

## PAPER – 7: DIRECT TAX LAWS & INTERNATIONAL TAXATION

### Part - II

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 2019-20, unless stated otherwise in the question.

#### Question 1

Sankar Ltd, engaged in the manufacture of footwear and leather products, for the past 8 years, reported a net profit of ₹ 272 lakhs as per the statement of profit and loss for the year ended 31st March, 2019. The company was subject to tax audit under section 44AB of the Income-tax Act, 1961. The net profit is arrived at after debiting or crediting the following amounts:

- (i) Depreciation charged on the basis of useful life of assets as per Companies Act is ₹ 32 lakhs.
- (ii) A sundry creditor whose amount of ₹ 32 lakhs was outstanding since long time, has been settled for ₹ 26 lakhs on 31st March, 2019 based on compromise settlement. The amount waived has been credited to the statement of profit and loss.
- (iii) Employers' contribution to EPF of ₹ 3 lakhs for the month of March, 2019 was deposited on 29th July, 2019.
- (iv) Interest payments debited ₹ 30 lakhs (Includes interest on term loan of ₹ 25 lakhs availed on 1-4-2018 at interest rate of 12% p.a towards purchase of machinery during the year).
- (v) Payment of ₹ 30 lakhs to A & Co., a subcontractor, for processing raw leather without deduction of tax is debited to statement of profit & loss. This amount includes ₹ 20 lakhs for purchase of chemicals and ₹ 10 lakhs towards labour charges which is separately shown in bills submitted.

#### Additional Information:

- (1) The company has not made provision for an amount of ₹ 12 lakhs being a fair estimate of the amount as payable to workers towards periodical wage revision once in 3 years in respect of existing employees. The provision is estimated on a reasonable certainty of the revision once in 3 years.

The Suggested Answers for Paper 7:- Direct Tax Laws and International Taxation are based on the provisions of direct tax laws as amended by the Finance Act, 2018, which is relevant for May, 2019 examination. The relevant assessment year is A.Y.2019-20.

- (2) The written down values of assets before allowing depreciation as per Income-tax Rules are as under:

Factory Buildings:	₹ 180 lakhs;
Plant & Machinery	₹ 170 lakhs (inclusive of ₹ 30 lakhs of machinery acquired on 1.11.2018 and put to use)
Computers:	₹ 15 lakhs

It may be noted that the above values have been duly recognised while providing depreciation in the books of accounts.

- (3) During the year 2018-19, the company has employed 24 additional employees (qualified as "workman" under the Industrial Disputes Act, 1947). All these employees contribute to a recognized provident fund. 12 out of 24 employees joined on 1.6.2018 on a salary of ₹ 23,000 per month, 4 joined on 1.7.2018 on a salary of ₹ 26,000 per month, and 8 joined on 1.11.2018 on a salary of ₹ 20,000 per month. The salaries of 2 employees who joined on 1.6.2018 are being settled by bearer cheques every month.
- (4) Sales includes 5000 leather bags sold to M/s Sankar (firm), a related party, at a price of ₹ 1,000 each. The selling price to others in the market is at ₹ 1,300 each.
- (5) Employees contribution to EPF of ₹ 3 lakhs recovered from their salaries for the month of March 2019 and shown in the Balance Sheet under the head Sundry Creditors was remitted on 31<sup>st</sup> May, 2019.

Compute the total income and tax payable of Sankar Ltd. for the Assessment Year 2019-20. The turnover of the company for the year ended 31.3.2017 was ₹ 52 crores. Ignore the provisions of MAT. **(14 Marks)**

**Answer**

**Computation of Total Income of Sankar Ltd. for the A.Y. 2019-20**

Particulars		Amount (₹)	
	Net profit as per the statement of profit and loss		2,72,00,000
	<b>Add: Items debited but to be considered separately or to be disallowed</b>		
(i)	Depreciation charged as per Companies Act, 2013	32,00,000	
(iii)	<b>Employer's contribution to EPF</b>	Nil	
	[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) i.e., 30.9.2019. Since the same has been debited to statement of profit and loss, no further adjustment is necessary]		

<p>(iv) <b>Interest on term loan for purchase of plant and machinery</b> [₹ 25 lakhs x 12% x 7/12]  [As per the proviso to section 36(1)(iii), interest paid in respect of capital borrowed for acquisition of an asset for the period from the date of borrowing till the date on which such asset is first put to use shall not be allowed as deduction. Since the same has been debited to statement of profit and loss, it has to be added back while computing business income]</p>	1,75,000	
<p>(v) <b>Payment of labour charges to A &amp; Co., a sub-contractor, without deduction of tax</b> [30% of ₹ 10 lakh]  [Under section 40(a)(ia), 30% of any sum paid to any resident on which tax is deductible is disallowed if tax is not deducted at source. In this case, TDS provisions under section 194C are attracted on labour charges which are shown separately in the bills. Since tax has not been deducted on labour charges, 30% of the expenditure shall be disallowed]</p>	3,00,000	36,75,000
<p><b>Add: Amount taxable but not credited to profit and loss account</b></p>		3,08,75,000
<p><b>AI(4) Sale of leather bag at a price lower than the fair market value</b> [₹ 300 x 5,000]  [The difference between the sale price (₹ 1,000 per leather bag) and the fair market value (₹ 1,300 per leather bag) multiplied by the quantity sold (5000 leather bags) has to be added since the sale is to a related party at a price lower than the fair market value]</p>	15,00,000	
<p><b>AI(5) Employee's contribution to EPF</b>  [Any sum received by the assessee from his employees as contribution to any provident fund is treated as income of the assessee. Since employees contribution to EPF has not been deposited on or before the due date under the PF Act, the same is not allowable as deduction as per section 36(1)(va)<sup>1</sup>.]</p>	3,00,000	<u>18,00,000</u>

<sup>1</sup> Employee contribution to PF deposited after the due date under PF Act is not allowable as deduction as per section 36(1)(va). This view has been affirmed by the Gujarat High Court in *CIT v. Gujarat State Road Transport Corporation (2014) 366 ITR 170*. Alternate view that the same is allowable as deduction if deposited on or before the due date of filing of return is possible as per the Delhi High Court ruling in *CIT v. AIMIL (2010) 321 ITR 508* and the Uttarakhand High Court ruling in the case of *CIT v. Kichha Sugar Co. Ltd. (2013) 356 ITR 151*.

			3,26,75,000
	<b>Less: Items credited to statement of profit and loss, but not includible in business income / permissible expenditure and allowances</b>		
	<b>(ii) Waiver of sundry creditor's outstanding amount</b> [Waiver of ₹ 6,00,000 from the sundry creditors is a benefit in respect of a trading-liability by way of remission or cessation thereof and is, hence, taxable under section 41(1). Since the amount is already credited to statement of profit & loss, no adjustment is necessary]	Nil	
	<b>AI (1) Provision for wages payable to workers</b> [The provision based on fair estimate of wages and reasonable certainty of revision is allowable as deduction, since ICDS X requires 'reasonable certainty' for recognition of a provision, which is present in this case. As the provision has not been debited to statement to profit and loss, the same has to be reduced while computing business income]		
		<u>12,00,000</u>	<u>12,00,000</u>
			<b>3,14,75,000</b>
	<b>Less: Depreciation as per Income-tax Rules, 1962</b>		
	<b>A(2) Depreciation under section 32</b>		
	Depreciation on factory building [10% of ₹180 lakh]	18,00,000	
	Depreciation on plant and machinery		
	- Depreciation@7.5% on ₹ 31.75 lakhs [₹ 30 lakh, being machinery cost + ₹ 1.75 lakh, being interest from 1.4.2018 to 31.10.2018] since machinery is put to use for less than 180 days].	2,38,125	
	- Depreciation@15% on ₹ 140 lakh [₹ 170 lakh – ₹ 30 lakh]	21,00,000	
	- Depreciation on computers [40% of ₹ 15 lakh]	<u>6,00,000</u>	
		47,38,125	
	<b>Add: Additional depreciation @10% on ₹ 31.75 lakh, since machinery is put to use for less than 180 days</b>	<u>3,17,500</u>	
			50,55,625

<b>Gross Total Income</b>	<b>2,64,19,375</b>
<b>Less: Deduction under Chapter VI-A</b>	
Under section 80JJAA [See Working Note below]	9,30,000
<b>Total Income</b>	<b>2,54,89,375</b>
<b>Total Income (Rounded off)</b>	<b>2,54,89,380</b>

**Computation of tax payable by Sankar Ltd. for the A.Y. 2019-20**

	₹
Tax payable on ₹ 2,54,89,380@25%, since the turnover of the company for the P.Y. 2016-17 does not exceed ₹ 250 crores	63,72,345
Add: Surcharge@7% (since the total income of the company exceeds ₹ 1 crore but does not exceed ₹ 10 crore)	4,46,064
	68,18,409
Add: Health and education cess@4%	2,72,736
<b>Tax liability</b>	<b>70,91,145</b>
<b>Tax liability (Rounded off)</b>	<b>70,91,150</b>

**Working Note:**

**Computation of deduction under section 80JJAA**

Sankar Ltd. is eligible for deduction under section 80JJAA since the company is subject to tax audit under section 44AB for A.Y.2019-20 and has employed "additional employees" during the P.Y.2018-19.

**Number of additional employees**

Total number of employees employed during the year	24
<b>Less:</b> Employees employed on 1.7.2018, since their total monthly emoluments exceed ₹ 25,000	4
Employees employed on 1.6.2018 whose emoluments are paid by bearer cheque	<u>2</u>
<b>Number of additional employees [10 employees employed on 1.6.2018 and 8 employed on 1.11.2018]</b>	<b><u>18</u></b>
Additional employee cost	₹ 31,00,000
₹ 23 lakh, being ₹ 23,000 × 10 × 10 + ₹ 8 lakh, being ₹ 20,000 × 5 × 8	
Deduction under section 80JJAA [30% of ₹ 31 lakh]	9,30,000

**Question 2**

(a) Alpha and Beta Tyres Limited, an Indian Company engaged in the manufacture of Tyres in Andhra Pradesh, has adopted IndAS from 1-4-2016. The following particulars are provided for the year ended 31.3.2019 :

1. Net profit as per statement of profit and loss is ₹ 20 crores after debit and credit of the following items:

**Items Debited:**

- (i) Depreciation ₹ 18 crores. Included in depreciation is ₹ 3 crores, being amount provided on revalued assets.
- (ii) Interest charged for delay in remittance of tax deducted at source ₹ 20 lakhs.

**Items Credited:**

- (i) Share Income from Association of Persons in which the company is a member ₹ 50 lakhs. (The AOP is charged to tax at Maximum Marginal Rate)
- (ii) Amount of ₹ 6 crores withdrawn from revaluation reserves on account of revaluation of assets.

**Other Information:**

1. The application of a financial creditor for corporate insolvency resolution process has been admitted by the Hyderabad Bench of the National Company Law Tribunal under section 7 of the Insolvency and Bankruptcy Code, 2016.
2. Brought forward business loss and depreciation.

Assessment Year	Business Loss	Depreciation
2015-16	₹ 3 crores	₹ 1 crore
2016-17	₹ 5 crores	₹ 2 crores

3. Items credited to other comprehensive income which will not be reclassified to profit or loss:
    - (i) Re-measurement of defined employee retirement benefits plan ₹ 50 lakhs.
    - (ii) Revaluation surplus of property, plant and equipment ₹ 1 crore.
  4. The transition amount as on convergence date 1-4-2016 stood at ₹ 5 crores including capital reserve of ₹ 50 lakhs (credit balance).
  5. Tax payable under the regular provisions of the Income-tax Act, 1961 is ₹ 0.73 crores.
- (i) **Compute Minimum Alternate Tax payable by the company for the Assessment Year 2019-20.**
  - (ii) **Compute the amount of MAT credit eligible for carried forward. (8 Marks)**

(b) The following data is furnished by Mr. Sumedh, a non-resident and a person of Indian Origin, for the financial year ended 31-3-2019:

A:	Long-term capital gains arising on transfer of foreign exchange asset on 31.7.2018 (computed)	₹ 6,50,000
	Expenditure wholly and exclusively incurred in connection with such transfer (not considered above)	₹ 80,000
	Interest on deposits held with private limited companies	₹ 5,90,000
	Interest on Government Securities	₹ 95,000
	Interest on deposits with public limited companies	₹ 2,60,000
	Dividends from Domestic Companies	₹ 75,000
B:	Savings and Investments	
	Investment in notified savings certificates referred to in section 10(4B) on 30.3.2019	₹ 2,00,000
	Investment in shares of Indian public limited companies on 31.12.2019	₹ 3,00,000
C:	Tax deducted at source	₹ 1,83,000

Compute balance tax payable / refund due for the assessment year 2019-20 in accordance with special provisions applicable to non-residents. **(6 Marks)**

**Answer**

(a) (i) **Computation of MAT payable by Alpha and Beta Tyres Limited under section 115JB for A.Y.2019-20**

Particulars	₹	₹
Net profit as per statement of profit and loss		20,00,00,000
<b>Add: Net profit to be increased by the following amounts as per Explanation 1 to section 115JB(2):</b>		
- Depreciation	18,00,00,000	
- Interest charged for delay in remittance of TDS	20,00,000	
[As per Explanation 2 to section 115JB, income-tax shall include, <i>inter alia</i> , any interest charged under the Act. Therefore, interest on delay in remittance of TDS has to be added back]		18,20,00,000
		38,20,00,000
<b>Less: Net profit to be decreased by the following amounts as per Explanation 1 to section 115JB(2):</b>		
- Depreciation other than depreciation on revaluation of assets [₹ 18 crore – ₹ 3 crore]	15,00,00,000	

-	Share income from Association of Persons [Share income of company in AOP has to be reduced while computing the book profit, since no income-tax is payable by the company on share income in AOP, as the AOP is chargeable to tax at Maximum Marginal Rate]	50,00,000	
-	Amount withdrawn from revaluation reserve [₹ 6 crore] to the extent it does not exceed depreciation on revaluation of assets [₹ 3 crore]	3,00,00,000	
-	Brought forward business loss of ₹ 8 crore [₹ 3 crore + ₹ 5 crore] and unabsorbed depreciation of ₹ 3 crore [₹ 1 crore + ₹ 2 crore]  [Since Alpha and Beta Tyres Limited is a company against which an application for corporate insolvency resolution process has been admitted by NCLT under section 7 of the Insolvency and Bankruptcy Code, 2016, the amount of total loss brought forward (including unabsorbed depreciation) is allowed to be reduced from the book profit for the purposes of levy of MAT under section 115JB].	11,00,00,000	
			29,50,00,000
	<b>Book profit computed in accordance with Explanation 1 to section 115JB(2)</b>		8,70,00,000
	<b>Add: Items credited to OCI that will not be reclassified to profit or loss:</b>		
	Re-measurement of defined employee benefit plan	50,00,000	
	Revaluation surplus of property, plant and equipment ₹ 1 crore [Book profit not to be increased by revaluation surplus for assets]	Nil	
			50,00,000
			9,20,00,000
	<b>Add: One-fifth of Transition amount [Credit Balance]</b>		
	Transition amount	5,00,00,000	
	<b>Less: Amounts to be excluded from transition amount</b>		
	Capital Reserve	50,00,000	
		4,50,00,000	
	One-fifth of ₹ 4,50,00,000		90,00,000
	<b>Book Profit for levy of MAT</b>		<b>10,10,00,000</b>



Computation of MAT	₹
MAT on book profit under section 115JB = 18.5% of ₹ 10,10,00,000	1,86,85,000
Add: Surcharge@12% (since book profit exceeds ₹10 crore)	22,42,200
	2,09,27,200
Less: Marginal relief (See Working Note below)	1,32,200
	2,07,95,000
Add: Health and education cess@4%	8,31,800
MAT liability for A.Y.2019-20	<b>2,16,26,800</b>

**Working Note: Computation of marginal relief**

Particulars	₹
MAT on book profit (including surcharge) computed on total income of ₹ 10.10 crore	2,09,27,200
Less: Maximum tax (including surcharge) which can be levied on total income of ₹ 10.10 crore:	2,07,95,000
Tax (including surcharge@7%) on ₹ 10 crore	1,97,95,000
Add: Income exceeding ₹ 10 crore	<u>10,00,000</u>
	<u>2,07,95,000</u>
<b>Marginal relief</b>	<b>1,32,200</b>

**(ii) Computation of MAT credit to be carried forward**

Particulars	₹
MAT liability for A.Y.2019-20 (rounded off)	2,16,26,800
Income-tax computed as per the normal provisions of the Act for A.Y.2019-20	73,00,000
Since the income-tax liability computed as per the regular provisions of the Income-tax Act, 1961 is less than the MAT payable, the book profit of ₹ 10,10,00,000 would be deemed to be the total income and tax is leviable@18.5%. The total tax liability (rounded off) is ₹ 2,16,26,800.	
<b>Computation of tax credit to be carried forward:</b>	
Tax payable for A.Y.2019-20 on deemed total income	2,16,26,800
Less: Income-tax payable as per the normal provisions of the Act	73,00,000
<b>Tax credit in respect of tax paid on deemed income</b>	<b>1,43,26,800</b>

## (b) Computation of tax payable/refund due to Mr. Sumedh for A.Y.2019-20

Particulars	₹	₹
<b>Capital Gains</b>		
Long-term capital gains on transfer of foreign exchange asset on 31.7.2018	6,50,000	
Less: Expenditure wholly and exclusively incurred with such transfer	<u>80,000</u>	5,70,000
Less: <b>Exemption under section 115F</b>		
- Investment of ₹ 2,00,000 in notified saving certificates referred to in section 10(4B) on 30.3.2019 [Investment in notified saving certificates referred to in section 10(4B) is to be made within six months after the date of transfer i.e., on or before 31.1.2019. Since investment is made after 31.1.2019, no exemption would be allowed]	Nil	
- Investment of ₹ 3,00,000 in shares of Indian Public Limited Companies on 31.12.2019 [Investment in specified assets, being shares in an Indian company is to be made within six months after the date of transfer i.e., on or before 31.1.2019. Since investment is made after 31.1.2019, no exemption would be allowed]	Nil	Nil
		5,70,000
<b>Income from other sources</b>		
<b>Investment Income<sup>2</sup></b>		
Interest on Government Securities	95,000	
Interest on deposits with public limited companies	<u>2,60,000</u>	
		3,55,000
<b>Other Incomes</b>		
Dividend from domestic companies of ₹ 75,000 [Exempt under section 10(34)]	Nil	
Interest on deposits with private limited companies	<u>5,90,000</u>	
		9,45,000
<b>Total Income</b>		<b>15,15,000</b>

<sup>2</sup>It is assumed that purchase of Government Securities and deposit with public limited companies had been made in convertible foreign exchange.

Particulars	₹	₹
<b>Tax liability [applying the special provisions under Chapter XII-A]</b>		
Tax@20% on investment income = 20% of ₹ 3,55,000	71,000	
Tax@10% on long-term capital gains = 10% of ₹ 5,70,000	57,000	
Tax on balance income of ₹ 5,90,000 at slab rate [₹ 18,000, being 20% of ₹ 90,000 + ₹ 12,500]	<u>30,500</u>	
		1,58,500
Add: Health and education cess@4%		6,340
Tax liability		<b>1,64,840</b>
Less: TDS		1,83,800
<b>Refund due</b>		<b>18,960</b>

**Question 3**

- (a) *M/s Mahan Charitable Trust is running an Educational Institution with hostel facility for the orphan children. It is registered under section 12AA.*

*The details of income and expenditure of the Trust are as given below:*

- (a) *Voluntary contributions received during the year ₹ 150 lakhs.*  
*This includes:*
- Corpus donation ₹ 20 lakhs*
  - Donation of ₹ 20 lakhs from Mr. Michael, a foreign donor, which was received on 31-3-2019.*
- (b) *Salary paid to teachers and administrative staff ₹ 40 lakhs.*
- (c) *Other general expenses ₹ 10 lakhs include payment to grocery stores of ₹ 30,000 by crossed cheque.*
- (d) *A land belonging to the Trust in a nearby village which was purchased in the year 2013-14 for ₹ 5 lakhs was sold for ₹ 10.50 lakhs and another land adjacent to the Trust premises was purchased for ₹ 12 lakhs to be used as playground for the children.*
- (e) *Five laptops costing ₹ 50,000 each were purchased during the year for teaching purposes.*
- (f) *The Trust had accumulated ₹ 30 lakhs under section 11(2) in the financial year 2014-15 for constructing a school building. Amount spent for the said purpose till 31-3-2019 was ₹ 27 lakhs. The project is completed with a saving in project cost.*
- (g) *Two additional rooms measuring 1500 sq. ft each was constructed in the existing hostel for the children. Cost of construction is ₹ 1200 per sq. ft.*

(h) It made a corpus donation of ₹ 20 lakhs to a charitable trust registered u/s 12AA having similar objects.

Compute taxable income of Mahan Charitable Trust for the assessment year 2019-20. Support your answer with necessary working notes. **(8 Marks)**

(b) Beta Inc. having its business in Singapore has advanced a loan of SD 1,60,000 to Beta Ltd, Mumbai. Book value of total assets of Beta Ltd was ₹ 125 lakhs. Beta Ltd provides software backup support to Beta Inc. Beta Ltd has spent 50,000 manhour during the financial year 2018-19 for the services rendered to Beta Inc. The cost for Beta Ltd is SD 75 / manhour. Beta Ltd has billed Beta Inc. at SD 90.75 / manhour.

Gama Ltd. in Mumbai which has a similar business model, provides software backup support to Olive Inc. in Penang, Malaysia. Gama Ltd's cost and operating profits are as hereunder:

Particulars	INR in lakhs
Direct costs	600
Indirect costs	200
Operating profits	200

(1) Calculate Arm's Length Price for the transaction between Beta Ltd. and Beta Inc. based on the above data of Gama Ltd. using the Transactional Net Margin Method. Assume ISD = ₹ 45.

(2) Explain, if there is any adjustment to be made to the total income of Beta Ltd.

Note: SD = Singapore Dollars

**(6 Marks)**

### Answer

(a) **Computation of total income of M/s. Mahan Charitable Trust for the A.Y.2019-20**

Particulars	₹	₹
Voluntary contributions received during the year		1,50,00,000
Less: Corpus Donation		<u>20,00,000</u>
		1,30,00,000
Income from property held under trust [Capital Gains from sale of land (₹ 10.50 lakhs – ₹ 5 lakhs) <sup>3</sup> ]		<u>5,50,000</u>
		1,35,50,000
Less: 15% of income eligible for being set apart without any condition <sup>4</sup>		<u>20,32,500</u>

<sup>3</sup>Since the question does not specify the CILs, indexation has been ignored

<sup>4</sup>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, on the basis of the plain reading of section 11(1)(a), 15% of income [i.e., 15% of ₹ 85,80,000 (₹ 1,35,50,000 - ₹ 40,00,000 - ₹ 9,70,000)] would be eligible to be set apart.

		1,15,17,500
Less: Amount applied for charitable purposes		
Salary paid to teachers and administrative staff	40,00,000	
General expenses [₹ 10,00,000 – ₹ 30,000, payment by crossed cheque disallowed due to application of section 40A(3)]	9,70,000	
Capital gains re-invested in purchase of land for the purpose of the trust deemed to be applied for charitable purposes [₹ 10.50 lakhs – ₹ 5 lakhs]	5,50,000	
Excess of purchase price of new land over sale consideration of old land treated as application of income, since the new land is used for the purpose of the trust [₹ 12 lakhs – ₹ 10.50 lakhs]	1,50,000	
- Cost of laptops purchased for teaching purposes [₹ 50,000 x 5]	2,50,000	
- Cost of construction of hostel rooms [2 x ₹ 1200 x 1500 sq. ft]	36,00,000	
- Corpus donations of ₹ 20 lakhs to a trust registered u/s 12AA not permissible as deduction	<u>Nil</u>	
		<u>95,20,000</u>
		19,97,500
Amount accumulated for constructing a school building (₹ 30 lakhs) less amount actually spent (₹ 27 lakhs) taxable in the P.Y.2019-20 (A.Y.2020-21), being the year immediately succeeding the P.Y.2018-19 (A.Y.2019-20), the year in which project is completed		<u>Nil</u>
<b>Total income [See Note below]</b>		<b><u>19,97,500</u></b>
<p><b>Note</b> – If the trust exercises the option to apply the donations received (to the extent of ₹ 17.475 lakhs, being taxable portion of income of the trust i.e., ₹ 19,97,500 – ₹ 2,50,000, the basic exemption limit) from Mr. Michael on 31.3.2019 on or before the due date of filing of return u/s 139(1) in the prescribed form, the income would be deemed to have been applied for charitable purposes in the A.Y.2019-20. However, ₹ 17.475 lakhs should be applied before the end of the previous year 2019-20.</p>		

- (b) Two enterprises are deemed to be associated enterprises where one enterprise advances loan constituting not less than 51% of the book value of the total assets of the other enterprise.

In this case, since Beta Inc., a foreign company, has advanced loan to Beta Ltd., an Indian company, and such loan constitutes 57.6% [(₹ 45 x 1,60,000 x 100/1,25,00,000)] of

the book value of total assets of Beta Ltd., Beta Inc and Beta Ltd. are deemed to be associated enterprises.

Since the transaction of provision of software backup support by Beta Ltd. to Beta Inc. is an international transaction between associated enterprises the provisions of transfer pricing would be attracted in this case.

**Determination of Operating Margin of transaction of provision of software backup support. by Beta Ltd. to Beta Inc**

Particulars	₹
Billing per manhour [SD 90.75/hour x ₹45]	4,083.75
Cost per man hour [SD 75/hour x ₹45]	<u>3,375.00</u>
<b>Operating profit per manhour</b>	<b><u>708.75</u></b>
<b>Operating profits to cost (%) [708.75 x 100/3375] = 21%</b>	

**Determination of Operating Margin of Comparable Uncontrolled transaction i.e., provision of software backup support. by Gama Ltd. to Olive Inc**

Particulars	₹ in lakhs
Direct Cost	600
Indirect Cost	<u>200</u>
<b>Total cost</b>	<b><u>800</u></b>
Operating profits	200
<b>Operating profits to cost (%) [200 x 100/800] = 25%</b>	

(1) **Computation of Arm's Length Price of provision of software backup support provided by Beta Ltd. to Beta Inc. by applying TNMM**

Particulars	₹
Cost for Beta Ltd. (per man hour) [SD 75 x ₹ 45/SD]	3,375.00
Add: Arm's length operating profit margin as % of cost (25% of ₹ 3,375)	<u>843.75</u>
<b>Arm's length price (per manhour) in INR [See Note]</b>	<b><u>4,218.75</u></b>
Arm's length price of total manhours spent by Beta Ltd. for providing software backup support to Beta Inc. [₹ 4,218.75 x 50,000 man hours] = ₹ 21,09,37,500	

(2) **Adjustment to be made to the total income of Beta Ltd.**

Particulars	₹
Arm's length price of total manhours spent by Beta Ltd. for providing software backup support to Beta Inc.	21,09,37,500
Less: Amount actually billed [90.75 SD x ₹ 45/SD x 50,000 manhours]	<u>20,41,87,500</u>
<b>Arm's length adjustment to be made to the total income of Beta Ltd.</b>	<b><u>67,50,000</u></b>

**Question 4**

(a) Deer Co Ltd engaged in the business of manufacture of furniture items on contract basis. It sub-contracted the production of cushion for the chairs to M/s Lion & Co, a sole proprietary concern. The sub-contractor M/s. Lion & Co procured the raw materials for production of cushions, performed further labour works and supplied the same to Deer Co Ltd. It raised its bill on Deer Co Ltd, showing the cost of raw materials ₹ 4,00,000 and labour charges ₹ 1,50,000, separately. Explain briefly the tax deduction requirement in the hands of Deer Co Ltd. **(2 Marks)**

(b) M/s PMPC, a partnership firm, is engaged in the manufacture of cardboard carton boxes used in packaging industry. During the year, it has sold cutting waste generated amounting to ₹ 30 lakhs to M/s P APC Ltd, a paper manufacturing company. It uses such cutting waste purchased as raw material for its production.

Discuss the implication of this transaction with respect to tax collected at source. **(2 Marks)**

**(c) First Alternative**

Maha Bank Ltd accepted fixed deposits of ₹ 20 crores in the name of Registrar General of the High Court and issued a fixed deposit receipt in compliance with a direction passed by the court in relation to certain proceedings. The Bank did not deduct tax on the interest accrued. The Assessing Officer issued a notice to the bank to show cause as to why it should not be treated as an assessee in default under sections 201(1) and 201(1A) for not deducting tax at source on interest accrued. Examine whether the bank is correct in not deducting tax on the interest accrued. **(4 Marks)**

**Second Alternative**

"Blue Moon", a popular television channel, incurred the following expenses:

- (a) It paid ₹ 50 lakhs as prize money to the winner of a famous quiz programme "Who will be a Millionaire?"
- (b) It paid ₹ 6 lakhs to a cameraman for shooting multi-episodes of a long documentary serial.

Examine TDS obligations in the hands of television channel for the above said payments.

**(4 Marks)**

(d) ABC & Co, an Indian LLP, is solely engaged in the manufacture and export of engine, engine parts including cooling systems and engine valves. It had supplied auto components worth ₹ 72 crores during financial year 2018-19 to XYZ LLP, a foreign LLP located in Germany, controlled by A & B, the partners of Indian LLP along with their relatives. Against the aggregate value of transactions entered into as mentioned above, the Indian LLP incurred an operating expenditure of ₹ 60 crores leaving an operating profit of ₹ 4.50 crores.

- (i) Compute the primary adjustment required to be made in A.Y.2019-20, if any, assuming that the Indian LLP exercised a valid option for application of safe harbour rules prescribed under Rule 10TD read with section 92CB of the Income-tax Act, 1961.
- (ii) Examine the applicability of safe harbour rules, if the Foreign LLP is located in a Notified Jurisdictional Area. **(6 Marks)**

**Answer**

- (a) TDS under section 194C is attracted on any sum payable to a resident contractor/sub-contractor for carrying out any work. However, “work” shall not include manufacturing or supplying a product according to the requirement or specification of a customer by using raw material purchased from a person, other than such customer, as such a contract is a ‘contract for sale’.

In this case, M/s Lion & Co. has to supply cushion for the chairs to Deer Co Ltd., according to the specifications of the customer by using materials purchased from a person other than the customer, Deer Co Ltd. Thus, the sub-contract for production of cushions is a ‘contract for sale’ and **not** a ‘works contract’.

Consequently, there is no liability to deduct tax at source under section 194C in this case.

- (b) As per section 206C(1), a seller of, *inter alia*, scrap is required to collect tax@1% from the buyer. Scrap means waste and scrap from the manufacture or mechanical working of materials which is definitely not usable as such because of breakage, cutting up, wear and other reasons.

However, tax is not required to be collected at source if the resident buyer furnishes to the person responsible for collecting tax, a declaration in the prescribed form that such scrap is to be utilised for the purposes of, *inter alia*, manufacturing.

Thus, no tax is required to be collected at source by M/s.PMPC, the seller, on sale of scrap to M/s PAPC, if M/s. PAPC furnishes to M/s. PMPC, a declaration in the prescribed form that such scrap is to be utilised as raw material for production of paper.

- (c) **[First Alternative]**

The issue under consideration is whether the bank is required to deduct tax at source on the amount of interest paid or payable on fixed deposits in the name of Registrar General of High Court.

Under section 194A, the bank is obliged to deduct tax at source in respect of any credit or payment of interest (exceeding ₹ 10,000) on deposits made with it. The expression “payee” under section 194A would mean the recipient of income whose account is maintained by the person paying interest.

However, in this case, the actual payee is not ascertainable and the person in whose name the interest is credited is not a person liable to pay tax under the Act. The Registrar



General is recipient of neither the amount credited to his account nor to interest accruing thereon. Therefore, he cannot be considered as a 'payee' for the purposes of section 194A. In the absence of a payee, the machinery provisions for deduction of tax from interest credited become ineffective.

The credit by the bank in the name of the Registrar General would, thus, not attract the provisions of section 194A. Therefore, the bank is correct in not deducting tax on the interest accrued.

**Note** – This issue came up before the Delhi High Court in *UCO Bank v. Dy. CIT (2014) 369 ITR 335*. The above answer is based on the Delhi High Court ruling in the said case. The CBDT has, vide Circular No. 23/2015 dated 28.12.2015 accepted the aforesaid judgment and clarified that interest on fixed deposits made in the name of the Registrar General of the Court or the depositor of the fund on the directions of the Court, will not be subject to TDS till the matter is decided by the Court.

**(c) [Second Alternative]**

- (a) Under section 194B, the person responsible for paying by way of winnings from any card game and other game in an amount exceeding ₹ 10,000 shall, at the time of payment, deduct income-tax at 30%.

Therefore, Blue Moon, a popular television channel, is required deducted tax at source @30% from the prize money of ₹ 50 lakh at the time of payment to the winner of a famous quiz programme.

- (b) Section 194J requires deduction of tax at source @10% from the amount credited or paid by way of fees for professional services, where such amount or aggregate of such amounts credited or paid to a person exceeds ₹ 30,000 in a financial year.

"Blue Moon", a television channel is required to deduct tax at source @10% under section 194J at the time of credit or payment, whichever is earlier, on the professional fees payable to the cameraman for shooting multi-episodes of a long documentary serial, since such amount exceeds ₹ 30,000 during the financial year.

**Note** - Alternatively, if the cameraman is an employee of the T.V. Channel, the provisions of section 192 will apply at the time of payment and tax would have to be deducted at the average rate of tax.

- (d) (i) ABC & Co., an Indian LLP, and XYZ LLP, a foreign LLP, are deemed to be associated enterprises, since XYZ LLP is controlled by A & B, who are the partners of ABC & Co., along with their relatives.

Engine, engine parts including cooling systems and engine valves fall within the meaning of "core auto components", and hence, export of all such parts originally manufactured by ABC & Co. is an eligible international transaction.

Since the Indian LLP is solely engaged in the manufacture and export<sup>5</sup> of such parts and has exercised a valid option for Safe Harbour Rules, it is an eligible assessee.

The Indian LLP should have declared an operating profit margin of not less than 12% in relation to operating expense, to be covered within the Safe Harbour Rules.

However, since ABC & Co. an Indian LLP has declared an operating profit margin of only 7.5% ( $\text{₹ } 4.5/\text{₹ } 60 \text{ crore} \times 100$ ), the same is not in accordance with the circumstance mentioned in Rule 10TD.

Hence, ABC & Co., an Indian LLP, has to make primary adjustment.

Accordingly, it has to declare operating profits margin of ₹ 7.2 crore, being 12% of operating expenses i.e., ₹ 60 crore.

Thus, primary adjustment of ₹ 2.7 crore [i.e., ₹ 7.2 crore – ₹ 4.5 crore] has to be made by ABC & Co.

- (ii) The Safe Harbour Rules shall not apply in respect of eligible international transactions entered into with an associated enterprise located in a notified jurisdictional area.

Therefore, if the foreign LLP is located in a NJA, the Safe Harbour Rules shall not be applicable, irrespective of the operating profit margin declared by the assessee.

#### Question 5

- (a) *Mr. Harish, a resident of India, for the financial year ended on 31-3-2019, owned*

- (i) *a land in Canada purchased in September, 2003*  
 (ii) *a flat in New Jersey (USA) purchased in April 2004 and*  
 (iii) *a shop in a commercial complex in Finland purchased in June 2004.*

*He also has authority to operate a bank account (maintained with Citibank, London) of a company in which his son and daughter are 100% shareholders since April 2017.*

*He has been served with notices u/s 148 for the Assessment Years 2004-05 to Assessment Years 2018-19 based on the information that he has not disclosed source of income for those asset acquisitions in his income tax returns in India.*

*Are the notices issued u/s 148 tenable in law?*

**(4 Marks)**

- (b) *The Assessing Officer surveyed a popular cinema hall by name "Thriller" which is within his jurisdiction at 12 o' clock in the midnight for collecting information which may be useful for the purpose of Income-tax Act, 1961. The concerned cinema hall is kept open for business everyday between 9 p.m. and 1 a.m. The owner of the cinema hall claims that the A.O. could not enter his business premises after sunset and at late in the*

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<sup>5</sup> 90% or more (100% in this case) of total turnover of ABC & Co. an Indian LLP during the relevant previous year is in the nature of original equipment manufacturer sales.

midnight. The Assessing Officer wanted to take away with him the books of account kept at the premises of the cinema hall. Examine the validity of the claim made by the owner of cinema hall and the proposed action of the Assessing Officer. **(4 Marks)**

- (c) Balmart Inc. of USA entered into the contract with three Indian startup companies operating in e-commerce segment, namely Klipkart Ltd., Mozon Ltd., and Run Run Ltd. for supplying know-how to develop an electronic retailer network.

Balmart Inc. made an application to the Authority for Advance Rulings (AAR) on the rate of withholding tax on receipts applicable to it. Klipkart Ltd. also made an application to the Assessing Officer for determination of the rate at which tax is deductible on the payments made to the said non-resident company. The Authority for Advance Rulings (AAR) rejected the application of Balmart Inc. on the ground that the question raised in the application is already pending before an income-tax authority.

Examine whether the rejection of application by the AAR is justified in law. **(3 Marks)**

- (d) Raghu Ltd made a payment of ₹ 3,00,000 on 30-6-2018 towards procuring online advertisement space to a foreign company which had no place of business in India. The company remitted the equalization levy on 23-3-2019. Calculate interest and penalty payable by Raghu Ltd. if any. **(3 Marks)**

#### Answer

- (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 re-computation 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, 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 Mr. Harish 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 15 assessment years i.e., from A.Y.2004-05 to A.Y.2018-19.

Hence, the Assessing Officer is justified in invoking reassessment provisions in respect of the earlier assessment years i.e., from A.Y.2004-05 and thereafter, since Mr. Harish first purchased an asset outside India in September 2003.

Accordingly, in view of the above provisions, the action of the Assessing Officer in issuing notices to Mr. Harish under section 148 for 15 assessment years i.e., from A.Y. 2004-05 to A.Y. 2018-19 is tenable in law.

- (b) The Assessing Officer can exercise his power of survey under section 133A only after obtaining the approval of the Joint Commissioner or Joint Director, as the case may be.

Assuming that he has obtained such approval in this case, he is empowered under section 133A to enter any place of business of the assessee within his jurisdiction only during the hours at which such place is open for the conduct of business.

In the case given, the “Thriller” a popular cinema hall is open from 9.00 p.m. to 1.00 a.m. for the conduct of business. The Assessing Officer entered the cinema hall at 12 o'clock in the night which falls within the working hours of the cinema hall.

Therefore, the claim made by the owner to the effect that the Assessing Officer could not enter the cinema hall at late night is not valid.

Further, as per section 133A(3)(ia), the Assessing Officer may, impound and retain in his custody for such period as he thinks fit, any books of account or other documents inspected by him. However, he shall not impound any books of account or other documents except after recording his reasons for doing so.

- (c) The issue under consideration is whether the Authority for Advance Rulings shall allow/reject an application for advance ruling where the question raised in the application is already pending before any income-tax authority or Appellate Tribunal or any Court.

An advance ruling is not only applicant specific, but is also transaction specific. The advance ruling is on a transaction entered into or undertaken by the applicant. That is why section 245S specifies that a ruling is binding (i) on the applicant, (ii) **the transaction** and (iii) the Principal Commissioner or Commissioner of Income-tax and those subordinate to him.

Therefore, AAR can reject the application made by Balmart Inc. before the AAR on the ground that similar issue is pending before the Assessing Officer in respect of the **same transaction** i.e., provision of technical know in case of Klipkart Ltd.

**Notes** – (1) *The facts of the case are similar to the facts in Nuclear Power Corporation of India Ltd. In Re, [2012] 343 ITR 220, wherein the above issue came up before the AAR. What is barred by the first proviso to section 245R(2) of the Act in the context of clause (i) thereof is the allowing of an application under section 245R(2) of the Act where “the question raised in the application is already pending before any Income-tax authority, or Appellate Tribunal or any court”. The significance of the dropping of the words, “in the applicant’s case” with effect from June 1, 2000, cannot be wholly ignored. On the basis of*

this view expressed by the AAR in the above case, explaining the impact of the dropping of the words “in the applicant’s case” with effect from 1.6.2000, a view can be taken that the AAR can reject the application made by Balmart Inc. before the AAR on the ground that similar issue is pending before the Assessing Officer in respect of the same transaction i.e., provision of technical know in case of Klipkart Ltd. The above answer is based on these lines.

**(2) Alternate Answer** - The issue relates to the admission or rejection of the application filed before the Advance Rulings Authority on the grounds specified in clause (i) of the first proviso to sub-section (2) of section 245R of the Income-tax Act, 1961.

The first proviso to section 245R(2) has been substituted by the Finance Act, 2000 with effect from 1.6.2000. Clause (i) of the first proviso, prior to and post amendment, reads as follows:

<b>Prior to 1.6.2000</b>	<b>On or After 1.6.2000</b>
<p>Provided that the Authority shall not allow the application <b><u>except in the case of a resident applicant</u></b> where the question raised in the application is already pending <b><u>in the applicant’s case</u></b> before any income-tax authority, the Appellate Tribunal or any court;</p>	<p>Provided that the Authority shall not allow the application where the question raised in the application is already pending before any income-tax authority or Appellate Tribunal or any court.</p>

The words “except in the case of a resident applicant” and “in the applicant’s case” has been removed in clause (i) of the first proviso with effect from 1.6.2000. However, the Explanatory Memorandum to the Finance Act, 2000, explaining the impact of the substitution, reads as follows “It is proposed to substitute the proviso to provide that the Authority shall not allow the application when the question raised is **already pending in the applicant’s case** before any income-tax authority, Appellate Tribunal or any court in regard to a non-resident applicant and resident applicant in relation to a transaction with a non-resident”. Therefore, according to the intent expressed in the Explanatory Memorandum, the AAR shall not allow the application both in the case of resident and non-resident applicant if the question raised is already **pending in the applicant’s case** before any income-tax authority. Thus, as per the Explanatory Memorandum, it is possible to take a view that even post-amendment, the Authority shall not allow the application only where a question is **pending in the applicant’s case** before any income-tax authority. Thus, an alternative view is possible on the basis of the AAR ruling in *Ericsson Telephone Corporation India AB v. CIT (1997) 224 ITR 203*, which continues to hold good even after the amendment, if we consider the intent expressed in the Explanatory Memorandum. **Accordingly, based on this view, the rejection of application by the AAR is not justified in law, since the question raised in the application made by Balmart Inc. is pending before the Assessing Officer in Klipkart Ltd.’s case, and not in the applicant’s case.**

**(d) Interest for failure to remit the equalization levy**

An assessee who fails to credit the equalisation levy or any part thereof within 7th of the month following the calendar month in which it is deducted, to the account of the Central Government, has to pay simple interest at the rate of 1% of such levy for every month or part of a month by which such crediting of the tax or any part thereof is delayed.

In the present case, Raghu Ltd. is required to remit the equalization levy of ₹ 18,000 i.e., 6% of ₹ 3,00,000 by 07.7.2018. However, since it remitted the said levy only on 23.3.2019, the interest ₹ 1,620 i.e., @1% would be levied for 9 months.

**Penalty for failure to pay equalisation levy**

Failure to remit equalisation levy to the Central Government on or before 7th of the following month, after deduction would attract a penalty of ₹ 1,000 for every day during which the failure continues. However, such penalty shall not exceed the amount of equalisation levy that he failed to pay.

Thus, in the present case, penalty of ₹ 2,59,000 (₹ 1000 x 259) would be limited to ₹ 18,000, being the amount of equalization levy which the assessee has failed to pay.

**Question 6**

(a) *You are appointed as the taxation manager of Tatla Well Ltd. In the context of tax planning, what all are the tests that are to be satisfied for the tax planning strategy to be successful? State them briefly.* **(4 Marks)**

(b) *Mr. Srinivasan was a Central Government pensioner, who expired on 10-5-2019. An amount of ₹ 10 lakhs in cash was deposited into his savings bank account maintained in a nationalized bank on 28-2-2019, which was reported by the banker u/s 285BA. A notice was issued by the Assessing Officer to Mrs. Srinivasan who is his legal representative to file his Return of Income. Mrs. Srinivasan has approached you as a Tax Consultant as to the course of action to be undertaken by her, since she is unaware of her deceased husband's financial dealings.*

*What will be your advice to Mrs. Srinivasan?* **(4 Marks)**

(c) *Examine and state the correctness or otherwise of each of the following statements in the context of international tax treaties between the countries and answer in brief with reasons/contents thereof:*

(i) *"Providing assistance in the collection of the fair and legitimate share of tax by the countries involved" is the sole objective of Tax Treaties entered among Countries.*

(ii) *A Protocol is an integral part of the Tax Treaty and has the same binding force as the main clauses therein.* **(6 Marks)**

**Answer**

(a) Successful tax planning must conform to two tests viz, conformity with the current law and flexibility.

In order to satisfy the first test, the essential requisite is a *comprehensive knowledge* of the law, rules and regulations on the part of the tax planner. This knowledge of law extends not only to the provisions of the taxing statutes and the case law that has developed on those statutes, but also to other branches of law, both civil and personal, so that the tax planner's device does not get defeated by the universal principles of jurisprudence.

The second test of flexibility seeks to ensure that the success of the *tax planning device* is *not nullified* by statutory negation. Flexibility essentially means that the device provides for suitable changes in accepted forms. Wherever possible, tax planning schemes should be flexible, designed so as to avoid irretrievable situations. The tax planner should, therefore, be watchful of all significant developments related to his field.

(b) The advice to Mrs. Srinivasan would be on the following lines –

Mrs. Srinivasan, the legal representative of Mr. Srinivasan, would be deemed to be an assessee for the purpose of the Income-tax Act, 1961. Mrs. Srinivasan would be liable to file return of income as a legal representative and pay any sum which Mr. Srinivasan would have been liable to pay if he had not died, in the like manner and to the same extent as the deceased. Any sum includes tax, penalties, interest or any other sum that would have been payable by her deceased husband. The liability of Mrs. Srinivasan would be limited to the extent to which, the estate of the deceased is capable of meeting the liability. No prosecution can, however, be initiated on Mrs. Srinivasan for any offence committed by her deceased husband.

(c) (i) **The statement is not correct.**

The objectives of tax treaties also include

- allocating tax rights,
- elimination of double taxation,
- ensuring non-discrimination between residents and non-residents and
- resolution of disputes of on account of different treaty interpretation.

(ii) The statement is **correct**.

Protocol is like a supplement to the treaty. In many treaties, in order to put certain matters beyond doubt, there is a protocol annexed at the end of the treaty, which clarifies borderline issues. Thus, one must refer to protocol before arriving at any final conclusion in respect of any tax treaty provision.