

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

Lotus Co. Ltd., is a listed company located in Jaipur. It is engaged in multiple activities at different locations. Books of account are maintained by each unit separately. The head office maintains books relating to common transactions. All the accounts are consolidated and the return of income is filed at Jaipur.

The following information is furnished unit wise for the year ended 31st March, 2020 :

- (a) **Medicine manufacturing unit, Delhi:** The Company has reported Net Profit of ₹ 200 lakhs in the books of account of the said business unit. It entered into an agreement for use of know-how owned by a renowned scientist. It paid royalty of ₹ 5 per unit of medicine sold as royalty and the amount of royalty paid during the previous year 2019-20 was ₹ 36 lakhs. The company deducted tax at source on the amounts paid up to December, 2019 and omitted to deduct tax at source on the royalty of ₹ 8 lakhs due for the period from January, 2020 to March, 2020. The payee admitted the royalty income fully, paid tax and filed his return of income before the “due date” specified in section 139(1).

The company paid ₹ 33,60,000 being 14% of basic salary plus DA of the employees in notified pension scheme and the amount so paid is debited as expenditure in the books of account.

- (b) **Garment manufacturing unit, Tirupur:** The Company has a manufacturing unit at Tirupur, Tamil Nadu. It reports a Net Profit of ₹ 90 lakhs as per books of account of the unit. It bought a trademark from Mr. Yellow for ₹ 20 lakhs on 01-06-2019 which is charged as expenditure in the books of account.

The unit paid ₹ 3 lakhs as interest on loan taken from a non-resident Indian. The tax was deducted at source in March, 2020 but it was remitted only on 06-05-2020.

The company paid ₹ 6 lakhs being the amount of income-tax payable by the employees on non-monetary perquisites provided by the company. This amount is debited in the books of account as expenditure.

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 January, 2021 examination. The relevant Assessment Year is A.Y.2020-21.

- (c) **Fertilizer producing unit, Narmada:** The Company established a fertilizer producing unit in Narmada, Gujarat which become operational in June, 2019. It has acquired a Land for ₹ 1 crore and put up a Building for ₹ 3 crores and installed new Plant and Machinery for ₹ 4 crores. The Net Profit as per books of account of the unit is ₹ 220 lakhs (after deducting depreciation on Building of ₹ 30 lakhs and Plant and Machinery of ₹ 60 lakhs).
- (d) **Warehousing facility for storage of edible oils at Chennai:** It established a warehousing facility for storage of edible oils from 01-08-2019. It made investments such as cost of Land ₹ 2 crores, Building ₹ 3 crores and Plant and Machinery (new) ₹ 5 crores. The Net Profit as per books (without deducting depreciation) was ₹ 70 lakhs.

Additional information:

The company mobilized capital during the previous year 2019-20 by public issue of shares. The application money was kept in bank pending allotment of shares. The interest income from the said deposit of ₹ 3,20,000 is credited to general reserve.

The company declared interim dividend @10% of share capital being ₹ 30 lakhs in October, 2019. It has 27% shareholding in Wire Inc., Singapore from whom it received ₹ 54 lakhs as dividend in January, 2020. Both dividend received and paid were credited and debited respectively in the Consolidated Statement of Profit and Loss.

The total turnover of the company for previous year 2017-18 was ₹ 282 crores and for financial year 2018-19 ₹ 405 crores. The company has MAT credit of ₹ 20 lakhs of the assessment year 2007-08. The book profit (computed) for the assessment year 2020-21 is ₹ 620 lakhs.

Compute the total income of the company and optimum income-tax liability for the assessment year 2020-21. Your answer must give reasons for treatment of each item given above and also for the tax liability. **(14 Marks)**

Answer

**Computation of total income and tax liability of Lotus Co. Ltd. for A.Y.2020-21
under the regular provisions of the Act**

Particulars	₹	₹
Profits and gains of business or profession		
Net profit from Medicine manufacturing unit, Delhi	2,00,00,000	
Add: Items debited but to be disallowed		
- Royalty on which tax is not deducted	2,40,000	
[30% of ₹ 8 lakhs, being payment of royalty without deduction of tax would be disallowed under section 40(a)(ia) while computing the business income of A.Y.2020-21. However, since the payee has admitted		

the income, paid tax and filed his return of income before due date, the same would be allowable in the P.Y. 2020-21 relevant to A.Y.2021-22, being the year in which tax was deducted and paid]		
- Employer's contribution to notified pension scheme	9,60,000	
[As per section 36(1)(iva), employer's contribution to the account of an employee under a Pension Scheme as referred to in section 80CCD would be allowed as deduction while computing business income only to the extent of 10% of salary and DA of the employee in the previous year. Therefore, ₹ 9,60,000 representing the excess 4% (i.e., ₹ 33,60,000 x 4%/14%) debited to profit and loss account has to be added back while computing business income]		
Net profit from Garment manufacturing unit, Tirupur	90,00,000	2,12,00,000
Add: Items debited but to be disallowed or to be treated separately		
- Trademark	20,00,000	
[Trademark is an intangible asset which is eligible for depreciation as per section 32. Since purchase cost of trademark has been debited to profit and loss account, the same has to be added back while computing business income]		
- Interest on loan taken from a non-resident	NIL	
[No disallowance under section 40(a)(i) is attracted in respect of interest, since tax has been deducted during the P.Y. 2019-20 and remitted on or before the due date of filing of return of income for A.Y. 2020-21]		
- Income-tax paid on non-monetary perquisites	<u>6,00,000</u>	
[As per section 40(a)(v), tax paid by employer on non-monetary perquisites is not allowable as deduction. Since the same has been debited to profit and loss account, the same has to be added back while computing business income]		
	1,16,00,000	

Less: Depreciation on trademark u/s 32 [₹ 20 lakhs x 25%]	<u>5,00,000</u>	1,11,00,000
Net profit from Fertilizer producing unit, Narmada	2,20,00,000	
Add: Items debited but to be disallowed or to be treated separately		
- Depreciation on building of ₹ 30 lakhs and on plant and machinery of ₹ 60 lakhs.	<u>90,00,000</u>	
[As per section 35AD, no deduction would be allowed under any other section in any previous year in respect of capital expenditure referred to in section 35AD. Hence, depreciation on building and plant and machinery is not allowable as deduction and the same has to be added back.]		
	3,10,00,000	
Less: Deduction u/s 35AD [Since fertilizer unit commenced operation on or after 1.4.2011, it is a specified business eligible for 100% deduction u/s 35AD in respect of capital expenditure. However, deduction is not available on expenditure incurred on acquisition of land. Deduction u/s 35AD is ₹ 7 crores, being ₹ 3 crore on building and ₹ 4 crore on plant and machinery. Since it is more beneficial for the company to claim deduction u/s 35AD, it is assumed that the company has opted to claim such deduction.]	<u>7,00,00,000</u>	
As per section 73A, loss from the specified business u/s 35AD can be set-off only against profits from another specified business. Since there is no other specified business, such loss has to be carried forward to A.Y. 2021-22.	(3,90,00,000)	
Net profit from Warehousing facility for storage of edible oils at Chennai	70,00,000	
Less: Depreciation u/s 32		
On building of ₹ 3 crores@10%	30,00,000	
On Plant & machinery of ₹ 5 crores@15%	75,00,000	
	<u>1,05,00,000</u>	
As per section 70(1), Business loss from one source is allowed to be set off from other source under the same head.		<u>(35,00,000)</u>
Net profit of Lotus Co. Ltd.		2,88,00,000
Add: Interest on share application money deposited in bank		<u>-</u>
[The interest on share application money deposited in a bank		

is not liable to be taxed, as the deposit was not for making additional income but to comply with the statutory requirement. The interest accrued on such deposit is merely incidental. The interest is eligible for set-off against share issue expenses. ^{1]}		
		2,88,00,000
Income from Other Sources		
Dividend from Wire Inc., a specified foreign company		<u>54,00,000</u>
Gross Total Income/Total Income		3,42,00,000
Computation of tax payable under the regular provisions of the Act		
Tax payable on ₹ 54,00,000 @15% [Dividend received by Lotus Co. Ltd., an Indian company, from Wire Inc., a specified foreign company (being a foreign company in which Lotus Co. Ltd. holds 26% or more in the nominal value of equity shares), is chargeable to tax @15% u/s 115BBD]	8,10,000	
Tax payable on ₹ 2,88,00,000@25% [Since the turnover of the company for the previous year 2017-18 does not exceed ₹ 400 crore]	<u>72,00,000</u>	
		80,10,000
Add: Surcharge @ 7%, since the total income of the company > ₹1 crore ≤ ₹ 10 crores		<u>5,60,700</u>
		85,70,700
Add: Health and education cess @ 4%		<u>3,42,828</u>
Tax liability		89,13,528
Tax liability (Rounded off)		89,13,530

Computation of tax liability of Lotus Co. Ltd. for the A.Y. 2020-21 under section 115JB

Particulars	₹
Minimum Alternate Tax @15% on book profit of ₹ 6,20,00,000	93,00,000
Add: Surcharge@7%, since the book profit of the company > ₹ 1 crore ≤ ₹ 10 crores	<u>6,51,000</u>
	99,51,000
Add: Health and Education cess@4%	<u>3,98,040</u>
Tax liability under section 115JB	1,03,49,040
Since the regular income-tax payable is less than the minimum alternate tax payable, the	

¹ CIT v. Sree Rama Multi Tech Ltd. [2018] 403 ITR 426 (SC)

book profit of ₹ 620 lakhs shall be deemed to be the total income and tax is leviable @15% thereof plus surcharge@7% and cess@4%. Therefore, the tax liability is ₹ 1,03,49,040.

MAT Credit to be carried forward

	₹
Tax liability under section 115JB	1,03,49,040
Less: Tax liability under the regular provisions of the Income-tax Act, 1961	<u>89,13,530</u>
Amount of Credit (115JAA)	<u>14,35,510</u>

MAT credit of ₹ 20,00,000 of A.Y. 2007-08 is allowed to be carried forward till A.Y. 2022-23 and MAT credit of ₹ 14,35,510 relating to A.Y. 2020-21 is allowed to be carried forward till A.Y. 2035-36.

Note - Lotus Co. Ltd. is eligible for concessional rate under section 115BAA @25.168% i.e., tax@22% plus surcharge@10% plus HEC@4% subject to tax at the rates mentioned in the said sections in Chapter XII. In case Lotus Co. Ltd. opted for concessional rate of tax u/s 115BAA, it would not be eligible for deduction u/s 35AD in respect of fertilizer producing unit, however, it can claim depreciation u/s 32 on building and plant and machinery. In that case, its total income u/s 115BAA would be -

Particulars	₹
Profit from Medicine manufacturing unit, Delhi	2,12,00,000
Profit from Garment manufacturing unit, Tirupur	1,11,00,000
Profit from Fertilizer producing unit, Narmada	2,20,00,000
Profit from Warehousing facility for storage of edible oils at Chennai	<u>(35,00,000)</u>
	5,08,00,000
Dividend from Wire Inc., a specified foreign company	<u>54,00,000</u>
Total Income	5,62,00,000
Tax liability under section 115BAA (22% + surcharge 10% + HEC 4%) = 25.168% on ₹ 508 lakhs	1,27,85,344
Tax on dividend ₹ 54 lakhs @ 15%+SC 10% +HEC 4% = 17.16% thereon	<u>9,26,640</u>
Tax liability	1,37,11,984
Tax liability (Round off)	1,37,11,980
Suggestion to Lotus Co Ltd	
In case Lotus Co Ltd prefers not to claim section 35AD deduction in respect of fertilizer producing unit it would also lose MAT credit of ₹ 20 lakhs as that would lapse by virtue of section 115JAA(8). Therefore, Lotus Co Ltd should not opt for section 115BAA for assessment year 2020-21, since the tax liability is higher under the regular provisions of the Act, and section 115JB.	

Question 2

(a) Sakshi Pvt. Ltd was converted into limited liability partnership (LLP) as Sakshi LLP on 1-07-2019. You are provided with the following particulars of Sakshi Pvt. Ltd. as on 31-03-2019:

- (i) Unabsorbed depreciation ₹ 25 Lakhs
- (ii) Business loss ₹ 23 Lakhs (relating to P.Y.2011-12)
- (iii) Unadjusted MAT credit u/s 115JAA ₹ 6 lakhs
- (iv) Written down value of the assets as per section 43(6) of the Income-tax Act:
Plant and Machinery (15%) ₹ 12 Lakhs (Market Value ₹ 18 Lakhs), Plant and Machinery ₹ 60 Lakhs (cost) – deduction claimed u/s 35AD, Building (10%) ₹ 30 Lakhs (Market Value ₹ 120 Lakhs)
- (v) Cost of land (acquired in year 2001) ₹ 60 lakhs (Market value ₹ 105 Lakhs)
- (vi) Expenditure on voluntary retirement incurred by the company during the P.Y. 2017-18 is ₹ 25 Lakhs. The company has been allowed deduction of ₹ 5 Lakhs for each year for the P.Y. 2017-18 and P.Y. 2018-19 u/s 35DDA.

Explain the tax treatment of each item stated above in the hands of LLP, assuming that the conversion satisfies all the conditions laid down in section 47(xiiib). **(8 Marks)**

(b) Mr. Robin, a non-resident, aged 62 years has following incomes for the F.Y.2019-20.

- | | |
|---|----------|
| - Income from a business in Jaipur (50% received in India) | 1,90,000 |
| - Dividend from a Chinese company received in Singapore | 95,600 |
| - Income from profession in Singapore, which was set up in India, received in Singapore but spent in India | 80,000 |
| - Agriculture Income from a land in Jodhpur | 45,000 |
| - Interest on Savings bank deposit in Sate Bank of India | 10,500 |
| - Income from a business in Singapore which is controlled from Jaipur (50% received in India) | 1,00,000 |
| - Income from agricultural land in Hong Kong received there and then brought to India | 41,300 |
| - Interest received from an India company on Rupee Denominated Bonds which were issued in Singapore on 01.03.2019 | 15,000 |
| - Income received from units of Unit Trust of India purchased in foreign currency | 20,000 |

- Long-term capital gain on sale of shares purchased and

sold through recognized stock exchange

1,25,000

You are required to compute his total income and tax liability for the A.Y.2020-21.

(6 Marks)

Answer

(a) Tax treatment in the hands of Sakshi LLP on conversion of Sakshi Pvt. Ltd. into Sakshi LLP

(i) Unabsorbed depreciation of ₹ 25 lakhs

As per section 72A(6A), Sakshi LLP would be able to carry forward and set-off the unabsorbed depreciation of ₹ 25 lakhs of Sakshi Pvt. Ltd. as on 31.3.2019.

However, if subsequent to the conversion, Sakshi LLP fails to fulfill any of the conditions mentioned in section 47(xiiiib), the set-off of depreciation so made in any previous year would be deemed to be the income chargeable to tax in the year in which such conditions are not complied with.

(ii) Business loss of ₹ 23 lakhs (relating to P.Y. 2011-12)

As per section 72A(6A), the business loss of ₹ 23 lakhs of Sakshi Pvt. Ltd. would be deemed to be the loss of Sakshi LLP for P.Y. 2019-20 and it would be able to set off and carry forward such loss.

The carry forward is for 8 assessment years subsequent to the assessment year 2020-21.

However, if subsequent to the conversion, Sakshi LLP fails to fulfill any of the conditions mentioned in section 47(xiiiib), the set-off of business loss so made in any previous year would be deemed to be the income chargeable to tax in the year in which such conditions are not complied with.

(iii) Unadjusted MAT credit u/s 115JJAA of ₹ 6 lakhs

As per section 115JJAA(7), in case of conversion of Sakshi Pvt. Ltd. into Sakshi LLP, the credit for MAT paid by Sakshi Pvt. Ltd. cannot be availed by the successor LLP i.e., Sakshi LLP.

(iv) Depreciation and written down value of assets

In case of conversion of Sakshi Pvt. Ltd. into Sakshi LLP, depreciation on assets shall be apportioned between the company and LLP in the ratio of the number of days for which the assets were used by them.

Total Depreciation

Plant and machinery (15%) = ₹ 12 lakhs x 15% = ₹ 1,80,000

Building (10%) = ₹ 30 lakhs x 10% = ₹ 3,00,000

In the hands of Sakshi LLP (for 275 days)

Plant and machinery (15%) = ₹ 1,80,000 x 275/366 = ₹ 1,35,246

Building (10%) = ₹ 3,00,000 x 275/366 = ₹ 2,25,410

WDV in the hands of Sakshi LLP

As per section 43(6), the actual cost of the block of assets in the hands of Sakshi LLP shall be the WDV of the block of assets as in the case of Sakshi Pvt. Ltd. on the date of conversion.

WDV of P & M (15%) = ₹ 12 lakhs – ₹ 44,754(1,80,000 x 91/366) = ₹ 11,55,246

WDV of Building (10%) = ₹ 30 lakhs – ₹ 74,590(3,00,000 x 91/366) = ₹ 29,25,410

Actual cost of Plant and machinery on which deduction has been allowed or is allowable to the assessee under section 35AD would be 'NIL' in the hands of Sakshi Pvt. Ltd. and Sakshi LLP.

(v) Cost of land acquired in 2001 at ₹ 60 lakhs (Market value ₹ 105 lakhs)

The cost of acquisition of land in the hands of Sakshi LLP would be the cost for which Sakshi Pvt. Ltd. acquired it, i.e., ₹ 60 lakh.

(vi) Expenditure on voluntary retirement benefit of ₹ 25 lakhs

As per section 35DDA, in case of conversion of Sakshi Pvt. Ltd. into Sakshi LLP, deduction would be available to Sakshi LLP for the remaining periods from the previous year in which conversion took place. Since deduction of ₹ 5 lakh each has been claimed by Sakshi Pvt Ltd. in P.Y. 2017-18 and P.Y. 2018-19, Sakshi LLP would be eligible for deduction of ₹ 5 lakh each for the remaining three previous years, namely P.Y.2019-20, P.Y.2020-21 and P.Y.2021-22 under section 35DDA.

(b) Computation of total income and tax liability of Mr. Robin for A.Y. 2020-21

As per section 5(2), Mr. Robin, a non-resident, is chargeable to tax in respect of income which accrues or arises or which is deemed to accrue or arise to him in India or which is received or deemed to be received in India in the relevant previous year.

Particulars		Amount (₹)
(i)	Income from a business in Jaipur	1,90,000
(ii)	Dividend from a Chinese company received in Singapore [Not taxable as the same accrues or arises outside India and is also received outside India]	Nil
(iii)	Income from profession in Singapore which was set up in India received in Singapore but spent in India [Not taxable, as it accrues or arises outside India and is also received outside India]	Nil
(iv)	Agriculture income from a land in Jodhpur [Exempt u/s 10(1)]	Exempt
(v)	Interest on saving bank deposit in SBI	10,500
(vi)	Income from a business in Singapore which is controlled from Jaipur	50,000

	(50% received in India) (50% of ₹ 1,00,000 is taxable in India)	
(vii)	Income from agricultural land in Hong Kong received there and then brought to India [Not taxable as such income accrues or arises outside India and is also received outside India]	Nil
(viii)	Interest received from an Indian company on rupee denominated bonds issued in Singapore on 1.3.2019 [Exempt u/s 10(4C)]	Exempt
(ix)	Income received from units of UTI purchased in foreign currency ₹ 20,000 ² [Exempt u/s 10(35), in case of both resident and non-resident]	Exempt
(x)	Long term capital gain on sale of shares purchased and sold through recognized stock exchange ³ [The gain in excess of ₹ 1,00,000 is taxable @10% u/s 112A]	<u>1,25,000</u>
	Gross Total Income	3,75,500
	Less: Deduction u/s 80TTA [Interest on savings bank account subject to maximum of ₹ 10,000]	<u>10,000</u>
	Total Income	3,65,500
	Tax liability⁴	
	Tax on ₹ 25,000, being in excess of ₹ 1 lakh @10% [u/s 112A]	2,500
	Tax on balance income of ₹ 2,40,500	<u>-</u>
		2,500
	Add: Health & education cess@4%	<u>100</u>
	Tax liability	2,600

Question 3

(a) *Shree Shani foundations, a charitable trust registered under section 12AA of the Income-tax Act, 1961 runs a hospital. The following particulars pertaining to the Previous Year 2019-20 are furnished to you by the trust:*

- (i) *Gross receipts from the hospital ₹ 345 lakhs.*
- (ii) *Voluntary contributions received from public ₹ 25 lakhs, (including anonymous donation (eligible for accumulation) ₹ 5 lakhs and corpus donation ₹ 2 lakhs from other charitable trusts), are not included in the Gross receipts.*

² Alternatively, as per section 115A, which contains the special provisions for tax on certain income of non-residents, such income is taxable @ 20%, if units are purchased in foreign currency.

³ It is logical to assume that STT has been paid.

⁴ Aggregation of agricultural income with non-agricultural income for computation of tax liability is not made since the total income of ₹ 2,40,500, excluding income chargeable at special rates (i.e., rates other than the mentioned in Paragraph A of Part I of the First Schedule), is less than the basic exemption limit.

- (iii) Hospital expenses ₹ 85 lakhs (revenue in nature and does not include the depreciation on hospital equipment amounting to ₹ 5 lakhs which have been claimed as application of income in the earlier years)
- (iv) Gross receipts includes a sum of ₹ 4 lakhs that was received on 31-03-2020.
- (v) Amount applied for the purpose of hospital ₹ 90 lakhs (includes repayment of loan taken earlier for the construction of hospital ₹ 10 lakhs).
- (vi) Donation of ₹ 3 lakhs given towards corpus to a trust registered under section 10(23C).
- (vii) Income from business which is incidental to the main object of the trust and separate books of account are also maintained by the trust in respect of such income ₹ 5 lakhs.

Compute the total income of the trust for the Assessment Year 2020-21 in order to avail maximum benefits within the four corners of law. **(8 Marks)**

- (b) Mrs. Indu, an individual resident and a retired employee, aged 60 years, is a well-known classical dancer. During the Previous Year 2019-20, she derives an income of ₹ 5,40,000 from dance show in Country 1. She also received ₹ 2,75,000 as Royalty (gross) for some literary work done from Country 2. Expenses incurred on earning royalty amounted to ₹ 50,000.

India does not have any Double Tax Avoidance Agreement under section 90 of the Income-tax Act, 1961, with these countries.

Her income from dance shows in India amounted to ₹ 7,20,000. She also received ₹ 50,000 as interest on fixed deposit with a nationalized bank. In view of tax planning, she has deposited ₹ 1,50,000 in Public Provident Fund and paid contribution to approved Pension Funds of LIC ₹ 32,000.

The tax paid by Mrs. Indu in Country 1 is @15% and Country 2 is @20%.

Compute the tax liability of Mrs. Indu for the Assessment Year 2020-21. **(6 Marks)**

Answer

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

Particulars	₹ in lakhs	₹ in lakhs
Gross receipts from Hospital		345.0000
Add: Voluntary contributions other than corpus donations of ₹ 2 lakhs and anonymous donation of ₹ 5 lakhs		18.0000
Add: Income from business incidental to the main object of the trust		<u>5.0000</u>
[Provisions of section 11(1), (2) or (3) or 3A will apply in respect of this income, since such business is incidental to]		

the main object of the trust and separate books of accounts are maintained]		
		368.0000
Add: Anonymous donations [to the extent not chargeable to tax @30% under section 115BBC(1)(i)] [See Note 1 & 2 below]		<u>1.2500</u>
		369.2500
Less: 15% of income eligible for being set apart without any condition ⁵		<u>55.3875</u>
		313.8625
Less: Amount applied for charitable purposes		
On revenue account – For Hospital (Depreciation in respect of hospital equipment of ₹ 5 lakhs, would not be allowed, since the same had been claimed as application of income in the earlier years)	85.00	
Amount applied for the purpose of hospital including ₹ 10 lakhs paid towards repayment of loan taken earlier for construction of hospital allowable as application of income	90.00	
Corpus donation to a trust registered under section 10(23C) is allowable	<u>3.00</u>	<u>178.0000</u>
		135.8625
Less: 85% of the amount of ₹ 4 lakhs received on 31.3.2020 would be deemed to be applied by virtue of Clause 2 of Explanation 2 below to Section 11(1) [See Note 3 below]		<u>3.4000</u>
Total income [other than anonymous donation taxable@30% under section 115BBC(1)(i)]		132.4625
Add: Anonymous donation taxable @30% u/s 115BBC(1)(i) [See Note 1 & 2 below]		<u>3.7500</u>
Total Income of the trust (including anonymous donation taxable@30%)		136.2125

⁵ 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).

Notes:

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

- ₹ 1.25 lakh, being 5% of the total donations received i.e., 5% of ₹ 25 lakhs [Voluntary contributions including Corpus donations ₹ 2 lakhs (+) Anonymous donations ₹ 5 lakhs]; or
- ₹ 1 lakh

Therefore, anonymous donations of ₹ 3.75 lakh (₹ 5 lakh – ₹ 1.25 lakh) would be subject to tax @30% under section 115BBC(1)(i).

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

- (2) As per the plain reading of section 13(7), it appears 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 ₹ 1.25 lakhs should not be added to ₹ 368 lakhs for 15% unconditional exemption. The total income would, accordingly, change.
- (3) Gross receipts include a sum of ₹ 4 lakhs which is received on 31.3.2020. Since the amount has been received during the previous year 2019-20, such sum has to be included in the gross receipts for the purpose of computing 15% unconditional exemption. However, since such sum cannot be applied during the previous year on account of being received on the last day of the previous year, 85% of such amount i.e., ₹ 3.4 lakhs, is deemed to be applied for the purpose of the trust by virtue of *Clause 2 of Explanation 2 below* to section 11(1) in the above solution. However, in the Income-tax Form ITR-7, the amount deemed to have been applied during the previous year as per *clause (2) of Explanation* to section 11(1) has been considered as application. In such case, entire income of 4 lakhs would be deemed as application. The total income would, accordingly, change.
- (b) Since Ms. Indu is resident in India for the P.Y.2019-20, her global income would be subject to tax in India. Therefore, income earned by her in Country 1 & 2 would be taxable in India. She would, however, be entitled to deduction under section 91, since India does not have a DTAA with Country 1 & 2, and all conditions under section 91 are satisfied.

Computation of total income of Ms. Indu for A.Y.2020-21

Particulars	₹	₹
Profits and Gains of Business or Profession		
Income from dance shows in India		7,20,000
Income from dance shows in Country 1		5,40,000
Royalty from literary work from Country 2	2,75,000	

Less: Expenses incurred	<u>50,000</u>	2,25,000
Income from Other Sources		
Interest on fixed deposits		<u>50,000</u>
Gross Total Income		15,35,000
Less: Deduction under Chapter VI-A		
Under section 80C – Deposits in PPF	1,50,000	
Under section 80CCC – Contribution to pension fund of LIC	<u>32,000</u>	
	1,82,000	
Restricted to ₹ 1,50,000 by virtue of section 80CCE	1,50,000	
Under section 80QQB – Royalty income of a resident from literary work ⁶ to the extent of ₹ 3,00,000.	2,25,000	
Under section 80TTB – Deduction allowable in respect of interest on fixed deposits, since Ms. Indu is a senior citizen resident in India	<u>50,000</u>	4,25,000
Total Income		11,10,000

Computation of tax liability of Ms. Indu for A.Y.2020-21

Particulars	₹
Tax on total income [30% of ₹ 1,10,000 + ₹ 1,10,000, eligible for higher exemption limit of ₹ 3,00,000, since she is a senior citizen]	1,43,000
Add: Health and education cess @4%	<u>5,720</u>
	1,48,720
Less: Rebate under section 91 (See Working Note below)	<u>72,350</u>
Tax Payable	76,370
Working Note:	
Calculation of Rebate under section 91:	₹
Average rate of tax in India [i.e., ₹ 1,48,720 / ₹ 11,10,000 x 100]	13.398%
Average rate of tax in Country 1	15%
Doubly taxed income pertaining to Country 1	₹
Income from dance shows	5,40,000

⁶ It is assumed that the royalty earned outside India has been brought into India in convertible foreign exchange within a period of six months from the end of the previous year.

Rebate under section 91 on ₹ 5,40,000 @13.398% [being the lower of average Indian tax rate (13.398%) and Country 1 tax rate (15%)]		72,350
Average rate of tax in Country 2	20%	
Doubly taxed income pertaining to Country 2		
Royalty (₹ 2,75,000 – ₹ 50,000 – ₹ 2,25,000)	Nil	
Since there is no doubly taxed income from Country 2, rebate under section 91 would also be Nil		Nil
Total rebate under section 91 (Country 1 + Country 2)		72,350

Question 4

(a) Decide whether TDS provisions are attracted in the following:

- (i) Krunal & Co LLP withdrew from its bank account ₹ 70 lakhs by cash up to 31.08.2019 and ₹ 55 lakhs from 01-09-2019 to 31-03-2020. The purpose of withdrawal from bank was for buying agricultural produce, from farmers/agriculturists, being raw material required for manufacture for finished products by it.
- (ii) Interest of ₹ 82,000 on Capital Gains Bond issued by Power Finance Corporation Ltd. to Mr. Ajay (aged 47), a non-resident individual. **(2 x 2 = 4 Marks)**

(b) The tax assessment of Mr. Bimal was completed on 20-12-2019 and the tax due was determined as ₹ 105 lakhs. The assessee has the following (i) Bank fixed deposit with SBI ₹ 20 lakhs; (ii) Receivable from Sunder & Co Ltd ₹ 25 lakhs. He gifted a land to his son (aged 38 years) 3 years ago whose present market value is ₹ 22 lakhs. He gifted a diamond necklace to his son's wife evidenced by a gift deed dated 05.10.2016. He owns a residential apartment in London acquired 13 years ago.

Discuss against which of the movable/immovable property the Tax Recovery Officer can proceed against for recovery of tax. **(4 Marks)**

(c) State with brief reasons, which method of determination of ALP will be most appropriate in the following cases:

- (i) A Co. Ltd., Mumbai is engaged in manufacture of garments. It manufactured and supplied as per the variation and customization in finishing of products to its associated enterprises Xylo Inc. UK as compared to the goods regularly sold to third parties.
- (ii) DEF Co. Ltd., is engaged in manufacture of medicines. It manufactured semi-finished drugs in bulk and sold to related parties located in India and outside India. It adds gross profit mark up on direct and indirect costs of production.
- (iii) ZY Ltd., Bengaluru provided identical call centre services to both related and unrelated parties. **(3 x 2 = 6 Marks)**

Answer

- (a) (i) Section 194N, provides that every person, including, *inter alia*, a banking company, who is responsible for paying, in cash, any sum or aggregate of sums exceeding ₹ 1 crore during the previous year to any person from one or more accounts maintained by such recipient-person with it, shall deduct tax at source @2% of sum exceeding ₹ 1 crore.

In the present case, M/s Krunal & Co. LLP has withdrawn ₹ 70,00,000 in cash upto 31.08.2019 and ₹ 55,00,000 from 1.9.2019 to 31.03.2020, which is totalling to ₹ 1.25 crores in aggregate during the previous year 2019-20. Since aggregate amount of cash withdrawals exceed ₹ 1 crore, bank is required deducted tax at source on the amount exceeding ₹ 1 crore i.e., ₹ 25 lakhs though he withdraws the same for buying agricultural produce from farmers, agriculturists, being raw material required for manufacture of finished products by it.

Though this provision is with effect from 1.9.2019, for considering the threshold of ₹ 1 crore, the withdrawals for the entire P.Y.2019-20 have to be taken into account.

- (ii) Any person responsible for paying interest (other than interest referred to in section 194LB or section 194LC or section 194LD) or any other sum chargeable to tax (other than salaries) to a non-corporate non-resident or to a foreign company is liable to deduct tax at source at the rates prescribed by the relevant Finance Act under section 195.

Since interest of ₹ 82,000 on Capital Gains Bond issued by Power Finance Corporation Ltd. is taxable in the hands of Mr. Ajay, being a non-resident, the provisions for tax deduction at source under section 195 are attracted in this case.

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

The assessee's movable or immovable property shall include any property which has been transferred, directly or indirectly by the assessee to his spouse or minor child or son's wife or son's minor child, otherwise than for adequate consideration, and which is held by, or stands in the name of any of the persons aforesaid.

In the present case, Mr. Bimal had transferred his land 3 years ago to his son who was 35 years old at that time. He also gifted a diamond necklace to his son's wife on 5.10.2016. He also has bank fixed deposits, receivables from Sunder & Co. Ltd. and residential apartment in London.

The Tax Recovery Officer can proceed to recover the tax by attaching -

- (i) bank fixed deposits,

- (ii) receivables from Sunder & Co. Ltd;
- (iii) residential apartment in London.

He can also proceed to recover the tax by attaching the diamond necklace gifted to his son's wife.

However, he cannot proceed to recover the tax by attaching the land which he transferred to his son, since at the time of transfer, his son was major.

- (c) (i) A Co. Ltd, Mumbai has manufactured and supplied garments as per the variations and customization in accordance with its AE. However, such customization is not carried by it on the goods sold to other unrelated parties.
- In cases of contract manufacturing transactions with AEs, the most appropriate method is the Transactional Net Margin Method (TNMM).
- (ii) DEF Co. Ltd. manufactures semi-finished drugs in bulk and sells them to related parties. In the case of sale of semi-finished goods to related parties, the most appropriate method is the Cost Plus Method, in which adjustment of gross profit mark-up is to be made on the direct and indirect costs of production.
- (iii) ZY Ltd., Bengaluru provided identical call centre services to both related and unrelated parties. In respect of provision of services, the most appropriate method can be either the Comparable Uncontrolled Price (CUP) or Cost Plus Method (CPM) and Transactional Net Margin method (TNMM), since in all these three methods there are similar transactions with related parties and unrelated parties; and adjustments are made for functional differences.

Question 5

- (a) *Aditya Co. Ltd. is engaged in manufacturing activity. The machineries owned by it have become old and obsolete. The company wants to know whether to replace machineries by borrowing loan (or) buy the finished goods from open market and sell in its brand name. Relevant details are as under:*

Cost of machinery if acquired ₹ 500 lakhs. The company has own funds of ₹ 200 lakhs and would borrow ₹ 300 lakhs from bank @ 9% per annum interest to buy the machinery. The sales would be ₹ 2500 lakhs with net profit of 15% before tax.

In case, the assessee decided to buy and sell the goods, the margin of profit would be 5%. The funds so retained would earn interest income of 9% per annum.

Note: *Ignore other commercial considerations and GST input tax credit. Assume tax rate @ 30% (ignore Surcharge and Cess).*

Advise the company suitably supporting your views.

(4 Marks)

- (b) *The assessment of R & Sons HUF was completed u/s 143(3) of the Income-tax Act 1961 with an addition of income of ₹ 7 Lakh to the returned income. The assessee contends that the order of the assessment is bad in law as no notice was issued u/s 143(2) even*

though the assessee had participated in the assessment proceedings. The Assessing Officer, relying on section 292BB, contends that when assessee has participated in assessment proceedings, now he cannot raise any objection on the assessment order.

Examine the validity of the contentions of both and give your opinion on who is correct.

OR

What do you understand by the term 'Legal Representative'? Write a short note on the assessment on legal representative. **(4 Marks)**

- (c) XYZ Ltd., an Indian company, to expand its overseas sales/exports, launched a massive advertisement campaign of its products. For the purpose of online advertisement, it utilized the services of MNO Inc., a London based company and JKL Inc., an Australian company. MNO Inc. has a permanent establishment in India, and the service is effectively connected to the permanent establishment in India. JKL Inc. has no permanent establishment in India. During the previous year 2019-20, XYZ Ltd. paid ₹ 3 lakhs to MNO Inc. and ₹ 2 lakhs to JKL Inc. for such services.

Discuss the tax implications/TDS implications of such payment and receipt in the hands of XYZ Ltd., MNO Inc. and JKL Inc. **(6 Marks)**

Answer

(a)

Particulars	Option 1	Option 2
	Own manufacture	Buy and Sell
	₹ in lakhs	₹ in lakhs
Profit on sale of ₹ 2500 lakhs @ 15% and 5%	375.00	125.00
Interest on bank deposit ₹ 200 lakhs @ 9%	-	18.00
EBT	375.00	143.00
Tax thereon @ 30%	112.50	42.90
Profit after tax	262.50	100.10
Add: Depreciation being non-cash charge	175.00	-
Depreciation @15% on ₹ 500 lakhs = ₹ 75 lakhs		
Additional depreciation @20% on ₹ 500 lakhs = ₹ 100 lakhs		
Cash/liquid profit	437.50	100.10

Conclusion: Based on the cash/liquid profit, it is advisable to replace machinery and manufacture than buy finished goods from open market and sell in its brand name.

(b) Section 292BB provides that where the assessee has participated in the proceedings, any notice which is required to be served upon him shall be deemed to have been duly served and the assessee would be precluded from taking any objection that the notice was -

- (a) not served upon him; or
- (b) not served upon him in time; or
- (c) served upon him in an improper manner.

Issue of notice under section 143(2) is mandatory for making a regular assessment under section 143(3).⁷ Section 292BB is a deeming provision that seeks to cure defects in any notice issued under any provision of the Income-tax Act, 1961, if the assessee has participated in the proceedings.

For section 292BB to apply, the notice must have emanated from the Department. It is only the infirmities in the manner of service of notice that the section seeks to cure. The section is not intended to cure the complete absence of notice itself.

Accordingly, non-issuance of notice under section 143(2) is not a curable defect under section 292BB in spite of participation by the assessee in assessment proceedings.

In the present case, since the assessment of R & Sons HUF was completed u/s 143(3) without issuing notice u/s 143(2), the assessment is bad in law and not a curable defect u/s 292BB. Therefore, the contention of R & Sons HUF, is valid and the contention of the Assessing Officer is not valid in spite of the fact that R & Sons HUF participated in the assessment proceedings.

OR

As per section 2(29), "Legal representative" means a person who in law represents the estate of a deceased person and includes any person who intermeddles with the estate of the deceased and where a party sues or is sued in a representative character, the person on whom the estate devolves on the death of the party so suing or sued.

As per section 159, the legal representative of the deceased shall, for the purposes of this Act, be deemed to be an assessee.

For the purpose of making an assessment and for the purpose of levying any sum in the hands of the legal representative –

- (a) any proceeding taken against the deceased before his death shall be deemed to have been taken against the legal representative and
- (b) may be continued against the legal representative from that stage at which it stood on the date of the death of the deceased;

⁷ Supreme Court in *CIT v. Laxman Das Khandelwal* (2019) 417 ITR 325.

- (c) any proceedings which could have been taken against the deceased if he had survived, may be taken against the legal representative; and
- (d) all the provisions of the Income-tax Act, 1961 would apply accordingly.

(c) On payment to MNO Inc.

Equalisation levy would not be attracted where the non-resident service provider (MNO Inc., in this case) has a permanent establishment in India and the service is effectively connected to the permanent establishment in India. Therefore, the XYZ Ltd. is not required to deduct equalisation levy on ₹ 3 lakhs, being the amount paid towards online advertisement services to MNO Inc, in this case.

However, tax has to be deducted by XYZ Ltd. at the rates in force under section 195 in respect of such payment to MNO Inc. Non-deduction of tax at source under section 195 would attract disallowance under section 40(a)(i) of 100% of the amount paid while computing business income.

MNO Inc. is chargeable to income-tax in respect of ₹ 3 lakhs received from XYZ Ltd. @40% and it can claim credit of tax deducted at source by XYZ Ltd.

On payment to JKL Inc.

Equalisation levy of 6% is attracted in respect of the amount of consideration for, *inter alia*, online advertisement, received or receivable by a non-resident not having permanent establishment in India, from, *inter alia*, a resident in India, if such consideration exceeds ₹ 1 lakh.

In this case, XYZ Ltd. is required to deduct equalisation levy of ₹ 12,000 i.e., @6% of ₹ 2 lakhs, being the amount paid towards online advertisement services provided by JKL 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.

Section 10(50) provides that any income arising from providing any specified service on or after the date on which the provisions of Chapter VIII of the Finance Act, 2016 comes into force, and chargeable to equalisation levy under that Chapter would be exempt from income-tax. Therefore, ₹ 2 lakh is exempt from income-tax in the hands of JKL Inc.

Question 6

- (a) *Assessing Officer came to know from the Investigation Wing of the Income-tax Department on 20-03-2020 that Mr. David has not disclosed acquisition of vacant land for ₹ 5 lakhs on 15-05-2014 in the books of account maintained by him for his business. What is the time limit for issuing notice under section 148? Should the Assessing Officer take prior approval of any superior income tax authority before issuing such notice? In case, Mr. David is agent of non-resident and the transaction of purchase of vacant land had occurred in the previous year 2009-10, what would be your answer? (4 Marks)*

- (b) A discretionary trust is liable to tax at the maximum marginal rate of income tax on their entire income [Section 164(1)]. Discuss the exceptions to the above statement. **(4 Marks)**
- (c) M/s. Universe Ltd. is a domestic company. Its turnover for the Previous Year 2017-18 was ₹ 300 crores. The following are the particulars furnished for the Assessment Year 2020-21:

Particulars	Income (₹)
As per Return of Income filed under section 139(1)	(8,00,000)
Determined under section 143(1)(a)	(4,00,000)
Assessed under section 143(3)	(70,000)
Reassessed under section 147	3,00,000

Can penalty be levied u/s 270A on M/s Universe Ltd.? If yes, compute the penalty leviable u/s 270A, if

- (i) under-reported income is not on account of mis-reporting.
- (ii) under-reported income is on account of mis-reporting. **(6 Marks)**

Answer

- (a) As per section 149(1), where the income which has escaped assessment amounts to or is likely to amount to ₹ 1 lakh or more, notice under section 148 has to be issued within 6 years from the end of the relevant assessment year. In such cases, notice can be issued by the Assessing Officer only with the approval of Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner.

In the present case, Mr. David has not disclosed the vacant land acquired on 15.5.2014 i.e., in P.Y. 2014-15 relevant to A.Y. 2015-16 in the books maintained by him for his business. Since income escaping assessment exceeds ₹ 1 lakh, notice can be issued within 6 years from the end of relevant assessment year. In this case, the 6 year time limit would expire on 31.3.2022.

The Assessing Officer can issue notice to Mr. David with the approval of Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner.

As per section 149(3), if the person on whom a notice under section 148 is to be served is a person treated as an agent of a non-resident under section 163 and the assessment, reassessment or re-computation in pursuance of the notice is to be made on him as the agent of such non-resident, the time limit is 6 years from the end of the relevant assessment year, beyond which such notice cannot be issued.

In case Mr. David is agent of non-resident and the transaction of purchase of vacant land had occurred in the P.Y. 2009-10, notice under section 148 cannot be issued since the six year time limit from the end of A.Y. 2010-11 had expired on 31.3.2017.

- (b) A discretionary trust will be liable to tax at the maximum marginal rate of income-tax on its entire income. Certain exceptions have been specified where the trust would not be taxed at the maximum marginal rate. The exceptions are as under:
- (1) Where none of the beneficiaries has any other income chargeable to tax exceeding the maximum amount not chargeable to income-tax in the case of an AOP and none of the beneficiaries is a beneficiary under any other trust; or
 - (2) Where the relevant income or part thereof is receivable under a trust declared by any person by a will and such trust is the only trust so declared by him; or
 - (3) Where the relevant income or part thereof is receivable under a trust created prior to 1.3.1970 by a non-testamentary instrument if the Assessing Officer is satisfied that the trust was so created *bona fide* exclusively for benefit of the relatives of settlor or where the settlor is a H.U.F. for the benefit of the members of such families in circumstances where such relatives or members are mainly dependent on the settlor for their support and maintenance; or
 - (4) In cases where the relevant income is receivable by the trustee on behalf of provident fund, superannuation fund, gratuity fund, pension fund or any other fund created bona fide by a person carrying on a business or profession exclusively for the benefit of persons employed in such business or profession.

In the above four cases the income of the trustees will not be taxed at the marginal rate but at the rate applicable to the total income of an association of persons.

- (c) M/s Universe Ltd. is deemed to have under-reported its income since:
- (1) the assessment u/s 143(3) has the effect of reducing the loss determined in a return processed u/s 143(1)(a); and
 - (2) the reassessment u/s 147 has the effect of converting the loss assessed u/s 143(3) into income.

Therefore, penalty is leviable under section 270A for under-reporting of income.

The applicable rate of tax for Universe Ltd., a domestic company, for A.Y.2020-21 is 25%, since its turnover for the P.Y.2017-18 does not exceed ₹ 400 crores

- (i) **Computation of penalty leviable under section 270A if under-reported income is not on account misreporting**

Particulars	₹	₹
<u>Assessment under section 143(3)</u>		
<u>Under-reported income:</u>		
Loss assessed u/s 143(3)	(70,000)	
(-) Loss determined under section 143(1)(a)	<u>(4,00,000)</u>	
	<u>3,30,000</u>	
Tax payable on under-reported income @25%	82,500	

Add: HEC@4%	<u>3,300</u>	
	<u>85,800</u>	
Penalty leviable @50% of tax payable		42,900
<u>Reassessment under section 147</u>		
<u>Under-reported income:</u>		
Total income reassessed under section 147	3,00,000	
(-) Loss assessed under section 143(3)	<u>(70,000)</u>	
	<u>3,70,000</u>	
Tax payable on under-reported income @25%	92,500	
Add: HEC @4%	<u>3,700</u>	
	96,200	
Penalty leviable@50% of tax payable		48,100

- (ii) **Computation of penalty leviable under section 270A if under-reported income is on account misreporting:** Where under reporting of income results from misreporting of income by any person, penalty would be leviable @200% of tax payable on such under-reported income. Thus, in such case penalty would be -

Particulars	₹	₹
<u>Assessment under section 143(3)</u>		
Tax payable on unreported income [computed in (i) above]	85,800	
Penalty leviable @200% of tax payable		1,71,600
<u>Reassessment under section 147</u>		
Tax payable on under-reported income [computed in (i) above]	96,200	
Penalty leviable @200% of tax payable		1,92,400