FINAL EXAMINATION
GROUP III
(SYLLABUS 2012)

SUGGESTED ANSWERS TO QUESTIONS
DECEMBER 2014

Paper-16: TAX MANAGEMENT AND PRACTICE

Time Allowed : 3 Hours **Full Marks : 100**

The figures in the margin on the right side indicate full marks.

Wherever required, the candidate may make suitable assumptions and state them clearly in the answer.

Working notes should form part of the relevant answer.

All the questions relate to the assessment year 2014- 15, unless stated otherwise.

Section A

Answer any five questions.

1.

(a) Shree Ram Charitable Trust registered under section 12AA of the Income-tax Act, 1961 runs a school. During the year ended 31st March, 2014, it sold one building for a sum of ₹ 50 lacs. The building was acquired by the trust at ₹10 lacs in the year 2009-10.

The trust utilized ₹41 lacs out of sale consideration in construction of an additional school building. 4

Advise the trust on the taxable capital gain.

(Cost inflation indices are: FY 2009 – 10 632
FY 2013 – 14 939)

(b) The Statement of Profit & Loss of Alpha Limited, a domestic company for the year ended 31st March, 2014 discloses a net profit of ₹120 lacs after debiting/crediting the following items:

(i)	**Provision for doubtful debts**	**₹2.40 lacs**
(ii)	**Provision for income tax**	**₹18 lacs**
(iii)	**Provision for deferred tax**	**₹9 lacs**
(iv)	**Depreciation (including depreciation on revaluation of assets ₹3 lacs.)**	**₹15 lacs**
(v)	**Provision from export in unit set up in Special Economic Zone (eligible for deduction under section 10AA)**	**₹22 lacs**
(vi)	**Provision for loss of subsidiary company**	**₹20 lacs**
(vii)	**Profit on sale of land held as capital asset for 10 years**	**₹10 lacs**

The Company has informed you that the entire capital gain on sale of land was invested in bonds of Rural Electrification Corporation Limited within six months from the date of sale.

Details of brought forward losses and unabsorbed depreciation as per books of the company:

Previous Year	Brought forward loss (₹ in lacs)	Unabsorbed depreciation (₹ in lacs)
2010-11	-	4
2011-12	2	3
2012-13	8	2

Compute "book profit" under section 115JB of the Income- tax Act, 1961 for the Assessment Year 2014 – 15. 10

Answer:

1. (a) As per section 11(1A) of the Income-tax Act, where a capital asset held under trust is transferred and if only a part of the net consideration is utilised for acquiring the new capital asset, so much of such capital gain as is equal to the amount, if any by which the amount so utilised exceeds the cost of the transferred asset shall be considered to have been applied for the objects of the trust and the exemption shall be restricted to such amount.
In the given case, the amount of capital gain = ₹ 50 lacs - ₹ 10 lacs = ₹40 lacs. The amount considered to be applied for the objects of the trust and exempted under section 11(1A) =₹ 41 lacs - ₹ 10 lacs = ₹ 31 lacs.
The balance capital gain of ₹ 9 lacs shall be treated as part of other income. Exemption, however, can also be claimed by utilizing 85% of the taxable capital gain towards the objects of the trust within the previous year.

(b) Computation of "Book Profit" of Alpha Limited for Assessment Year 2014 - 15

Particulars	₹ in lacs	₹ in lacs
Net profit as per Statement of Profit & loss		120
Add: Provision for doubtful debts	2.40	
Provision for income tax	18	
Provision for deferred tax	9	
Depreciation	15	
Provision for loss of subsidiary company	20	64.40
		184.40
Less: Depreciation (excluding depreciation on revaluation)	12	
Lower of brought forward loss or unabsorbed depreciation as per Books	9	21
Book profit		163.40

Notes:
1. Profit from export in unit set up in Special Economic Zone though eligible for deduction under section 10AA for computation of total income is not eligible for deduction in computing "book profit" for determination of minimum alternate tax.
2. Investment in bonds of Rural Electrification Corporation Limited entitles the assessee company to claim exemption of capital gain in computation of total income. But in computation of "book profit" under section 115JB, capital gain cannot be excluded nor exemption under section 54F can be claimed.

2. (a) State briefly with reasons whether credit under the CENVAT Credit Rules, 2004 would be available in the following cases : 1 ½ × 4 = 6
- **(i) Inputs are pilfered from the store-room;**
- **(ii) Durable and returnable packing material user for clearance of final product;**
- **(iii) An input becomes a waste and is sold as scrap; and**
- **(iv) Inputs used in trail runs.**

(b) M/s. Ajanta Ltd. incorporated on 1st April 2013, is engaged in the manufacture of a

product covered by Notification No. 8/2003 – CE dated 1st March, 2003. It expects the following during the year 2013-2014.

(i) Clearances of such manufacturing products : ₹700 lakhs (Excise Duty @12.36%)

(ii) Value of inputs to be used in manufacture : ₹140 lakhs (Excise Duty @ 12.36%)

(iii) Value of input services to be used in manufacture : ₹150 lakhs (Service Tax @ 12.36%)

(iv) Value of capital goods purchased and received : ₹20 lakhs (Excise Duty @ 10.30%)

All amounts are exclusive of duties/taxes. Discuss whether M/s. Ajanta Ltd. should opt for the SSI-exemption during the year 2014-15. Show your workings and cite relevant case-laws, if any. 8

Answer:

2. (a) The admissibility of CENVAT credit is discussed as under –

(i) Inputs are pilfered from the store-room:
No. since credit on inputs is available only for inputs used in the factory for manufacturer of final products. If the inputs are lost in the store-room without being used at all, credit of duty paid on such inputs will not be available.

(ii) Final product is cleared in durable and returnable packing material:
Yes. The definition of 'input' covers all goods used in the factory of production by the manufacturer and such packing has relationship with the manufacture of the final products therefore, Cenvat credit will be available on durable and returnable packing material. Besides this, since the proportionate cost of durable container is included in assessable value of final product, they are eligible for Cenvat credit.

(iii) An input becomes a waste and is sold as scrap:
Yes. If inputs becomes waste and sold as scrap, it cannot be *said that* input is cleared 'as such' [Rule 3(4) of the Cenvat Credit Rules 2004]. What is cleared is 'waste' and duty will be payable as if waste has been removed. In case the inputs have become waste during the manufacturing process, then the CENVAT credit shall be allowed on such waste, even if such waste is exempted or chargeable with nil rate of duty.

(iv) Inputs used in trial runs:
Yes. Inputs used in trial runs during the production or commissioning of plant are eligible for CENVAT credit as they are used in the manufacture of final product. Since trial run/production is a pre-requisite for manufacture of the final product, hence, they bear relationship with the manufacture of the final product. Hence, they are eligible as 'input]. – Fertiliser Corporation of India v. CCEx.

(b) Computation of duty liability in alternative situations for availing SSI Exemption by M/s. Ajanta Ltd. during the year 2013 – 14:

Particulars	With SSI-Exemption (₹ In lakh)	Without SSI-Exemption (₹ In lakh)
Value of clearance; of the final product	700	700
Less: First clearances upto ₹ 150 lakhs exempt	150	0
Dutiable clearances	550	700
Excise duty @ 12.36%	67.98	86.52
CENVAT CREDIT AVAILABLE:		
Less : Cenvat credit of inputs:		
Under SSI exemption, the inputs used in exempt clearances shall not be eligible for credit. The inputs used in dutiable clearances shall only be eligible as follows: Total Duty on Input: ₹140 lakhs * 12.36% = ₹17.304 lakhs		17.304
For SSI Exemption- ₹17.304 lakhs * ₹550 lakhs/₹700 lakhs	13.596	

CENVAT credit of input services: ₹150 lakhs * 12.36% - ₹18.54 lakhs (Ref Note-1)	18.54	18.54
CENVAT credit of capital goods (100% credit is available in the year of receipt = ₹20 lakhs & 10.30%= ₹2.06 lakhs	2.06	2.06
Total CENVAT Credit Available	34.196	37.904
Total Excise Duty Payable	33.784	48.616

Suggestion: Since the net excise duty payable shall be less in the case of SSI-exemption, hence, it is suggested that M/s. Ajanta Ltd should opt for the SSI- exemption during the year 2013 -14.

Note:
(1) Input service credit available even during SSI-exemption [Vallabh Vidyanagar Concrete Factory v. CCEx. [2010]18 STR 271(tri. -Ahmd.)] : The notification no. 8/2003 – CE specifically provides for denial of credit of duty paid on inputs, but does not provide for denial of Cenvat credit on input service. In respect of capital goods also, the credit is allowed even during the period of exemption to SSI manufacturers and this is because notification does not provide for denial of Cenvat credit on capital goods. In absence of any such restriction in the notification no. 8/2003-CE in respect of input services, a unit availing of SSI- Exemption is eligible for the cenvat credit of service tax paid on input services.

3. (a) Due to urgent requirements, Akash Smelters Ltd., air lifted a machinery from Denmark for CIF price of Euro 20,000.
The air freight paid was Euro 1500 and Insurance Euro 400.
Central Govt. has notified an exchange rate of Euro = ₹72 at the relevant time.
Basic duty payable on imports, besides applicable cess is 10%.
Similar goods manufactured in India attract excise duty of 12% plus applicable cess.
Special Additional customs duty payable is 4%.
You are required to ascertain the total value of imported goods and the customs duty payable by the importer. 7

(b) The return of income for the assessment year 2013-14 was filed, by Mr. Suryanarayana on 21-12-2013. The summarised results were as under :

	(₹ In lac)
Unabsorbed business loss	**32**
Unabsorbed depreciation	**22**
Unabsorbed tax holiday relief u/s 80-IB of Unit B	**12**
For the assessment year 2014-15 for which the return of income will be filed on 29-09-2014, the pertinent data are as below :	
Sales turnover	**1250**
Business income before current depreciation	**76**
Depreciation of current year only	**19**
Tax holiday relief u/s 80-IB of Unit B	**38**

Compute the total income of the assessee for the assessment year 2014 – 2015 7

Answer:

3. (a)

	EURO
CIF price of machine, as given	**20,000**
Less: Actual air freight paid	**(1,500)**
insurance paid	**(400)**
FOB price	**18,100**
Add: Freight (restricted to 20% of FOB i.e. 4,000)	**1,500**
Insurance - Actual (1.125% of FOB if actual is not available)	**400**
CIF value for customs purposes	**20,000**
	Rs.
Equivalent value in INR at Euro = 72	**14,40,000**
Add: Landing charges at 1% of above	**14,400**
Assessable value	**14,54,400**
Add: BCD at 10%	**1,45,440**
	15,99,840
Additional customs duty (ACD) at 12% on 15,99,840	**1,91,981**
Education cess at 2% on BCD + ACD	**6,748**
SAH cess at 1%	**3,374**
	18,01,943
Add: Special ACD at 4% of above	**72,078**
Total value of imported goods	**18,74,021**
Total customs duty payable (1,45,440+1,91,981+6,748+3,374+72,078)	**4,19,621**

3. (b)

Assessment year 2013 – 14

For the assessment year 2013-14, the return of income was filed on 21- 02- 2013, which is beyond the due date specified u/s 139(1).

Hence the assessee cannot carry forward business loss [as per section 80 read with section 139(3).

The assessee can however carry forward the unabsorbed depreciation to future years, since there is no requirement that return of income should be filed within the date specified u/s 139(1) for the same.

As per section 80AC, where the return of income is filed beyond the due date, the assessee will not be entitled to claim deduction u/s 80-IB. So this benefit will also lapse.

Assessment year 2014 – 15

Since the return of income will be filed within the due date, the assessee can claim deduction u/s 80- IB.

Profits and gains of business or profession	
Business income before current deprecation	76
Less: Depreciation for AY 2014-15 (As per sec 32(2), unabsorbed depreciation has to be added to current depreciation)	41
Business income/gross total income	35

Less: Deduction under chapter VIA Tax holiday relief u/s 80- IB (To be restricted to GTI)	35
Total Income	0

If time limit is available, balance of deduction u/s 80-IB of ₹ 3 lacs can be carried forward.

4. (a) Answer the following question with reference to the provisions of Foreign Trade Policy:

(i) M/s. B. Ltd. manufactures goods by using imported inputs and supplies the same under Aid Programme of the United Nations. The payment for such supply is received in free foreign exchange. Can M/s. B. Ltd. seek Advance Authorization in relation to the supplies made by it? 2

(ii) LMN Ltd., has imported inputs without payment of duty under Advance Authorization. The CIF value of such inputs is ₹20 lakhs. The inputs are processed and the final product is exported. The exports made by LMN Ltd., are subject to general rate of value addition prescribed under Advance Authorization Scheme. No other input is being used by LMN Ltd. in the processing. What should be the minimum FOB value of the exports made by the LMN Ltd. as per the provisions of Advance Authorization? 1

(b) M/s. Partik, was started on 16-02-11. During the year ended 31-03-2013, taxable services were rendered to the tune of ₹19,20,000. In the next year, the value of taxable services rendered was ₹ 8,43,000.

During the first half of the year 2013-14, the firm rendered taxable services to the extent of ₹ 6 lakhs.

The details of services rendered during the second half year are given below:

(i)	**Receipts towards supply of agricultural farm labour**	**2.2**
(ii)	**Services rendered to World Health Organisation**	**1.3**
(iii)	**Services rendered to charitable trusts registered u/s 12AA of the Income-tax Act, 1961**	**8.2**

The amounts above do not include service tax and wherever the same is due, the clients have paid the same.

Compute the value of taxable services and service tax payable for the year ended 31-03-2014. 7

(c) M/s. BSP Ltd. has imported machinery from Canada. From following information furnished, compute the assessable value and total customs duty payable under the Customs Act, 1962 and also provide suitable notes in support of your answer. 2+1+1

	US $
(i) Cost of the machine at the factory of the exporter	**2,000**
(ii) Transport charges from the factory of exporter to the port for shipment	**80**
(iii) Handling charges paid for loading the machine in the ship	**5**
(iv) Buying commission paid by the importer	**10**
(v) Lighterage charges paid by the importer	**20**
(vi) Freight incurred from port of entry to Inland Container depot	**100**
(vii) Ship demurrage charges	**40**
(viii) Freight charges from exporting country to India	**500**

Date of bill of entry	**20.01.2014 (Rate of BCD 20%. Exchange rate as notified by CBEC ₹ 60 per US$)**

Date of entry inward	**25.03.2014 (Rate of BCD 10%. Exchange rate as notified by CBEC ₹ 58 per US$)**
Additional duty payable under section 3(1) Customs Tariff Act, 1975	**12%**

Answer:

4. (a)

(i) Advance Authorisation can be issued for supplies made to United Nations Organisations or under Aid Programme of the United Nations or other multilateral agencies and such supplies need to be paid for in free foreign exchange. Therefore, B Ltd. can seek an Advance Authorisation for the supplies made by it as per provisions of Forign Trade Policy 2009-14.

(ii) Advance Authorisation necessitates exports with a minimum of 20% value addition. So, Value Addition = FOB value of export realized - CIF value of inputs covered by authorization.

So FOB Value should be ₹20 lakhs + 20% = ₹24 lakhs. Therefore, the minimum FOB value of the exports made by LMN Ltd. should be ₹24 lakhs.

(b) Computation of value of Taxable service provided by Mr. Pratik for the year 2013 - 14

Mr. Pratik is eligible for threshold exemption under Notification No.33/2012-ST, if the "Aggregate Value" of taxable services provided during the year 2013- 14 is up to ₹10 lakhs. Balance amount is Taxable

Value of taxable services and service tax payable by M/s Pratik for the year ended 31-3-2014

	Rs.
(i) Receipts towards supply of agricultural farm labour	Nil
[Covered by Negative list, hence not taxable]	
(ii) Services rendered to World Health Organisation	Nil
[Covered by Mega Notification exemption]	
(iii) Services rendered to charitable trusts registered u/s 12AA of the IT Act are taxable.	8.2
Value of taxable services in second half year	8.2
Value of taxable services in first half year	6
Gross vale of services rendered in FY 2014-14	14.2
Less: Exemption to Small Service provider under Notification No. 33/2012/ST (not available since taxable turnover during the preceding financial year exceed Rs. 10 lakh.)	Nil
Value of taxable services in FY 2013-14	14.2
Service tax payable @ 12.36%	1,75,512

For considering exemption to Small Service providers under Notification No. 33/2012/ST, taxable services rendered in earlier year is relevant.

Since the value of taxable services in FY 2012-13 was less than ₹10 lakhs the exemption of ₹ 10 lakhs is available.

4. (c) Computation of assessable value and customs duty payable of imported machinery by M/S BSP Ltd.

Particulars	US $
Cost of the machine at the factory	2,000

Transport charges upto port	80
Handling charges at the port	5
F. O. B.	2,085
Freight charges up to India	500
Insurance charges @ 1.125% of F.O.B. - (Note1)	23.456
Lighterage charges paid by the importer (Note 4)	20
Ship demurrage charges on chartered vessels	40
C.I.F. Value	2,668.456

Particulars	₹
C.I.F. in Indian rupees @ ₹60/- per $ (Note - 5)	1,60,107
Add: Landing charges @ 1% of CIF (Notes1)	1,601
Assessable value	1,61,708
Add: Basic customs duty @ 10% that is the rate of duty in force on the date on which order permitting clearances are passed (a)	16,171
Total	1,77,879
Add: CVD @12% (b) ([EC and SHEC on CVD are exempt]	21,346
Total	1,99,225
Add: Education cesses @ 3% of [(a) + (b) [2% education cess + 1% secondary and higher education cess] [c]	1,125
Total [d]	2,00,350
Additional duty u/s 3(5) @ 5% of (d) above [e]	10,018
Total custom duty payable [(a) + (b) + (c) + (e)]	48,660

Notes:

(1) Insurance charges and landing charges are included @ 1.125% of FOB value of goods and 1% of CIF value of goods respectively [Clauses (iii) and (i) of first proviso to rule 10(2) of Customs Valuation (Determination of Value of Imported goods) Rules, 2007.

(2) Buying commission is not included in the assessable value [Rule 10(1)(a)(i) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007].

(3) Freight incurred from port of entry to Inland Container depot is not includible in assessable value [Fourth proviso to rule 10(2) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007.

(4) Ship demurrage charges and lighterage charges are included in the assessable value [Explanation to Rule 10(2) of Customs Valuation Determination of Value of Imported Goods) Rules, 2007]

(5) Rate of exchange notified by CBEC on the date of presentation of bill of entry is considered [Explanation to section 14 of the Customs Act 1962]

(6) Rate of duly is the rate prevalent on the date of presentation of bill of entry or the rate prevalent on the date of entry inwards, whichever is later [Section 15 of the Customs Act, 1962].

5. (a) In the context of the provisions of section 143(1) of the Income-tax Act, 1961 regarding summary assessment, answer the following questions:

(i) What are the adjustments that can be made by the Assessing Officer in course of processing of return of income? 2

(ii) What is the time limit for sending intimation under section 143(1)? 1

(iii) Is it mandatory for the Assessing Officer to process every return under section 143(1)? 1

(iv) What do you understand by "incorrect claim apparent from any information in the return"? 3

(b) River, Sea and Ocean are partners of a firm engaged in the business of

manufacturing in Visakhapatnam. The Balance Sheet of the firm as on 31st March, 2014 is given below :

₹ in Lacs

Partners' Capital:			**Land at Visakhapatnam**	**600**
River	**600**		**Land at Hyderabad**	**400**
Sea	**800**		**(construction not permitted)**	
Ocean	**400**		**Factory Building**	**300**
		1800	**Residential House**	**400**
Bank overdraft (secured by charge on stock and debtors)		**300**	**Plant & Machinery (WDV)**	**600**
Term loan from bank (secured by charge on gold and silver)		**1000**	**Gold and silver.**	**700**
Creditors		**600**	**Stock**	**300**
			Cash at Bank	**400**
		3700		**3700**

Open market prices of two urban lands assesed by independent valuer are ₹1000 lacs and ₹100 lacs respectively. The market value of gold and silver on the balance sheet date is ₹1200 lacs. The value of the residential house as per Rule 3 of Schedule III is ₹450 lacs.

Term loan was taken for purchase of (a) plant and machinery ₹600 lacs; (b) land at Visakhapatnam ₹ 400 lacs.
The residential house is occupied by partner River who looks after the manufacturing operation of the firm.
Partner Sea is a resident of UK.
Profits of the firm are shared in the ratio of 2:2:1.
Sea owns a residential house valued at ₹50 lacs in London. Sea took a loan for investment in the firm. Outstanding amount of such loan on 31st March, 2014 is ₹ 10 lacs.
Compute net wealth of Sea as on 31st March, 2014. 7

Answer:

5. (a)

(i) Adjustments that can be made in course of processing of return under section 143(1) are the following:
   (a) Any arithmetical errors in the return;
   (b) Any incorrect claim apparent from any information in the return

(ii) Time limit for sending intimation under section 143(1) is one year from the end of the financial year in which the return is filed by the assessee.

(iii) Processing of return under section 143(1) is mandatory except in a case where a notice has been issued to the assessee under section 143(2) taking up the case for regular assessment.

(iv) "An incorrect claim apparent from any information in the return" shall mean the following claims, on the basis of an entry in the return of income:
   (a) of an item which is inconsistent with another entry of the same or some other item in the return of income.
   (b) In respect of which the information required to be furnished under the Act to substantiate the entry has not been furnished.
   (c) In respect of deduction, where such deduction exceeds specified statutory limit expressed as monetary amount or percentage or ratio or fraction.

5. (b)

Computation of net wealth of the firm as on 31st March, 2014

Particulars	₹ In lacs
Land at Visakhapatnam- market value exceeds book value by more than 20%. Hence market value is considered.	1,000
Land at Hyderabad-as construction is not permitted, it is not an asset under section 2(ea). Hence it is excluded	-
Residential House- as the value as per Schedule III does not exceed book value by more than 20%, book value is considered	400
Gold and silver- market value exceeds book value by more than 20%. Hence market value is considered	1,200
	2,600
Less: Deductible Debt-term loan taken for acquiring land at Visakhapatnam	400
Net Wealth	2,200

Note: Factory building, plant and machinery, stock and cash at bank are not assets under section 2(ea)

Computation of Net Wealth of Sea as on 31st March, 2014

Particulars	₹ In lacs
Value of interest in the assets of the firm: ₹800 lacs + (2,200 lacs – 1,800 lacs) × 2/5	960
Less: Exemption under section 5(vi) in respect of his share in residential house belonging to the firm (400 × 960/2,200)	174.55
	785.45
Less: Loan taken for investment in the firm deductible under section 2(m)	10
Net Wealth	775.45

Note: As sea is a non- resident, house owned by him in London is not liable to wealth tax in India by virtue of section 6.

6. (a) Ms. Anandi, a resident in India and Singapore in previous year 2013-14, owns residential properties at Singapore and India. He has earned income of ₹40 lacs from business carried on in Singapore during 2013-14. She also transferred certain capital asset in Singapore and derived a short-term capital gain of ₹12 lacs from such transfer. M/s. Anandi has no permanent establishment of business in India. However, she received rent of ₹ 7.20 lacs from letting out one house property in Kolkata. She also owns a house in Jaipur where she stays as and when she visits India.

The Article 4 of the Double Taxation Avoidance Agreement between India and Singapore inter alia reads as follows :

"Resident

1. ***For the purposes of this Agreement, the term "resident of a Contracting State" means any person who is a resident of a Contracting State in accordance with the taxation laws of that State.***
2. ***Where by reason of the provisions of paragraph 1, an individual is a resident of both Contracting States, then his status shall be determined as follows : -***
   a. ***he shall be deemed to be a resident of the State in which he has a permanent home available to him; if he has a permanent home available to him in both States, he shall be deemed to be a resident of the State with which his personal and economic relations are closer (centre of vital interests");***

State with reasons whether the business income of Ms. Anandi earned in India and capital gain from transfer of capital asset situated in Singapore be liable to income tax in India. 7

(b) What is meant by 'Importer Exporter Code number' (IEC)? State the procedure for obtaining IEC number. When is the quoting of IEC number not required for import/export? 5

(c) Can a registered VAT dealer claim input tax credit (ITC) on the basis of photostat copy of purchase invoice, when the original invoice is claimed to be lost? What is the way out for the dealer to claim the ITC? 2

Answer:

6. (a)

As per section 5(1) of the Income-tax Act, a resident is chargeable to tax in respect of his global income. In the given case, Anandi is a resident both in India and Singapore as per the law of both the countries for the previous year 2013-14. In such case it is necessary to examine the relevant clause of the DTAA between India and Singapore to ascertain his residential status.

The Article 4 of the DTAA provides that where an individual is a resident of both the Contracting States, then he shall be deemed to be resident of the Contracting State in which he has permanent home available to him.

Anandi stays in her house in Jaipur during her visits. So it can be said that she has a permanent home in India.

Next rule for determination of residential status is the existence of permanent establishment. If she has permanent home in both the Contracting States, she shall be deemed to be the resident of the Contracting State with which her personal and economic relations are closer (centre of vital interests).

Anandi has no permanent establishment of business in India. Hence, applying the Clause 4 of the DTAA, she shall be deemed to be resident of Singapore.

Since she is a non-resident in India based on the principle laid down in the DTAA, income earned outside India does not form part of total income under section 5(2). Hence, her business income and capital gain of ₹ 40 lacs and ₹ 12 lacs respectively in Singapore are not chargeable to tax in India.

6. (b)

Import/ Export Code Number

Every importer and exporter must obtain an "Importer Exporter code Number" (IEC) from DGFT (Director General of Foreign Trade) or officer authorised by him, by applying in prescribed Form (section 7 of FT (D&R) Act).

Procedure for obtaining the IEC Number

An application in the prescribed form has to be submitted to the office of the jurisdictional Joint Director of Foreign Trade wherein details including Bank Account Number and PAN have to be furnished. After processing the application, the office of the Joint DGFT would grant the IEC Certificate.

Quoting IEC number, when not required

Import and export without IEC number is not permitted, unless specifically exempted. Thus where an exemption is obtained, IEC number need not be quoted.

The IEC number has to be indicated in the documents filed with Customs for clearance of imported goods. This number is not required in case of import of gifts and baggage.

6. (c)

The VAT invoices should be kept with due care as credit of input-tax can be availed of only on the basis of such invoice. In case the original invoice is lost or misplaced, a duplicate authenticated copy of the same must be obtained from the issuing dealer. Input tax credit cannot be utilized on the basis of photo stat copy of the invoice.

Section B
Tax Practice & Procedures

Question No. 9 is Compulsory.
Answer any one question from the rest in this section.

7. (a) Vaibhav Chemicals Ltd., are putting up a plant wherein two additives are to be added to the bitumen to improve its quality.
The Managing Director wants to know whether such process will be treated as manufacture under excise law.
As the Cost Accountant of the company, your views are solicited on the issue. Advise the Managing Director in an appropriate mariner. 5

(b) Srinivas Surgiments Ltd., has received a huge order from a chain of hospitals for manufacture and supply of antiseptic cleansing solution, which will be used for degerming or scrubbing the skin of the patients prior to a surgical operation.
The company wants to know whether the aforesaid solution can be classified as a "medicament" under excise law. Please guide them suitably. 5

(c) Anabhaya Roller Flour Mills Ltd., are entering into a handling and transportation contract with Vallabh Transports, a partnership firm. It is proposed to insert a specific clause in the agreement between two parties that all taxes, including service tax liability, which the former company is required to pay, shall be deducted at source and remitted to the tax authorities for the account of Vallabh Transports. As the service tax consultant, your view is sought as to whether by insertion of a clause in the contract, the service tax liability can be shifted to the other party. 5

Answer:

7. (a) Improvement of quality using additives, whether amounts to manufacture

As the Cost Accountant of the company, I will draw the attention of the MD to the decision of the Apex Court in **CCE vs Oscar Chemical P Ltd**. (2012) 276 ELT 162 (SC). In this case, the Supreme Court had to consider an identical situation.

The Supreme Court pointed out that "Manufacture" could be said to have taken place, when there was transformation of raw materials into a new and different article having different identity, character and use.

The Court was of the opinion that it was a settled principle that a mere improvement in quality will not amount *to* manufacture.

Only when there is a change or series of changes to the original commodity takes place to such an extent that commercially, it can no longer remain as the original commodity that a manufacture can said to have taken place.

The Court noted that in the impugned process, there was a mere improvement of quality of the bitumen and bitumen remained as bitumen only.

The Court further pointed that it was not specified as manufacture in section 2(f) of the CE Act, 1944 or in Chapter notes of First Schedule to the Tariff Act.

Advice will be given on above lines to the Managing Director.

7. (b)

The Supreme Court dealt with an identical situation in CCE vs Workhardt Life Sciences Ltd. (2012) 271 ELT 299 (SC).

Facts of the Case:

Wockhardt Life Sciences Ltd. was the manufacturer of Povidone Iodine Cleansing Solution USP and Wokadine Surgical Scrub. The only difference between these two products was that Wokadine was a branded product whereas Povidone Iodine Cleansing Solution was a generic name.

The Revenue contended that the said products were not medicament in terms of Chapter Note 2(i) of the Tariff Act as it neither had "Prophylactic" nor "Therapeutic"

usage. The Revenue said that in order to qualify as a medicament, the goods must be capable of curing or preventing some disease or aliment. Therefore, the said products cannot be classified under Chapter Heading 3003 of Tariff Act. They submitted that the product in dispute, namely Povidone Iodine Solution or its patent and proprietary equivalent Wokadine surgical scrub, was essentially used as a medicated detergent.

The assessee stated that the Revenue, in their show cause notices, had admitted that the products in issue were antiseptic and used by surgeons for cleaning or de-germing their hands and scrubbing surface of skin of patient before operation. They further submitted that the products were medicament in which some carriers were added and therefore, it would fall under chapter sub-heading 3003 and not under chapter 34.

Point of Dispute:

The assessee's claim before the authorities and also before the Tribunal was that the aforesaid products were medicaments and, therefore, required to be classified under Chapter sub-heading 3003 of the Tariff, whereas the Revenue's stand was that the products in question are detergents and, therefore, to be classified under chapter subheading 3402.90.

Decision of the Case:

The Supreme Court observed that it is the specific case of the assessee that the products in question are primarily used for external treatment of the human-beings for the purpose of the prevention of the disease. This is not disputed by the Revenue. Revenue's stand is that since the products in question are primarily used as detergents/cleansing preparation, they cannot be brought under the definition of medicaments. Medicaments are products which can be used either for therapeutic or prophylactic usage. The Court said that since the product in question is basically and primarily used for the prophylactic uses, the Tribunal was justified in coming to a conclusion that the product was a medicament. The miniscule quantity of the prophylactic ingredient is not a relevant factor.

The Court said that the combined factor that requires to be taken note of for the purpose the classification of the goods are the composition, the product literature, the label, the character of the product and the use to which the product is put. In the instant case, it is not is dispute that this is used by the surgeons for the purpose of cleaning or de-germing their hands and scrubbing the surface of the skin of the patient that portion is operated upon. The purpose is to prevent the infection or disease. Therefore, the product in question can be safely classified as "medicament" which would fall under chapter sub-heading 3003 which is a specific entry and not under chapter sub-heading 3402.90 which is a residuary entry.

Thus, on the basis of the above observation by the Court the Revenue's appeal was rejected.

7. (c)

Shifting service tax liability to the other party by inserting a clause in contract

The situation akin to the one given in the problem arose in the case of **Rastriya ispat Nigam Ltd. vs. Dewan chand Ram Saran** (2012) 26 ELT 289 (SC). The appellant, a Govt. of India undertaking is engaged in the manufacture of steel products and pig- iron. The respondent was a partnership firm carrying on the business of transportation of goods. In the year 1997, the appellant appointed the respondent as the handling contractor A formal contract was entered into between the two of them on 17.6.1998, Terms and conditions for handling of iron and steel materials, though recorded in a separate document, formed a part of this contract. Clause 9.0 of these terms and conditions was concerning the payment of Bills. This clause stated, inter alia, that The Contractor shall bear and pay all taxes, duties and other liabilities in connection with discharge of his obligations under this agreement.

The dispute between the parties was that even though the service tax liability for

transport of goods fell on the service recipient as per Finance Act, 1994, the same was shifted to the service provider (respondent here), by virtue of the specific clause in the agreement.

The Apex Court felt that upon reading this specific clause in the contract it was clear that the contractor (service provider) had agreed to service tax liability which fell on the service receiver (other party).

As regards shifting of service tax liability, the Supreme Court observed that service tax was an indirect tax, which can be passed on and that an assessee can contract to shift such liability.

The Finance Act, 1994 is relevant as between an assessee and service tax liability and is not relevant as regards determination of rights of one party (service receiver) on another (service provider). There is nothing in law preventing the parties from entering into agreement as regards discharge of tax liability.

Thus, in essence, the Apex Court has held that through a specific clause in an agreement, the service tax liability may be shifted to another party. Consequently, the present clause proposed to be inserted in the agreement is valid and binding in law.

8. (a) Madubaala Finance Ltd., has started a new NDFC Division for its leasing activities. For this new NBFC Division, the company anticipates VAT liability but wants to light/contest the levy of VAT. The NBFC Division plans to collect from its customers on an adhoc basis, amounts towards possible VAT liability (which will be disputed by the company with VAT authorities). These amounts so collected will not be parked in a separate interest-bearing account. These amounts will be refundable to the customers, if the assessee were to succeed before the VAT authorities.

The management wishes to know whether the above collections from customers be treated as the income of the company, and if taxed, under what head of income will the same be taxed. *5*

(b) Jupiter Pharma Ltd., a pharmaceutical company, plans to collect "service charges" from the tenants of the buildings owned by it. The service agreement is dependent upon the rental agreement, which is executed by the company with the tenants. Services provided under the service agreement are in respect of staircase of the building, lift, common entrance, main road leading to the building through the compound, drainage facilities, open space in/around the building, air condition facility, etc.

The company wishes to know whether the service charges collected will be taxed under the head 'Income from house property' or as income from other sources. Advise them suitably. *5*

(c) Mrs. Kavita Agarwal, a resident, plans to sell the following properties to residents in India, during the last quarter of 2013-14:

- **(i) Agricultural lands in urban area for ₹ 55 lacs;**
- **(ii) Agricultural lands in non-urban area (situate in a place which is at an aerial distance of 30 kms from nearby municipality) for ₹ 80 lacs;**
- **(iii) Residential house for ₹ 90 lacs. The valuation for stamp duty purposes is ₹ 110 lacs.**

She wants to know whether she would suffer any tax deduction at source (TDS) under the provisions of the Income-tax Act, 1961, and if yes, the applicable rate and the quantum of TDS. *5*

Answer:

8. (a) **Taxability of collections towards disputed VAT liability**

The situation outlined in the problem resembles the one adjudicated by the Apex Court in Sundaram Finance Ltd. vs. ACIT (2012) 349 ITR 356 (SC).

According to the assessee, in order to safeguard itself against, *inter alia,* the possible sales tax liabilities, the assessee received ₹36.5 lacs as contingent deposits; from its

customers which were "refundable", if the assessee was to succeed in its challenge to the levy of the said sales tax. According to the assessee, the sum of ₹36.5 lacs was, therefore, an imprest with a liability to refund, that the said sum had the character of "deposits" and hence, were not taxable in the year of receipt, but would be taxable only in the year in which the liability to refund the sales tax ceased [in case the assessee failed in the pending sales tax appeals).

The Supreme Court observed that:

- ❖ It is well settled that in determining whether a receipt is liable to be taxed, the taxing authorities cannot ignore the legal character of the transaction which is the source of the receipt.
- ❖ The taxing authorities are bound to determine the true legal character of the transaction. In the present case, the assessee had received ₹36.5 lacs in the assessment year in question.
- ❖ The said sum of ₹36.5 lacs was not kept in a separate interest bearing bank account but it formed part of the business turnover.

In view of the above, applying the substance over form test the Supreme Court was satisfied that in the present case the said sum of ₹36.5 lacs constituted trading receipt/ business income. The said amount was collected from the customers. The said amount was collected towards sales tax liability. The said amount formed part of the turnover.

The ratio of the Supreme Court decision is squarely applicable and hence the collections in questions towards disputed VAT liability will be taxed as income. Since it is a trading receipt, it will be taxed under the head "Profits and gains of business or profession".

8. (b) **Taxability of service charges collected from tenants**

The Bombay High Court had to consider a similar situation in the case of CIT vs. J.K. Investors (Bom) Ltd. (2012) 211 Taxman 383 (Bom).

The Bombay High Court observed and held thus:

i) It is an undisputed fact that no services are being provided by the assessee to the occupants of its property and that the service charges have to be included as a part of its rental income.

ii) The test to determine whether the service agreement is different from the rent agreement would be whether the service agreement could stand independently of the rent agreement. In the instant case, the service agreement is dependent upon the rent agreement, as in the absence of the rent agreement there could be no service agreement.

iii) It may also be pointed out that according to the assessee, the services being provided under the service agreement are in respect of staircase of the building, lift, common entrance, main road leading to the building through the compound, drainage facilities, open space in/around the building, air condition facility, etc. These are services which are not separately provided, but go along with the occupation of the property.

iv) Therefore, the amounts received as service charges are to be considered as a part of the rent received and subjected to tax under the head 'Income from house property'.

Applying the ratio of the above judgment, the advice will be that the service charges collected will be taxed as income from house property and not as income from other sources.

8. (c)

TDS on sale of immovable property u/s 194-IA

Deduction of tax at source has to be made u/s 194-IA where there is transfer of immovable property for a consideration of ₹ 50 lacs or more.

The TDS rate is 1% of the total consideration.

"Immovable property" means any land (other than agricultural land) or any building or part of a building.

"Agricultural land" means agricultural land in India, not being a land situate in any area referred to in items (a) and (b) of section 2(14)(iii).

Therefore, the TDS obligation will be:

(i) Agricultural lands in urban area for ₹ 55 lacs: The provisions of section 194-IA are attracted.

TDS rate is 1% and TDS to be deducted is ₹ 55,000

(ii) Agricultural lands in non-urban area for ₹ 80 lacs : The provision of section 194-IA are NOT attracted.

(iii) Residential house for ₹ 90 lacs: The provisions of section 194-IA are attracted.

TDS rate is 1% on actual consideration and TDS to be deducted is ₹ 90,000. What is relevant is actual consideration and not the valuation for stamp duty purposes.

9. (a) The top management of a big multinational group of companies, in the context of framing global tax planning strategy, wants to know whether transfer pricing provisions under the. Income-tax Act, 1961 will be attracted in respect of the following transactions:

(i) Provisions of scientific research services by foreign company to its Indian subsidiary, J Ltd. 3

(ii) Lease of equipment by K Ltd., an Indian company, from T Inc., a Singapore company. T Inc. is a "specified foreign company" as defined in section 115BBD in relation to K Ltd.

Your considered opinion is sought on the above. 2

(b) Hajee Moosa Ltd., the assessee, a domestic company, exported on 1.2.2014, bananas to Mystery Inc., for an amount of ₹ 81 lacs. Mystery Inc is located in a Notified Jurisdictional Area (NJA). Mystery Inc., is not associated with the assessee in any manner whatsoever, and is a rank outsider. During the year, the assessee has billed ₹ 84 lacs and ₹86 lacs for sale of similar goods of identical quantity to Sun Inc. and Moon Inc., respectively, which are located in Kuala Lumpur (not a NJA) and both of which are not associated enterprises of the assessee.

The permissible variation notified by Central Government for such class of international transaction is 5% of the transaction price.

The management wants to know the tax implications under section 94A in respect of the above transaction entered into by the assessee with Mystery Inc., during the assessment year 2014-15. Advise them suitably. 5

(c) Daffodils Packagings Ltd., the assessee, is a manufacturer of packaging machines, made to the orders of the customers. Each machine is subject to stringent testing, before delivery to the customer. The assessee plans to claim Cenvat credit on the testing materials purchased by it.

You are required to state whether the same is correct, with the help of judicial pronouncements and applicable provisions of law. 5

Answer:

9. (a) **International transactions**

(i) The scope of term "international transaction" has been widened by the Finance Act, 2012 by insertion of *Explanation* to section 92B. According to the said *Explanation,* international transaction includes, inter alia, provision of scientific research services.

The foreign company and its Indian subsidiary are deemed to be associated enterprises, since the foreign holding company of J Ltd., fulfils the condition of holding shares carrying not less than 26% of the voting power in Indian subsidiary.

Since the provision of scientific research services by the foreign company to Indian company, is an "international transaction" between associated enterprises, transfer pricing provisions are attracted in this case.

(ii) Lease of tangible property fails within the scope of "international transaction". Tangible property includes equipment. T Inc. is a specified foreign company in relation to K Ltd. Therefore, the condition of K Ltd. holding shares carrying not less than 26% of the voting power in T Inc is satisfied. Hence, T inc, and K Ltd. are associated enterprises.

Therefore, lease of equipment by K Ltd., an Indian company, from T Inc., a foreign company is an international transaction between associated enterprises, and consequently, the provisions of transfer pricing are attracted in this case.

9. (b) **Advise on Computation of ALP**

As per section 94A, in case an assessee enters into any transaction where one of the parties thereto located in the notified jurisdictional Area (NJA) then the parties to the transaction shall be treated as associated enterprises and the transaction shall be deemed to be an international transaction. The transfer pricing provisions would, therefore be attracted in such a case. However, the benefit of the permissible variation between the transfer price and the arm's length price, as notified by the Central Government, shall not be available in such a case.

Since Mystery inc. is located in a NJA, the transaction of export of bananas by the assessee- company, would be deemed to be an international transaction. Further, Mystery Inc. and the assessee would be deemed to be associated enterprises. It is immaterial that Mystery Inc is a rank outsider and is not associated with the assessee in any manner.

Therefore, the provisions of transfer pricing would be attracted in this case.

The prices of Rs. 84 lakhs and Rs. 86 lakhs charged for sale of similar goods to Sun Inc. and Moon Inc. respectively, being independent entities located in a non-NJA country, can be taken into consideration for determining the arm's length price (ALP) under Comparable Uncontrolled Price(CUP) Method.

Since more than one price is determined by the CUP Method, the ALP would be the arithmetical mean of such prices.

Therefore, ALP - Rs. 85,00,000 i.e.,[(Rs. 84,00,000 + 86,00,000)/2]

Transfer Price = Rs. 81, 00,000

Since the ALP is more than the transfer price, the ALP of Rs. 85,00,000 would be considered for computing the income from the international transaction between the assessee and Mystery Inc. The net profit of the assessee will increase by Rs 4 lacs, as a consequence.

The benefit of permissible variation @5% of transfer price in respect of such class of international transaction is not available in respect of this transaction, since one of the parties thereto is located in a NJA.

9. (c) **Cenvat credit on testing materials**

In Flex Engineering Ltd. vs. Commissioner of Central Excise 2012 (276) ELT, 153 (S.C*)*, the Supreme Court had to consider a similar situation.

The following issues are involved:

(i) Whether duties paid on testing material would be eligible as credit under rule 2(k) of the CENVAT Credit Rules, 2004]?

(ii) Whether such use of material in testing in view of the purposes mentioned above, could be said to be used in the manufacture of or use in relation to the manufacture of the final products viz., machines as assembled?

The Supreme Court held that the process of manufacture would not be complete if a product is not saleable as it would not be marketable. Thus, the duty of excise would not be leviable on it.

The Supreme Court was of the opinion that the process of testing the customized F&S machines was inextricably connected with the manufacturing process, in as much as, until this process is carried out in terms of the afore-extracted covenant in the purchase order, the manufacturing process is not complete, the machines are not fit for sale and hence, not marketable at the factory gate. The Court was, therefore, of the opinion that the manufacturing process in the present case gets completed on testing of the said machine.

Hence, the afore-stated goods viz. the flexible plastic films used for testing the F&S machines are inputs used in relation to the manufacture of the final product and would be eligible for CENVAT credit under rule 2(k) the CENVAT Credit Rules, 2004.

In view of the above decision of the Supreme Court, the management can be advised that it can claim Cenvat credit on the impugned items.