

**FINAL EXAMINATION
GROUP - III
(SYLLABUS 2016)**

SUGGESTED ANSWERS TO QUESTIONS

JUNE - 2017

Paper-16 : DIRECT TAX LAWS AND INTERNATIONAL TAXATION

Time Allowed : 3 Hours

Full Marks : 100

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

Working notes should form part of the relevant answers.

All questions relate to Assessment Year 2017 – 18 and the provisions referred are those of the Income-tax Act, 1961.

Answer Question No. 1 which is compulsory and any five from question Nos. 2 to 8.

Section – A

1. Choose the most appropriate alternative and give justification in brief/brief working for your answer: 2x10=20
- (a) Health insurance premium paid for Mr. Ram being non-resident (age 70) is deductible up to _____.
- (A) ` 25,000
(B) ` 30,000
(C) ` 5,000
(D) ` 50,000
- (b) Mr. Xavier (age 55) a non-resident individual received dividend of ` 12 lakhs from Fair Trading Co (P) Ltd. in August, 2016. He has no other income in India. His tax liability for the dividend income would be
- (A) Nil
(B) ` 1,90,550
(C) ` 61,800
(D) ` 3,70,800
- (c) XYZ (P) Ltd. decided to buy-back shares from the shareholders. It bought 30000 shares of ` 10 each by paying ` 40 per share. The accumulated profits of the company on the date of buy-back was ` 30 lakhs. The buy-back was 30% of the total paid up capital. The tax liability on the company for buy-back of shares would be
- (A) Nil
(B) ` 12,36,000
(C) ` 4,32,600
(D) ` 1,85,400
- (d) Kumar Industries is engaged in manufacture of leather products. It was set up in backward area and became eligible for subsidy @25% for the generator acquired by it for ` 12 lakhs on 15.12.2016. It received the subsidy in March 2017. The amount of depreciation for the year at the applicable rate would be

- (A) Nil
 (B) ₹ 90,000
 (C) ₹ 67,500
 (D) ₹ 1,80,000
- (e) Ms. Pinky resigned from employment from Zeet University after serving for 4 years and 8 months. She received ₹ 1,40,000 from recognized provident fund. The amount of tax deductible at source under section 192A would be
 (A) Nil
 (B) @ 20% being ₹ 28,000
 (C) @ 30% being ₹ 42,000
 (D) @ 10% being ₹ 14,000
- (f) Mr. Murali employed in a company constructed a residential house property for self-occupation by availing bank loan of ₹ 50 lakhs. Interest on the loan for the year amounts to ₹ 2,60,000. He paid ₹ 1,70,000 up to 31.03.2017. The amount of interest eligible for deduction in the hands of Mr. Murali would be
 (A) ₹ 30,000
 (B) ₹ 2,60,000
 (C) ₹ 2,00,000
 (D) ₹ 1,70,000
- (g) Mr. Santhanam is employed in Gama Ltd. He opted for transfer of funds from superannuation fund to National Pension Systems Trust referred to in section 80CCD and accordingly ₹ 5 lakhs was transferred from approved superannuation fund to an account held with National Pension Systems Trust. His salary income (excluding the said transfer) amounts to ₹ 9,40,000 (computed). His total income after considering the transfer would be
 (A) ₹ 9,40,000
 (B) ₹ 10,90,000
 (C) ₹ 12,90,000
 (D) ₹ 14,40,000
- (h) Pai Softwares Ltd. is engaged in BPO at Bengaluru. It acquired computers for ₹ 20 lakhs on 10.05.2016. It also acquired computer softwares for ₹ 10 lakhs in July 2016. The total amount of depreciation claim in respect of these assets would be
 (A) ₹ 4,50,000
 (B) ₹ 12,00,000
 (C) ₹ 7,50,000
 (D) ₹ 14,50,000
- (i) Beta Ltd. of Mumbai is subsidiary of Unity Inc. of USA. Beta Ltd. purchased goods from Unity Inc. Transfer pricing adjustment would arise between them when
 (A) Sale price is less than arm's length price.
 (B) Sale price is equal to Indian market price.
 (C) Purchase price is more than arm's length price.
 (D) Purchase price is less than arm's length price.
- (j) An advance pricing agreement is valid for a period specified in APA but not exceeding _____ consecutive financial years.
 (A) 1
 (B) 5

(C) 3
(D) 10

Answer:

1. (a) (A) ₹ 25,000

Justification for the answer: Explanation to section 80D says senior citizen means an individual resident in India who is of the age of 60 years or more during the relevant previous year. Thus a non-resident though has completed 60 years is not eligible for enhanced deduction of ₹ 30,000 but eligible for regular deduction of ₹ 25,000.

(b) (A) NIL

Justification for the answer: Section 115BBDA does not cover non-resident individuals, HUF or firm (including LLP). Therefore, the dividend distributed by the domestic company for which DDT is paid under section 115-0 is eligible for exemption under section 10(34).

(c) (D) ₹ 1,85,400

Justification for the answer: Under section 115QA, when shares are liable for buyback in the case of company not being a listed company, the company has to pay 20.6% on the distributed income as tax. In this case the company pays ₹ 12 lakhs of which ₹ 9 lakh belongs to accumulated profits.

Tax at 20.6% being ₹ 1,85,400 is the liability on the company.

Alternatively, the workings are as under:

| | | |
|-----------|-------------|--------------------------------|
| FSC | 30,000 x 40 | 12,00,000 |
| Less: COA | 30,000 x 10 | <u>3,00,000</u> |
| | | 9,00,000 x 20.60% = ₹ 1,85,400 |

(d) (C) ₹ 67,500

Justification for the answer: The amount of subsidy received from the State Government or any other authority shall go to reduce the actual cost of asset computed under section 43(1) and hence the applicable depreciation would be computed on the resultant value. Depreciation at 15% on ₹ 9 lakhs being ₹ 1,35,000 and 50% thereon being ₹ 67,500 would be the eligible amount.

(e) (D) @ 10% being ₹ 14,000

Justification for the answer: Amount received from accumulated balance by the employee when it is taxable as per the provisions of rule 8 of Part A of the 4th Schedule, tax is deductible at source @ 10% when the aggregate payment exceeds ₹ 50,000.

(f) (C) ₹ 2,00,000

Justification for the answer: Where a house property acquired or constructed with borrowed capital on or after 01.04.1999 and is used for self residential use, the maximum amount of deduction allowable would be ₹ 2,00,000. The balance amount is eligible for carry forward and set off in the subsequent assessment years.

(g) (A) ₹ 9,40,000

Justification for the answer: Section 10(13)(v) was amended to provide exemption in respect of transfer from approved superannuation fund to National Pension Systems Trust referred to in section 80CCD. Hence the amount transferred is not chargeable to tax.

(h) (B) ₹ 12,00,000

Justification for the answer: Depreciation On computers is 60% of ₹ 20 lakhs, which works out to ₹ 12 lakhs.

Software ₹ 10 lakhs is a deductible business expenditure u/s 37(1).

(i) (C) Purchase price is more than arm's length price.

Justification for the answer: When the purchase price is more than arm's length price the income of the Indian undertaking chargeable to tax in India is understated. Hence, the transfer pricing adjustment would arise.

(j) (B) 5

Justification for the answer: As per section 92CC(4) an advance pricing agreement is valid for a period but not exceeding 5 consecutive financial years.

Section – B

2. (a) **Mitra & Co. a partnership firm consisting of 5 partners was constituted on 01.04.2016.**

On the same date all the partners contributed capital of ₹ 5 lakhs each. Also, one partner Ashwin contributed a vacant land owned by him as his capital contribution on the same date besides capital contribution in cash. The land was inherited by him from his father in June 2009 when the fair market value was ₹ 15 lakhs. It was acquired originally by his father in April, 1991 for ₹ 1 lakh. The fair market value on the date of contribution was ₹ 30 lakhs and it was recorded in the books at ₹ 40 lakhs by credit to his capital account.

The firm was engaged in developing and trading of vacant sites. It incurred development expenses of ₹ 18 lakhs on the land contributed by the partner Ashwin. The total extent of land contributed amounts to 30,000 sq. ft. After leaving space for road, park etc. the firm could plot 8 sites of 2400 sq.ft. each, which were sold for ₹ 10 lakhs each after incurring brokerage @ 2.5% of the sale price. The stamp duty valuation was ₹ 12 lakhs for each plot of land.

The deed of partnership provides for monthly working partner's salary of ₹ 20,000 each and interest on capital (including contribution of land) at 15% per annum.

Cost inflation index: F.Y. 1991-92 = 199; F.Y. 2009-10 = 632; F.Y. 2016-17 = 1125

Compute the presumptive income under section 44AD and income as per the regular provisions of the firm for the Assessment Year 2017-18. Also, work out the tax implication in the hands of partner, Mr. Ashwin.

8

(b) **ACHARYA LLP, a limited liability partnership in India is engaged in development of software and providing IT enabled services through two units, one of which is located in a notified Special Economic Zone (SEZ) in Chennai (commenced from 01.04.2006).**

The particulars relating to previous year 2016-17 furnished by the assessee are as follows:

Total Turnover: SEZ unit ` 120 lakhs and the other unit ` 100 lakhs

Export Turnover: SEZ unit ` 100 lakhs and the other unit 60 lakhs

Profit: SEZ unit ` 48 lakhs and the other unit ` 42 lakhs

Amount debited to Profit and Loss Account towards Special Economic Zone Re-Investment Reserve Account ` 21 lakhs.

The Assessee has no other income during the year.

(i) Compute tax payable by ACHARYA LLP for the Assessment Year 2017-18.

(ii) Will the amount of tax payable change, if ACHARYA LLP is an overseas entity? 8

Answer:

2. (a)

Computation of Total Income of Mitra & Co. for the Assessment Year 2017-18

| | | Regular provisions | Presumptive provisions |
|---|-----------|--------------------|------------------------|
| Sale consideration | | 80,00,000 | 80,00,000 |
| Income @ 8% | | | 6,40,000 |
| Cost of land as recorded in the books (As per section 45(3)) | 40,00,000 | | |
| Brokerage @ 2.5% | 2,00,000 | | |
| Development expenses | 18,00,000 | | |
| Interest on capital-cash `25 lakhs @ 12% | 3,00,000 | | |
| Interest on capital in kind `40 lakhs @ 12% | 4,80,000 | | |
| | | 67,80,000 | |
| Book Profit | | 12,20,000 | |
| Less deduction U/s.40(b) | | | |
| Actual salary paid `20,000 × 5 ×12 (A) | 12,00,000 | | |
| Allowable U/s.40(b) | | | |
| On first `3,00,000 @ 90% | 2,70,000 | | |
| On balance `9,20,000 @ 60% | 5,52,000 | | |
| (B) | 8,22,000 | | |
| Lesser of the two is deductible | | 8,22,000 | |
| | | 3,98,000 | |
| Add: The difference between fair market price and sale consideration under section 43CA | | | |
| ` 2,00,000 × 8 | | 16,00,000 | 16,00,000 |
| Total Income | | 19,98,000 | 22,40,000 |
| Impact on partner Mr. Ashwin | | | |
| Sale consideration (deemed) | 40,00,000 | | |
| Less: Indexed cost | | | |
| ` 1,00,000 × 1125/199 [See Note below] | 5,65,327 | | |
| Long-term capital gain | 34,34,673 | | |
| Income from Business | | | |
| Interest on capital – cash | 60,000 | | |
| Interest on capital contributed - in kind | 4,80,000 | | |

| | | | |
|--|-----------|--|--|
| Working partner salary @ 20% `8,22,000 | 1,64,400 | | |
| Total Income | 41,39,073 | | |

Note: Ashwin inherited the land from his father in June 2009 and his father had acquired the same in April, 1991. There are number of High Court decisions which state that in such a situation, one has to go back till the capital asset was acquired in a mode other than those not regarded as "Transfer".

(b)

| | |
|------------------------------|----------------|
| Profit of unit in SEZ | 48 Lacs |
| Add: Amt debited to SRA | <u>21</u> Lacs |
| POB | 69 Lacs |
| Less: Exemption u/s 10AA | |
| 50% (69 x 100/120) or 21 WEL | <u>21</u> Lacs |
| | 48 Lacs |
| Add: Others | <u>42</u> lacs |
| Total Income | <u>90</u> Lacs |

Computation of total income and tax liability of ACHARYA LLP as per the normal provisions of the Act for A.Y. 2017-18

| Particulars | | ` (in lakh) |
|---|-------|-------------|
| Business income (before deduction under section 10AA)(` 48 lacs + ` 42 lacs) | | 90.00 |
| Add: Amount debited to SEZ Re-investment Reserve | | 21.00 |
| | | 111.00 |
| Less: Deduction under section 10AA | | |
| = `48 lacs x ` 100 lacs / ` 120 lacs = 40x50% (being the 11 th year) | 28.75 | |
| Amount debited to SEZ Re-investment Reserve Account | 21.00 | |
| Whichever is less is deductible | | 21.00 |
| Total Income | | 90.00 |
| Tax on total income@30% | | 27.00 |
| Add: Education cess @2% & SHEC @1% | | 0.81 |
| Tax liability (as per normal provisions) | | 27.81 |

Computation of Adjusted total income and Alternate Minimum tax of ACHARYA LLP as per the provisions of section 115JC for A.Y. 2017-18

| Particulars | ` (in lakh) |
|--|-------------|
| Total income as per the normal provisions | 90.00 |
| Add: Deduction under section 10AA | 21.00 |
| Adjusted total income | 111.00 |
| Tax @18.5% of Adjusted Total Income | 20.535 |
| Add: Surcharge @12% as the adjusted total income is >1 crore | 2.4642 |
| | 22.9992 |
| Add: Education cess @2% & SHEC @1% | 0.6899 |
| Alternate Minimum Tax as per section 115JC | 23.6891 |

(i) Since the tax payable as per the normal provisions of the Act is more than the alternate minimum tax payable, the total income as per normal provisions shall be liable to tax and the tax payable for A.Y. 2017-18 shall be ` 27.81 lakhs.

There would be no tax credit for ACHARYA LLP to carry forward and set off against income-tax payable in the subsequent 10 assessment years.

- (ii) The provisions of alternate minimum tax would also be applicable to an overseas LLP. Hence, the tax liability would remain the same even where ACHARYA LLP is an overseas entity.

3. (a) What are the incomes which can be declared under the Income Declaration Scheme, 2016? Narrate the step by step processes involved in the declaration process. **8**

(b) (i) Balaji Airlines Ltd. paid ₹ 10 lakhs to Airport Authority of India towards landing and parking charges. The payment was towards use of land in the airport besides technical services involving navigation, security and other ancillary services. The tax was deducted at source under section 194C at 2%. The Income Tax Officer (TDS) held that the assessee ought to have deducted tax under section 194-I i.e. towards rent. Discuss the consequence of the action of the Assessing Officer and also the correctness of such decision.

(ii) Venkat & Co. a partnership firm was constituted on 01.06.2015 with four partners. All the partners contributed ₹ 10 lakhs each by way of capital. While examining the return of the Assessment Year 2016-17, the Assessing Officer verified the source of investments made by the partners. Not satisfied with the explanation of the partners/firm, the Assessing Officer assessed to tax ₹ 25 lakhs as unexplained cash credit under section 68 of the Act in the hands of the firm. Decide the validity of the action of the Assessing Officer. **4+4=8**

Answer:

3. (a) Declaration of Undisclosed Income

As per Section 183(1) of the Income Declaration Scheme the following incomes can be declared-

- (1) Any income chargeable to tax which has not been declared by a person by filing return of income
- (2) Any income chargeable to tax which has not been disclosed in the return of income furnished by the person before the date of commencement of the scheme
- (3) Any income chargeable to tax which has escaped assessment as such person omitted or failed to furnish a return or to disclose truly and fully all material facts necessary for assessment or otherwise
 - (a) Declaration under the Scheme Form No. 1
 - (b) Jurisdictional Principal CIT to issue acknowledgement Form No. 2
 - (c) Proof of payment of tax, surcharge, penalty Form No 3
 - (d) Certificate of acceptance of declaration to be issued within 15 days of submission of proof of payment Form No 4.

(b) (i) The assessee has deducted tax at source under section 194C at 2% and the Assessing Officer holds that the tax ought to have been deducted under section 194-I @ 10%. The obvious consequence of the action would be disallowance at 30% of expenditure by invoking section 40(a)(ia) of the Act.

In this case, the assessee has not paid the amount merely for use of land. The payment is also towards other services such as use of airport land for landing, the technical services involving navigation, security and other ancillary services.

As the payment was not for use of land, the provisions of section 194-I are not attracted.

The payment is for various composite services and hence only the provisions of section 194C could be applied and not section 194-I. Thus the disallowance contemplated by the Assessing Officer is not tenable in law.
Case law reference Japan Airlines Co Ltd v. CIT(2015)377 ITR 372 (SC)

- (ii) When there is a credit in the books of the firm and if the source for such credit is not explained, the Assessing Officer may assess the same as deemed income of the assessee of the year of such credit by invoking section 68.
When section 68 is invoked for the purpose of taxing the unexplained tax credit, such income is liable to tax at 30% under section 115BBE. [Now taxable at 77.25% plus penalty under section 271AAC @ 10% of the credit]

In the case of a firm, the onus of the firm is discharged when the amounts credited in the books of account is attributed to the partners who paid the amount to the firm. The Assessing Officer may well verify the capacity of the partners who contributed the amounts as capital and he cannot saddle the firm with addition under section 68.
When the firm was constituted on 01.06.2015 with a capital contribution of ` 40 lakhs by the partners, it could not be assessed to tax in its hands since it has come to existence only on that date and it could not have earned such income on that date. Thus the action of the Assessing Officer is not tenable in law.
Case law reference: CIT v. M. Venkateswara Rao (2015) 370 ITR 212 (T & AP).

4. (a) Outline the legislative objective of bringing into existence the provisions relating to transfer pricing in relation to international transactions? 5

(b) The statement of profit & loss of BG (P) Ltd, a resident company engaged in manufacturing activity, shows a net profit of ` 36 lakhs for the year ended 31.03.2017, after debit/credit of the following items:

Credited to Profit and Loss Account:

- (i) Long term capital gain on sale of vacant site ` 25,00,000.**
- (ii) Dividend from Indian companies ` 10,20,000.**
- (iii) Rent from commercial property ` 3,00,000.**

Debited to Profit and Loss Account:

- (i) Depreciation ` 13,00,000.**
- (ii) Donation to electoral trust ` 80,000.**
- (iii) Advertisement in souvenir of political party ` 45,000.**
- (iv) Interest paid to non-resident ` 1,00,000 (without deduction of tax at source).**
- (v) Salary payable to managing director ` 15,00,000 but not paid till 31. 03. 2017. (no tax was deducted at source).**
- (vi) Sold goods for ` 5 lakhs to a firm in which the wife of managing director had 25% share. Discount @ 10% of the sale price was given to the firm.**
- (vii) Loss from trading in commodity derivatives ` 1,60,000.**
- (viii) Provision for income-tax ` 4,25,000.**
- (ix) Proposed dividend ` 7,50,000.**

Additional Information:

Depreciation allowable as per the Income-tax Act, 1961 ` 14,50,000.

The long-term capital gain on sale of unused land (computed) is ` 21,20,000. The company purchased a residential building in December 2016 by investing the entire

sale consideration. The newly acquired building was meant to be used as quarters by managing director.

Compute the total income of the company for the Assessment Year 2017-18. Ignore MAT provisions.

11

Answer:

4. (a) The presence of multinational enterprises in India and their ability to allocate profits in different jurisdictions by controlling prices in intra-group transactions prompted the Government to set up an Expert Group to examine the issues relating to transfer pricing.

There is a possibility that two or more entities belonging to the same multinational group can fix up their prices for goods and services and allocate profits among the enterprises within the group in such a way that there may be either no profit or negligible profit in the jurisdiction which taxes such profits and substantial profit in the jurisdiction which is tax haven or where the tax liability is minimum. This may adversely affect a country's share of due revenue.

The increasing participation of multinational groups in economic activities in India has given rise to new and complex issues emerging from transactions entered into between two or more enterprises belonging to the same multinational group. The profits derived by such enterprises carrying on business in India can be controlled by the multinational group, by manipulating the prices charged and paid in such intra-group transactions, which may lead to erosion of tax revenue.

Therefore, transfer pricing provisions have been brought in by the Finance Act, 2001 with a view to provide a statutory framework which can lead to computation of reasonable, fair and equitable profits and tax in India, in the case of such multinational enterprises.

(b)

Computation of total income of BG (P) Ltd for the Assessment Year 2017-18

| | | |
|---|-----------|-----------|
| Profits and gains of business or profession: | | |
| Net Profit as per Profit and Loss Account | | 36,00,000 |
| Add: | | |
| Depreciation debited to Profit and Loss Account | | 13,00,000 |
| Donation to electoral trust | | 80,000 |
| Advertisement in souvenir of political party - disallowed | | 45,000 |
| Interest paid to non-resident without deduction of tax at source – disallowed @ 100% | | 1,00,000 |
| Salary payable to managing director - shown as payable but liable for tax deduction at source when shown as payable. Tax is deductible only at the time of actual payment | | Nil |
| Discount to related party - not covered by section 40A(2)(b) | | Nil |
| Loss from commodity trading being regular business loss, no adjustment is required | | Nil |
| Provision for income-tax | | 4,25,000 |
| Proposed dividend | | 7,50,000 |
| | | 63,00,000 |
| Less: | | |
| Long term capital gain on sale of vacant site | 25,00,000 | |
| Dividend from Indian companies | 10,20,000 | |
| Rent from commercial property - considered separately | 3,00,000 | |

| | | |
|--|-----------|-----------|
| Depreciation allowable as per Income-tax Act | 14,50,000 | |
| | | 52,70,000 |
| Income from Profits and gains of business or profession | | 10,30,000 |
| | | |
| Income from House property: | | |
| Rent received | 3,00,000 | |
| Less : Deduction U/s. 24 @ 30% | 90,000 | |
| | | 2,10,000 |
| Long term capital gain | | |
| From sale of unused land | 21,20,000 | |
| Less: Exemption U/s.54 F - not available for company assessee | Nil | |
| | | 21,20,000 |
| Income from Other Sources: | | |
| Dividend from other Indian companies - taxable as it is more than ` 10 lakhs(Note:1) | | Nil |
| Gross Total Income | | 33,60,000 |
| Less: Deduction under section 80GGB in respect of donation to electoral trust | | 80,000 |
| Total Income | | 32,80,000 |

Note:1 Dividend in excess of ` 10 Lakh is taxable only in case of an Individual, HUF, and Firm being resident in India.

5. (a) Saraswati Ltd. has received a proper notice under section 148 for the Assessment Year 2014-15 on 22.03.2017. They also anticipate similar notices for the Assessment Years 2011-12 and 2012-13 for which they have already furnished return of income and for which assessments have been completed. On a scrutiny of the books of account produced, you have seen huge amounts of income which has escaped taxation. The tax effect for AY 2014-15 is ` 35 lakhs and for AYs 2011-12 and 2012-13 the differential tax is likely to exceed ` 1 crore. The company seeks your advice as to what should be done now. Advise the company suitably. 7
- (b) Brahma Ltd., discarded certain number of assets forming part of a block of assets during the previous year 2016-17. The Assessing Officer has disallowed the depreciation pertaining to such discarded assets. Discuss whether such action of the Assessing Officer is tenable in law. 4
- (c) Maushyaputra Ltd., issued debentures of ` 5 crores, redeemable after six years. The debenture holders were given an option of taking up the interest for all the six years upfront, at a discount. All the debenture holders opted for the same. The company complied with the TDS formalities. The Assessing officer is of the view that only one-sixth of the interest is allowable in the current year. Is the contention of the Assessing Officer correct in law? 5

Answer:

5. (a) Settlement Commission
As per section 245C, an assessee may, at any stage of a case relating to him, make an application in the prescribed form and manner to the Settlement Commission. "Case" means any proceeding for assessment which may be pending before an Assessing Officer on the date on which such application is made.

A proceeding for assessment or reassessment or recomputation under section 147 is

deemed to have commenced from the date of issue of notice under section 148. Where a notice under section 148 is issued for any assessment year, a proceeding under section 147 shall be deemed to have commenced on the date of issue of such notice and the assessee can approach the Settlement Commission for other assessment years as well, even if notice under section 148 for such other assessment years have not been issued but could have been issued on that date. However, a return of income for such other assessment years should have been furnished under section 139 or in response to notice under section 142.

In the case on hand, M/s. Saraswati Ltd. has received a notice under section 148 for the A.Y.2014-15 and also anticipates similar notices for the A.Y. 2011-12 and A.Y. 2012-13, for which return of income has been furnished. Thus, a proceeding for assessment is pending before an Assessing Officer i.e., the basic condition for approaching Settlement Commission is satisfied.

Moreover, since after examination of the books of account, huge amount of concealed income is also noticed, it is presumed that the second condition that the additional amount of income-tax payable on the income disclosed in the application should exceed ` 10 lakhs has also been satisfied.

Based on these facts, assuming that the necessary conditions are fulfilled, our advice as consultant to M/s. Saraswati Ltd. would be to approach the Settlement Commission to have his case settled and apply for grant of immunity from penalty and prosecution.

(b) Depreciation on discarded assets

The issue under consideration is whether disallowance of depreciation made by the AO in arriving at the WDV of the block of asset, with regard to the discarded asset is justified.

One of the conditions for claim of depreciation under section 32 is that the eligible asset must have been put to use for the purpose of business or profession.

The other aspect to be considered is whether merely discarding an obsolete machinery, which is physically available, will attract the expression "moneys payable" appearing in section 43(6), so as to deduct its value from the WDV of the block.

The expression "used for the purposes of the business" in section 32 when used with respect to discarded machinery would mean the use in the business, not only in the relevant financial year/previous year, but also in the earlier financial years.

The discarded machinery may not be actually used in the relevant previous year but depreciation can be claimed as long as it was used for the purposes of business in the earlier years provided the block continues to exist in the relevant previous year.

Therefore, the condition for claiming depreciation in respect of the discarded machine would be satisfied if it was used in the earlier previous years for the business.

Coming to the issue of "moneys payable" as per section 43(6), the machinery has not been sold as machinery or scrap or disposed off, and it continues to exist. Hence it will not form part of "moneys payable", which alone is deductible while computing the WDV of the block to which it belongs.

The disallowance by the AO is hence not tenable in law.

Such a view was taken in the case of CIT v. Yamaha Motor India Pvt. Ltd, (2010) 328

ITR 297 (Del).

- (c) The issue under consideration is whether, in a case where debentures are issued with maturity at the end of five years, and the debenture holders are given an option of upfront payment of interest in the first year itself, whether the entire upfront interest paid be claimed as deduction by the company in the first year or should the same be deferred over a period of five years; and would the treatment of such interest as deferred revenue expenditure in the books of account have any impact on the tax treatment.

Under section 36(1)(iii), deduction of the amount of interest paid in respect of capital borrowed for the purposes of business or profession, is allowable as deduction.

The moment the option for upfront payment was exercised by the subscriber, the liability of X Ltd. to make the payment in that year had arisen. Not only had the liability arisen in the previous year in question, it was even quantified and discharged as well in that very year.

When the deduction of entire upfront payment of interest is allowable as per the Income-tax Act, 1961, the fact that a different treatment was given in the books of account could not be a factor which would bar the company from claiming the entire expenditure as a deduction.

The contention of the AO is not correct. The assessee can claim the entire amount of debenture interest paid upfront, in the current year, The Supreme Court has taken the said view in the case of Taparia Tools Ltd. v. JCIT (2015) 372 ITR 605.

6. (a) Pradhan (P) Ltd. gives you the following information for the Financial Year 2016-17:

- (i) It paid a refundable deposit of ` 5 lakhs to the landlord where the company has commenced manufacturing activity during the year.
- (ii) It paid ` 3 lakhs to a hotel accommodation where the training programme for the marketing force was conducted.
- (iii) Paid non-compete fee of ` 10 lakhs to a director who was associated with the company for the last 15 years.
- (iv) It filed the quarterly statement of TDS for the quarter ended 30.09.2016 on 05.01.2017. The amount of tax deducted and remitted in the quarter is ` 60,000.
- (v) It received interest-free loan of ` 7 lakhs from its subsidiary company in December 2016 to meet its working capital requirements. The subsidiary company has accumulated profit of ` 20 lakhs.
- (vi) It engaged a famous tennis player Mr. Mahesh as Brand Ambassador for promoting its products and paid ` 2 lakhs as fee to him.
- (vii) It acquired a luxury car for ` 15 lakhs by making payment by cheque on 01.10.2016.
- (viii) It paid ` 30,000 to travel agents for purchase of train and air tickets to the company officials during the year.

You are requested to state in brief the consequences of the above transaction as per TDS/TCS provisions of the Income-tax Act, 1961. 8

- (b) Parthiv, aged 45, is resident of India. During the F.Y. 2016-17, interest of ` 3,10,000 was credited to his Non-resident (External) Account with UBI ` 70,000 being interest on fixed deposit with UBI, was credited to his saving bank account during this period. He

also received ` 13,000 as interest on this saving account.

Is Parthiv required to file return of income?

What will be your answer, if he also owns one shop in Delhi having area of 250 sq.ft., for which he has received gross rent of ` 21,000 per month, property taxes being borne by the tenant?

8

Answer:

6. (a) (i) Payment of refundable deposit to landlord would not attract TDS provisions of section 194-1 (Circular No. 718 dated 22.08.1995).
- (ii) Payment to hotel accommodation would be in the nature of rent attracting the provisions of section 194-1. Hence the company must deduct tax at source @ 10% on the payments made to hotel if the same is more than ` 1,80,000 in aggregate in a financial year.
- (iii) Non-compete fee is chargeable to tax under section 28(va). It is also liable for tax deduction under section 194J at 10% as the payment exceeds the threshold limit of ` 30,000.
- (iv) Fee for late filing quarterly statement is ` 200 per day to be reckoned from 01.11.2016 to 05.01.2017 (65 days). The late fee payment is ` 13,000 which is less than the amount of tax deducted at source for the quarter ended 30.09.2016.
- (v) Receipt of interest-free loan from subsidiary company in which the company has substantial interest is chargeable to tax as deemed dividend. No tax is deductible at source on the amount of deemed dividend by the payer viz. subsidiary company.
- (vi) Payment to brand ambassador being a sports person covered by notified profession under section 194J, tax is deductible at source @ 10% on the payment. Where PAN of the payee is not available, the tax deductible at source would be 20%.
- (vii) Purchase of luxury car exceeding ` 10 lakhs is liable for tax collection at source at 1% w.e.f. 01.06.2016. Hence the company has to pay 1% more to the vendor by way of TCS.
- (viii) Payment to travel agents for purchase of tickets would not attract the provisions of section 194C and hence no tax is deductible at source. [Circular 713 dated 02.08.1995].
- (b) An individual is required to furnish a return of income under section 139(1) if his total income, before giving effect to the deductions under Chapter VI-A, exceeds the maximum amount not chargeable to tax i.e. ` 2,50,000 (for A.Y. 2017-18).

Computation of total income of Mr. Parthiv for A.Y. 2017-18

| Particulars | ` |
|---|--------|
| Income from other sources | |
| Interest earned from Non-resident (External) Account ` 3,10,000 section 10(4)(ii), assuming that Mr.Parthiv has been permitted by RBI to the aforesaid account] | |
| Interest on fixed deposit with SBI | 70,000 |
| Interest on savings bank account | 13,000 |
| Gross Total Income | 83,000 |
| Less: Deduction under section 80TTA (Interest on saving bank account) | 10,000 |
| Total Income | 73,000 |

Since the total income of Mr. Parthiv for A.Y. 2017-18, before giving effect to the

deductions under Chapter VI-A, is less than the basic exemption limit of ` 2,50,000, he is not required to file return of income for A.Y. 2017-18.

Situation 2

When he receives shop rent, his income from house property is `21,000×12 = ` 2,52,000

Standard deduction of 30% is available. Net income is ` 176,400.

This will get added to the gross total income.

Revised GTI is ` 2,59,400

As this exceeds ` 2,50,000 he will be required to file the return of income.

7. (a) Mr. Ram gave cash gift of ` 10 lakhs to his younger brother Mr. Bharat's wife Smt. Mandavi. On the same date Mr. Bharat gave gift to wife of Mr. Ram viz, Smt. Sita a vacant land measuring 2000 sq.ft. The stamp duty valuation of the land on the date of gift was ` 8 lakhs.

Smt. Mandavi invested ` 8 lakhs in bank fixed deposit fetching interest at 7% per annum and commenced a business with the balance of ` 2 lakhs along with her own capital of ` 3 lakhs. The profit for the year from the business amounts to ` 1,50,000.

Determine the tax implication of the above transaction in the hands of all the parties. Would your answer be different if all of them are non-relatives? 8

- (b) In the context of e-commerce transactions, explain why the existing income tax laws are inadequate. 8

Answer:

7. (a)

| |
|--|
| The amount gifted by Mr. Ram and Mr. Bharat would fall in the exceptions to section 56(2)(vii) as they are 'relatives'. The amount gifted hence would not be liable to tax as income. |
| The relationship from donee's perspective it would be brother of spouse. |
| The gift up to ` 8 lakhs is covered by cross-transfer. Hence, the income arising therefrom is liable for clubbing in the hands of spouse of the person deriving such income. |
| In the case of Smt. Sita, who received vacant site there is no income. Hence, the clubbing provision will not operate. |
| As regards Smt. Mandavi, the interest income of ` 56,000 (`8 lakhs × 7%) is liable for clubbing in the hands of Mr. Bharat. |
| As regards income from business which includes the extra gift of ` 2 lakhs by Mr. Ram (brother of her spouse) is not liable for clubbing. Hence the business income will have no tax implication. |
| In case they are not relatives: |
| The principles relating to cross-transfer will not apply when they are not relatives. |
| The amount received by Smt. Mandavi from Mr. Ram would be assessed as income under section 56(2). The business income of Smt. Mandavi and interest income will not be liable for any clubbing and hence would be taxed in her hands. |
| The stamp duty value of land received by Smt. Sita is assessable to tax as income under the head 'other sources'. |

- (b) Why the existing rules are inadequate for taxation of e-commerce transactions?

There are several reasons for which the nexus based or permanent establishment-based concept of tax regime is unsuitable for the digital economy.

First, in a digital economy, a company or business enterprise has the ability to have significant digital presence in the economy of a country without being liable to taxation due to the lack of nexus under the current tax regimes.

Second, International tax treaties do not usually permit taxation of business profits of a non-resident enterprise in the absence of a permanent establishment to which these profits are attributable. For example, many jurisdictions would not tax income derived by a non-resident enterprise from remote sales to customers located in that jurisdiction unless the enterprise maintained some degree of physical presence in that jurisdiction.

As a result, the issue of nexus also relates to the domestic rules for the taxation of non-resident enterprises.

Third, there remains considerable ambiguity regarding the characterization of income arising from transactions involving telecommunication networks, software and data exchange. These disputes on characterization of payments are more commonly observed in countries like India, having tax treaties that allocate taxing rights to the source jurisdiction in respect of royalty and fee for technical services.

Finally, the continuing ambiguity related to nexus and characterization of the payments have the potential of giving rise to tax disputes, particularly in countries like India, where the tax treaties allocate taxing rights to the source jurisdiction. The resultant ambiguity, uncertainty and unpredictability can develop as a significant constraint for the expansion of digital economy in India. This makes an important case for finding a solution to all these issues, in the form of a simple, clear and predictable tax rule that unambiguously defines the tax liability of digital enterprises, thereby facilitating their business planning, reducing their tax risk and contingent liabilities, while also reducing compliance costs, disputes and administrative burden.

8. Write Short notes (any four):

4x4=16

- (a) Distinction between Tax Avoidance and Tax Evasion**
- (b) Penalties that are imposable for violation of Transfer pricing provisions**
- (c) Best Judgement Assessment**
- (d) Memorandum of Cross Objection**
- (e) Condonation of delay in filling appeal before CIT (Appeal)**

Answer:

8. (a) Distinguish between Tax avoidance & Tax evasion.

| Tax avoidance | Tax evasion |
|--|---|
| It is termed as a planning to reduce tax burdens taking all permissible ways within the law. | Methods adopted illegally to avoid payment of tax liability. Suppression Income, Inflation of expenditure are some of the attempts to reduce or negate tax liability. |
| It defeats the basic intention of law. | It is totally against the law. |
| The loopholes of law taken in to the advantages of tax payers | It is an attempt to evade the tax by unfair means. |
| It evolves mala fide intension. | It is unlawful. |
| It has legal sanction. | As it is unlawful, punishable under relevant law. |

(b) List out four Penalties that are imposable under Transfer Pricing:

Following are the penalties to be imposed due to noncompliance of provisions of

Transfer Pricing,

| Relevant Sections | Particulars of penalty | Quantum of Penalty |
|-------------------|---|--|
| 271AA | Failure to keep and maintain prescribed information/documents in respect of international or specified domestic transaction or failure to report any international or domestic transaction or furnish incorrect information | 2% of value of each international transaction or specified domestic transaction entered by such person |
| 271(l)(c) | Adjustment to tax payers income during assessment | 100% to 300% of tax on adjusted amount |
| 271BA | Failure to furnish accountant's report u/s 92E | ₹ 1,00,000 |
| 271G | Failure to furnish information/documents during assessment u/s 92D(3) | 2% value of international transactions or specified domestic transactions for each failure. |

(c) **Best Judgment Assessment:**

The Assessing Officer after considering all material facts which he has gathered is under an obligation to make an assessment of the total income or less to the best of his judgment in the following cases.

- If the person fails to make a return as required under s. 139(1) and he has not made a return or a revised return under section 139 (4) or section 149(5).
- if any person fails to comply with all the terms and conditions stipulated under a notice u/s. 142(1) or fails to comply with the directions requiring him to get his accounts audited in terms' of section 142(2A).
- If the person after having filed a return, fails to comply with the terms of a notice under section 143(2) requiring his presence or production of evidence and documents.
- If the Assessing officer is not satisfied about the correctness and the completeness of the accounts of the Assessee or if no method of accounting has been regularly employed by the Assessee.

In case of best judgment assessment an Assessee has a right to file an appeal under section 246A or to make an application for revision under section 246 to the Income Tax Commissioner. The best judgment assessment can only be made after giving the Assessee an opportunity of being heard. Such opportunities shall be given by issuance of notice by way of a showcase as to why the assessment should not be completed to the best of the judgment and that opportunity for hearing will not be necessary where notice u/s 142(1) has already been issued. The best judgement assessment needs to be completed by 21 months from end of the assessment year in which income was first assessable. Before assume the assessment, the AO must record that there has been noncompliance on the part of assessee to various notices.

(d) **Memorandum of Cross Objection**

On filing of the appeal to the ITAT by the taxpayer or by the Assessing Officer (as the case may be) the opposite party will be intimated about the appeal and the opposite party has to file a memorandum of cross objection with the ITAT. The memorandum of cross objection is to be filed within a period of 30 days of receipt of notice. The memorandum of cross objection is to be filed in Form No. 36A. There is no fee for filing the memorandum of cross objection. The ITAT may accept a memorandum of cross objection even after the period of 30 days if it is satisfied that there was sufficient cause for not submitting the same within the prescribed time.

(e) **Condonation of delay in filing appeal before CIT (Appeal)**

Section 249(3) enables the CIT (Appeal) to admit an appeal after the examination of the time limit of 30 days if he is satisfied that the appellant had sufficient cause for not

presenting it within the time limit prescribed. In case of an appeal filed beyond the period of 30 days, it is recommended that the same shall be accompanied by a petition for condonation of delay explaining the reasons for the delay. In appropriate cases, it is also advisable to file an affidavit confirming the reasons for the delay. As far as possible an attempt shall be to explain the reasons for each and every day's delay in filing the appeal. The words sufficient cause shall be interpreted liberally with a view to advance the cause of justice. The provision conferring right of appeal should be construed in a reasonable, practical and liberal manner [**Mela Ram and Sons vs. CIT (29-ITR-607) (SC); CIT vs. Grafik India (194-ITR-645) (SC)**].

If the appellant has acted diligently then normally the delay gets condoned. However if the delay is caused due to negligence on the part of the appellant, it become difficult to get the delay condoned. Where the reason for delay in filing first appeal is attributed to negligence or inaction on the part of tax consultant and there is no malafide imputable to the assessee the delay can be condoned. -**Shakti Clearing Agency (P) Ltd. vs. ITO (2003) 127 Taxmann 49**.