

- Penalty for infraction of law
 - Unpaid interest to financial institutions
 - Profits from a new industrial undertaking eligible for deduction under section 80-IA
 - Dividend received on investment in Indian companies
- (2) For computing the book profit, since provisions for GST is an ascertain liability, it is not added back.
- (3) No adjustment is required in respect of interest on borrowed capital of ₹ 1,00,000 payable to Y, not debited to statement of profit and loss, since the net profit as per the Statement of Profit and Loss prepared as per the Companies Act and the items specified for exclusion/inclusion under section 115JB alone have to be considered while computing the book profit for levy of MAT.
- (4) Depreciation as per Income-tax Act, 1961 is not relevant for computing book profit for levy of MAT.

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

Particulars	₹
Indian Income [Income from Rifle Shooting in India]	17,20,000
Foreign Income [Income from Rifle Shooting in Country X]	<u>14,50,000</u>
Gross Total Income	31,70,000
Less: Deduction under Chapter VI-A	₹
<u>Deduction under section 80C</u>	
Life insurance premium	1,10,000
Deposit in PPF	<u>1,50,000</u>
	<u>2,60,000</u>
The aggregate of deduction under section 80C has to be restricted to ₹ 1,50,000	1,50,000
<u>Deduction under section 80D</u>	
Medical insurance premium of ₹ 32,000 paid for his father aged 82 years, allowable as deduction to a maximum of ₹ 50,000, since his father is a senior citizen (assuming that his father is also a resident in India) and payment is made by any mode other than cash.	<u>32,000</u>
	<u>1,82,000</u>
Total Income	<u>29,88,000</u>
<u>Tax on Total Income</u>	
Income-tax	7,06,400
Add: Health & Education cess @ 4%	<u>28,256</u>
	7,34,656
Average rate of tax in India (i.e. ₹ 7,34,656/₹ 29,88,000 × 100)	24.5869%
Average rate of tax in foreign country (i.e. ₹ 2,61,000/₹ 14,50,000 × 100)	18.00%
Rebate under section 91 on ₹ 14.50 lakh @ 18% (lower of average Indian-tax rate or average foreign tax rate)	<u>2,61,000</u>
Tax payable in India (₹ 7,34,656 – ₹ 2,61,000)	<u>4,73,656</u>
Tax payable (rounded off)	4,73,660

Note: Mr. Kashyap shall be allowed deduction under section 91, since the following conditions are fulfilled;

- (a) He is a resident in India during the relevant previous year.
 - (b) The income accrues or arises to him 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 Country X in his hands and he has paid tax on such income in Country X.
 - (d) There is no agreement under section 90 for the relief or avoidance of double taxation between India and Country X where the income has accrued or arisen.
3. (a) As per section 115TD, the accreted income of "Satya", a charitable trust, registered under section 12AA which is merged with M/s Aadhaar (P) Ltd., an entity not entitled for registration under section 12AA, would be chargeable to tax at the rate of 34.944% [30% plus surcharge @12% plus cess@4%].

Computation of accreted income and tax liability in the hands of the Satya trust arising as a result of merger with M/s. Aadhaar (P) Ltd.

Particulars	Amount (₹)
Aggregate FMV of total assets as on 1.4.2020, being the specified date (date of merger) [See Working Note 1]	1,16,73,000
Less: Total liability computed in accordance with the prescribed method of valuation [See Working Note 2]	<u>67,00,000</u>
Accreted Income	<u>49,73,000</u>
Tax Liability @ 34.944% of ₹ 49,73,000 (rounded off)	17,37,765
Working Notes:	
(1) Aggregate fair market value of total assets on the date of merger	
- Land at Gwalior, being immovable property, purchased on 1.10.2011	-
Since the trust was registered only on 15.3.2014 and benefit of section 11 and 12 was available to the trust only from A.Y.2014-15, relevant to P.Y.2013-14, being the previous year in which the application for registration is made, the value of land purchased in P.Y.2011-12, in respect of which benefit under sections 11 and 12 was not availed, has to be ignored for computing accreted income.	
- Land at Indore, being an immovable property, purchased on 21.11.2014	1,05,00,000
[The fair market value of land would be higher of ₹ 105 lakhs i.e., price that the land would ordinarily fetch if sold in the open market and ₹ 90 lakhs, being stamp duty value as on the specified date, i.e., 1.4.2020]	
- Quoted equity shares of XYZ Ltd. [3,000 x ₹ 265 per share]	7,95,000
[₹ 265 per share, being the average of the lowest (₹ 250) and highest price (₹ 280) of such shares on the specified date i.e., on 1.4.2020]	
- Preference shares of TLP Ltd. [1,800 x ₹ 210 per share]	

[The fair market value which it would fetch if sold in the open market on the specified date i.e. FMV on 1.4.2020]		3,78,000
		<u>1,16,73,000</u>
(2) Total liability		
- Reserves and Surplus ₹ 21 lakhs [not includible]		-
- Corpus Fund of ₹ 14 lakhs [not includible]		-
- Provision for taxation ₹ 10 lakhs [not includible]		-
- Other Liabilities		
[₹ 112 lakhs - ₹ 21 lakhs - ₹ 14 lakhs - ₹ 10 lakhs]		<u>67,00,000</u>
		<u>67,00,000</u>

- (b) Any income arising from an international transaction, where two or more “associated enterprises” enter into a mutual agreement or arrangement, shall be computed having regard to arm’s length price as per the provisions of Chapter X of the Act.

Section 92A defines an “associated enterprise” and sub-section (2) of this section speaks of the situations when the two enterprises shall be deemed to associated enterprises. Applying the provisions of section 92A(2)(a) to the given facts, it is clear that “Info tech Ltd.” is associated with RIDA Inc. of Germany, because this company holds shares carrying not less than 26% of the voting power in Info tech Ltd.

Computation of Arm’s Length Price as per Cost Plus Method

Particulars		₹ (in crores)
Gross profit Mark up in case of Mira Industries [an unrelated party]	50.0%	
Less: Differences to be adjusted		
- Value of technical know-how (10% of 50%)	5.0%	
- Quantity discount to RIDA Inc. (15% of 50%)	<u>7.5%</u>	
	37.5%	
Add: Cost of credit to RIDA Inc., (15% of 100%)	<u>15.0%</u>	
Arm’s Length gross mark up	<u>52.5%</u>	
Cost incurred by Info tech Ltd. for executing RIDA Inc’s work		25,00,000
Add: Adjusted gross profit (₹ 25,00,000 x 52.5%)		<u>13,12,500</u>
Arm’s Length billed value		38,12,500
Less: Actual Billed Income in case of RIDA Inc. (₹ 2500 x 1500 man hours)		<u>37,50,000</u>
Total Income of Info tech Ltd to be increased by		<u>62,500</u>

4. (a) As per the provisions of section 194H, a person is liable to deduct tax at source at the time of credit or payment of commission to any resident, whichever is earlier.

In the present case, XYZ Airways Ltd. correctly deducted tax at source under section 194H from the commission@9% of the minimum fixed commercial price paid to the travel agents, who were allowed to sell the air tickets at any price higher than the minimum fixed commercial price subject to a maximum published price. However, the Assessing Officer contended that the airline company was required to deduct tax at source on the difference between the minimum fixed commercial price and the maximum published price by treating it as “additional special commission” in the hands of the agents.

The facts of the case are similar to the case of *CIT v. Qatar Airways (2011) 332 ITR 253*, where the Bombay High Court held that the difference between the maximum published price and the

minimum fixed commercial price cannot be taken as “additional special commission” in the hands of the agents. This is because the maximum published price is the maximum price and the airline company has granted permission to the agents to sell the tickets at a price lower than the maximum published price. Further, the airline company would have no information about the exact rate at which the tickets were ultimately sold by its agents. In order to deduct tax at source on the difference between actual sale price and minimum fixed commercial price, the exact income in the hands of the agents must be ascertainable by the airline company. However, it is not so ascertainable in this case, since the agents are given discretion to sell the tickets at any rate between the minimum fixed commercial price and the maximum published price. **It would be impracticable and unreasonable to expect the airline company to get a feedback from its numerous agents in respect of the price at which the tickets were sold by them.**

Applying the rationale of the above case to the case on hand, XYZ Airways Ltd. is not liable to deduct tax at source under section 194H on the difference between the maximum published price and the minimum fixed commercial price, even though the amount earned by the agent over and above the minimum fixed commercial price is taxable as income in their hands.

Therefore, the contention of the Assessing Officer is not tenable in law.

- (b) I. Section 194H requires deduction of tax at source @5% (3.75% from 14.5.2020 to 31.3.2021 from commission and brokerage payments to a resident. However, no tax is to be deducted at source where the amount of such payment does not exceed ₹ 15,000.

In the given case, ‘Shine Packaging Ltd.’, the consignee, has not remitted the commission of ₹ 65,000 to the consignor ‘ABC Developers’ while remitting the sale consideration.

Since, the retention of commission by the consignee/ agent amounts to constructive payment of the same to him by the consignor/ principal, deduction of tax at source is required to be made from the amount of commission [CBDT Circular No. 619 dated 4/12/1991].

Therefore, ABC Developers has to deduct tax at source at the rate of 3.75% on the amount of commission.

- II. The definition of “work” under section 194C includes manufacturing or supplying a product according to the requirement or specification of a customer by using material purchased from such customer.

In the instant case, Y Ltd. manufactures the product as per the specification given by X Ltd. **by using the raw materials purchased from X Ltd. Therefore, it falls within the definition of “work” under section 194C.**

Consequently, tax is to be deducted @ 1.5% by X Ltd., on the invoice value excluding the value of material purchased from such customer if such value is mentioned separately in the invoice. If the material component is not mentioned separately in the invoice, tax is to be deducted on the whole of the invoice value.

- (c) Mayur Ltd., an Indian company and U Ltd., a Country X 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 U Ltd. is not less than 51% of the book value of the total assets of Mayur Ltd., the two companies are deemed to be associated enterprises.

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

- (i) The interest rate charged by U Ltd on loan advanced to Mayur Ltd. is 8% p.a. whereas the arm’s length interest charged in a comparable uncontrolled transaction (with another Indian company) by U 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 Mayur Ltd for P.Y.2020-21 = ₹ 150 crores + primary adjustments of ₹ 850 crores = ₹ 1000 crores.

- (ii) The excess money (i.e., ₹ 850 crores) lying with U Ltd. has to be repatriated within 90 days from 30.11.2021, being the due date for filing return of income.

If the excess money is not repatriated on or before 28th February, 2022, it would be deemed as an advance made by Mayur Ltd. to U Ltd. and interest would be chargeable from 30.11.2021 at six month LIBOR as on 30th September, 2021 + 3%, since the loan is denominated in Euros. Such interest would be included in the total income of Mayur Ltd.

- (iii) If Mayur 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].

5. (a) Income chargeable to tax shall be deemed to have escaped assessment for the purpose of section 147, where a person, being a resident other than not ordinarily resident in India, holds, as a beneficial owner or otherwise any asset located outside India or is a beneficiary of any asset located outside India or has a signing authority in any account located outside India. Accordingly, the Assessing Officer can serve a notice under section 148 on such assessee requiring him to furnish a return of income within the specified period, for the purpose of making an assessment, reassessment or recomputation under section 147.

Under section 149, an extended time limit of sixteen years is available for issue of notice under section 148 for an assessment or reassessment, in case income in relation to such assets located outside India has escaped assessment.

As per *Explanation* to section 149, the above provisions, so amended by the Finance Act, 2012, would also apply to any assessment year prior to A.Y.2013-14.

In this case, income chargeable to tax shall be deemed to have escaped assessment for the purpose of section 147, since Neerja has assets located outside India.

Therefore, on this basis, the Assessing Officer formed a belief that the income has escaped assessment and consequently, issued notice under section 148 for 14 assessment years i.e. from A.Y.2008-09 to A.Y.2021-22.

Hence, the Assessing Officer is justified in invoking reassessment proceedings in respect of the earlier assessment years also. However, the extended time limit of 16 years for invoking reassessment proceedings would be available only in respect of A.Y.2011-12 and thereafter, since Neerja first purchased an asset outside India only in July 2010.

Accordingly, in view of the above provisions, the action of the Assessing Officer in issuing notices to Neerja under section 148 for 11 assessment years i.e., from A.Y. 2011-12 to A.Y. 2021-22 is in order. However, he cannot issue notice under section 148 for A.Y. 2008-09 to A.Y.2010-11, since the time limit of 4 years or 6 years, as the case may be, has since elapsed.

- (b) As per section 133(6), power is given to an Assessing Officer to issue notice, for the purposes of the Act, requiring any person, including a banking company, to furnish information in respect of such points or matters or to furnish statement of accounts and affairs verified in the manner specified by the Assessing Officer, as may be useful for, or relevant to, any enquiry or proceeding under the Act. Therefore, the provisions of this section can be invoked even in case of any enquiry and it is not necessary that any proceeding should be pending against the customer for the same.

However, in respect of an enquiry, in case where no proceeding is pending, this power **cannot** be exercised by any Income-tax authority below the rank of Principal Director or Director or Principal Commissioner or Commissioner, **other than the Joint Director or Deputy Director or Assistant Director**, without the prior approval of the Principal Director or Director or Principal Commissioner or Commissioner, as the case may be.

Therefore, the Assessing Officer can issue notice under section 133(6) asking for particulars relating to a customer in the specified format duly verified in the prescribed manner from the banking company, even if no proceeding is pending against such customer, provided he has obtained the prior approval of the Principal Director or Director or the Principal Commissioner or Commissioner, as the case may be.

Hence, in such a case, the action of bank in refusing to provide the particulars relating to a customer as required by the Assessing Officer on the ground that no proceeding was pending against the customer, is **not** correct.

Note - The Supreme Court, in the case of *Kathirotor Service Co-operative Bank Ltd. v. CIT(CIB)(2014) 360 ITR 0243*, held that information of general nature could be called for from banks. In that case, since notices had been issued after obtaining the approval of the Commissioner, the assessing authority has not erred in issuing the notices to the assessee requiring them to furnish information regarding account holders. The Supreme Court, therefore, held that for such enquiry under section 133(6), the notices could be validly issued by the assessing authority.

- (c) Base Erosion and Profit Shifting (BEPS) refers to tax planning strategies that exploit gaps and mismatches in tax rules to make profits 'disappear' for tax purposes or to shift profits to locations where there is little or no real activity but the taxes are low, resulting in little or no overall corporate tax being paid.

Adverse Effects of BEPS:

- (1) Governments have to cope with less revenue and a higher cost to ensure compliance.
 - (2) In developing countries, the lack of tax revenue leads to significant under-funding of public investment that could help foster economic growth.
 - (3) BEPS undermines the integrity of the tax system, as reporting of low corporate taxes is considered to be unfair. When tax laws permit businesses to reduce their tax burden by shifting their income away from jurisdictions where income producing activities are conducted, other taxpayers, especially individual taxpayers in that jurisdiction bear a greater share of the burden. This gives rise to tax fairness issues on account of individuals having to bear a higher tax burden.
 - (4) Enterprises that operate only in domestic markets, including family-owned businesses or new innovative businesses, may have difficulty competing with MNEs that have the ability to shift their profits across borders to avoid or reduce tax. Fair competition is harmed by the distortions induced by BEPS.
6. (a) As per the provisions of section 281B, there can be provisional attachment to protect the interest of Revenue in certain cases i.e., -
- (a) The proceeding for the assessment of any income or for the assessment or reassessment of any income which has escaped assessment should be pending.
 - (b) Such attachment should be necessary for the purpose of protecting the interest of Revenue in the opinion of the Assessing Officer.

- (c) The previous approval of the Principal Chief Commissioner or Chief Commissioner, Principal Commissioner or Commissioner, Principal Director General or Director General or Principal Director or Director has been obtained by the Assessing Officer.
- (d) The Assessing Officer, may, by an order in writing attach provisionally any property belonging to the assessee in the manner provided in the Second Schedule.

Such provisional attachment shall cease to have effect after the expiry of a period of six months from the date of order made under section 281B(1). However, the period can be extended by the Principal Chief Commissioner or Chief Commissioner, Principal Commissioner or Commissioner, Principal Director General or Director General or Principal Director or Director, as the case may be, for the reasons to be recorded in writing for a further period or periods as he thinks fit. The total period of extension in any case cannot exceed 2 years or 60 days after the date of order of assessment or reassessment, whichever is later.

The Assessing Officer shall, by order in writing, revoke provisional attachment of a property made under section 281B(1) in a case where the assessee furnishes a guarantee from a scheduled bank, for an amount not less than the fair market value of such provisionally attached property or for an amount which is sufficient to protect the interests of the revenue.

- (b) The arrangement of routing investment through Country 'Y' results into a tax benefit. Since there is no business purpose in incorporating company Z Pvt. Ltd. in Country 'Y', it can be said that the main purpose of the arrangement is to obtain a tax benefit. The alternate course available in this case is direct investment in R (P) Ltd. joint venture by D Pvt. Ltd. The tax benefit would be the difference in tax liabilities between the two available courses.

The next question is, does the arrangement have any tainted element? It is evident that there is no commercial substance in incorporating Z Pvt. Ltd. as it does not have any effect on the business risk of D Pvt. Ltd. or cash flow of D Pvt. Ltd. As the twin conditions of main purpose being tax benefit and existence of a tainted element are satisfied, GAAR may be invoked.

Additionally, as all rights of shareholders of R (P) Ltd. are being exercised by D Pvt. Ltd instead of Z Pvt. Ltd, it again shows that Z Pvt. Ltd lacks commercial substance.

Hence, GAAR provisions can be invoked in this case.

- (c) The residential status of a foreign company is determined on the basis of place of effective management (POEM) of the company.

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

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

- the passive income is not more than 50% of its total income; **and**
- less than 50% of its total assets are situated in India; **and**
- less than 50% of total number of employees are situated in India or are resident in India; **and**
- the payroll expenses incurred on such employees is less than 50% of its total payroll expenditure.

S Ltd. shall be regarded as a company engaged in active business outside India for P.Y.2020-21 for POEM purpose only if it satisfies all the four conditions cumulatively.

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

Total income of S Ltd. during the P.Y. 2020-21 is ₹ 110 crores [(₹ 25 crores + ₹ 50 crores) + (₹ 20 crores + ₹ 15 crores)]

Passive income is the aggregate of, -

- (i) income from the transactions where both the purchase and sale of goods is from/to its associated enterprises; and
- (ii) income by way of royalty, dividend, capital gains, interest or rental income;

Passive Income of S Ltd. is ₹ 50 crores, being sum total of :

- (i) ₹ 15 crores, income from transactions where both purchases and sales are from/to associated enterprises (₹ 5 crores in India and ₹ 10 crores in Malaysia)
- (ii) ₹ 35 crores, being interest and dividend from investment (₹ 20 crores in India and ₹ 15 crores in Malaysia)

Percentage of passive income to total income = ₹ 50 crore/ ₹ 110 crore x 100 = 45.45%

Since passive income of S Ltd. is **45.45%, which is not more than 50%** of its total income, the first condition is satisfied.

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

Value of total assets of S Ltd. during the P.Y. 2020-21 is ₹ 610 crores [₹ 210 crores, in India + ₹ 400 crores, in Malaysia]

Value of total assets of S Ltd. in India during the P.Y. 2020-21 is ₹ 210 crores

Percentage of assets situated in India to total assets = ₹ 210 crores/₹ 610 crores x 100 = 34.43%

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

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

Number of employees situated in India or are resident in India is 70

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

Percentage of employees situated in India or are resident in India to total number of employees is 70/160 x 100 = **43.75%**

Since employees situated in India or are residents in India of S Ltd. **are less than 50%** of its total employees, the third condition for ABOI test is satisfied.

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

Payroll expenses on employees employed in and resident of India = ₹ 8 crores.

Total payroll expenses = ₹ 20 crores (₹ 8 crores + ₹ 12 crores)

Percentage of payroll expenses of employees situated in India or are resident in India to the total payroll expenses = 8 x 100/20 = **40%**

Since the payroll expenses incurred on employees situated in India or resident in India **is less than 50% of its total payroll expenditure**, the fourth condition for ABOI test is also satisfied.

Since S Ltd. has satisfied all the four conditions, the company would be said to be engaged in "active business outside India" during the P.Y.2020-21.

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

Since S Ltd. is engaged in active business outside India in P.Y. 2020-21 and majority of its board meetings i.e., 5 out of 9, were held outside India, POEM of S Ltd. would be outside India.

Therefore, S Ltd. would be non-resident in India for the P.Y. 2020-21.