

Paper 16- DIRECT TAX LAWS AND INTERNATIONAL TAXATION

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Full Marks: 100

Time allowed: 3 hours

Section - A

- 1. Multiple Choice Questions with Justification: [10x2=20]**
- (i) The Chief Executive Officer of every political party has to file the return of income of the party if the total income of the party without giving effect to the provisions of section _____ exceeds the maximum amount not chargeable to income-tax.
- (a) 11
 - (b) 12
 - (c) 13
 - (d) 13A
- (ii) What is the due date of filing the return of income in case of a company who is required to furnish a report in Form No. 3CEB under section 92E?
- (a) September 30 of the assessment year
 - (b) November 30 of the assessment the year
 - (c) July 31 of the assessment year
 - (d) June 30 of relevant assessment the year
- (iii) One of the following, can be carried forward even return of income is filed after due date:
- (a) Unabsorbed Depreciation
 - (b) Business Loss
 - (c) Short term capital loss
 - (d) Long term capital loss
- (iv) Assessment under following section is termed as scrutiny assessment
- (a) 143(3)
 - (b) 144
 - (c) Both of the above
 - (d) None of the above
- (v) The objective of carrying out assessment u/s 147 is to bring under the tax net _____:
- (a) Any money, bullion, jewellery, valuable article, etc. which are undisclosed
 - (b) Any income which has escaped assessment
 - (c) Any of the above
 - (d) Both of the above
- (vi) MAT shall not apply to any income accruing or arising to a company from
- (a) Life insurance business
 - (b) Banking business
 - (c) Business of transmission of electricity
 - (d) All of the above
- (vii) Any mistake which is apparent from the record in any order passed by the Assessing Officer can be rectified under section _____.
- (a) 154
 - (b) 147
 - (c) 143
 - (d) 254

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- (viii) If a person fails to comply with the provisions relating to PAN (i.e. obtaining PAN, quoting PAN, etc.), then penalty can be levied under section _____
(a) 270A
(b) 272
(c) 272A
(d) 272B
- (ix) An appeal to the Commissioner of Income-tax (Appeals) shall be filed in Form No. _____.
(a) 35
(b) 36
(c) 34C
(d) 35B
- (x) An application (in quadruplicate) for advance ruling by a resident applicant for determination of his tax liability arising out of one or more transactions valuing ₹ 100 crore or more in total which has been undertaken or is proposed to be undertaken by him is to be made in Form No. _____.
(a) 34D
(b) 34DA
(c) 34E
(d) 34EA

Answer:

(i) (d) As per sec. 139(4B), the Chief Executive Officer of every political party has to file the return of income of the party if the total income of the party without giving effect to the provisions of sec. 13A exceeds the maximum amount not chargeable to income-tax.

(ii) (b) As per explanation 2 to sec. 139(1), the due date of filing the return in case of a company who is required to furnish a report in Form No. 3CEB u/s 92E is November 30 of the assessment year.

(iii) (a) Unabsorbed depreciation can be carried forward even if the return of loss is submitted after the due date, as it is not covered under Chapter VI of set off or carry forward of losses but covered u/s 32(2).

(iv) (a) Assessment u/s 144 is termed as 'Best Judgment Assessment'. Assessment u/s 143(3) is termed as 'Scrutiny Assessment'

(v) (b) The objective of carrying out assessment or reassessment or recomputation u/s 147 is to bring under the tax net any income which has escaped assessment. Sec. 147 is also known as Income Escaping Assessment.

(vi) (a) The provision of section 115JB is not applicable to any income accruing or arising to a company from life insurance business referred to in sec. 115B

(vii) (a) Any mistake which is apparent from the record in an order passed by the Assessing Officer can be rectified u/s 154.

(viii) (d) Section 272B provides for penalty of ₹ 10,000 in case of default by the taxpayer in complying with the provisions relating to PAN, i.e., not obtaining PAN, even though he is liable to obtain PAN or knowingly quoting incorrect PAN in any prescribed document in which PAN is to be quoted or intimating incorrect PAN to the person deducting tax or person collecting tax.

(ix) (a) An appeal to the Commissioner of Income-tax (Appeals) shall be filed in Form No. 35.

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(x) (b) An application (in quadruplicate) for advance ruling shall be made by a resident applicant, for determination of his tax liability arising out of one or more transactions valuing ₹ 100 crore or more in total which has been undertaken or is proposed to be undertaken by him, in Form No. 34DA.

Section-B (Answer any five questions out of seven questions)

2.(a) Mr. Q, a non-resident, operates an aircraft between Singapore and Chennai. He received the following amounts in the course of the business of operation of aircraft during the previous year:

- (i) ₹ 2 crores in India on account of carriage of passengers from Chennai.
- (ii) ₹ 1 crore in India on account of carriage of goods from Chennai.
- (iii) ₹ 3 crores in India on account of carriage of passengers from Singapore.
- (iv) ₹ 1 crore in Singapore on account of carriage of passengers from Chennai.
- (v) The total expenditure incurred by Mr. Q for the purposes of the business during the year was ₹ 6.75 crores.

Compute income chargeable to tax of the foreign airlines. [8]

(b) Virat Ltd. is a widely held company. It is currently considering a major expansion of its production facilities and the following alternatives are available:

Particulars	Alt-1	Alt-2	Alt-3
	(₹)	(₹)	(₹)
Share capital	50,00,000	20,00,000	10,00,000
14% Debentures	—	20,00,000	15,00,000
18% Loan from Bank	—	10,00,000	25,00,000

Expected rate of return before tax is 30%. Rate of dividend of the company since 1995 has not been less than 22% and date of dividend declaration is 30th June every year. Which alternative should the company opt with reference to tax planning? [8]

Answer:

(a) Computation of income of Mr. Q for the A.Y. 2018-19

Particulars	Amount
Amount received in India on account of carriage of passengers from Chennai	2,00,00,000
Amount received in India on account of carriage of goods from Chennai	1,00,00,000
Amount received in India on account of carriage of passengers from Singapore	3,00,00,000
Amount received in Singapore on account of carriage of passengers from Chennai	1,00,00,000
Total	7,00,00,000
Total Income (as per sec. 44BBA being 5% of above)	35,00,000

(b) Before taking the source of finances i.e. Capital or borrowings, the comparison between pre commencement period and post commencement period should be made. The comparison is as follows:

- (1) (i) Dividend is not deductible either for pre commencement period or in the post commencement period in India;

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(ii) Interest is capitalised for pre-commencement period, i.e. added to the cost of project (cost of fixed assets) and its depreciation is calculated on capitalised value of assets. In post commencement period, interest is fully deductible.

(2) (i) Cost of raising finance in case of capital is not deductible as revenue expenditure but amortised u/s 35D of the Act. If such expenditure is incurred after the commencement of the business, Section 35D is applicable provided the expenditure is undertaken for expansion purposes.

(ii) Cost of borrowing funds in case of pre commencement period is capitalised and in case of post commencement period, it is deductible fully in the year.

The above consideration will go a long way in suggesting the managements of corporate entities to adopt a suitable capital structure and selecting the appropriate financing sources by providing an optimal capital mix for the organization.

Computation of Net Benefit in different Alternative

Particulars	Alt - 1	Alt - 2	Alt - 3
Share Capital	50,00,000	20,00,000	10,00,000
14% Debentures	—	15,00,000	15,00,000
18% loan from Bank	—	25,00,000	25,00,000
EBIT	15,00,000	15,00,000	15,00,000
Cost to Company			
Debenture Interest	—	2,80,000	2,10,000
Interest on loan from Bank	—	1,80,000	4,50,000
Net Profit before tax and dividend	15,00,000	10,40,000	8,40,000
Tax Payable @ 30.9%	4,63,500	3,21,360	2,59,560
Profit after tax	10,36,500	7,18,640	5,80,400
Dividend @ 22%	11,00,000	4,40,000	2,20,000
Profit after cost of capital	(63,500)	2,78,640	3,60,400

Hence, Alt-3 is better.

3. Following is the profit and loss account of Z Ltd. for the year ended on 31-3-2018:

Particulars	Amount	Particulars	Amount
To Raw material consumed	23,25,000	By Sale	1,60,00,000
To Rent	3,50,000	By Closing Stock	10,00,000
To Salary & Wages	12,00,000	By Revaluation Reserve	25,000
To Depreciation	5,00,000	By General Reserve	65,000
To Provision for contingencies	75,000	By Dividend from domestic companies	35,000
To Wealth Tax	50,000		
To Provision for bad debts	40,000		
To Proposed dividend	1,00,000		
To Provision for Income tax	1,05,000		
To Net Profit	1,23,80,000		
	1,71,25,000		1,71,25,000

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Additional Information:

- (1) Company is entitled to get exemption u/s 10(38) ₹ 1,00,000
- (2) The amount of depreciation includes depreciation on revaluation of assets ₹ 50,000. Further, for the purpose of Income tax, depreciation is ₹ 4,00,000.
- (3) Turnover of the company during the previous year was ₹ 53 crores.
- (4) In past few years, company had suffered losses, following balances are still unabsorbed:

	As per Income tax Act	As per books of Accounts
Depreciation	₹ 65,00,000	Nil
Losses	₹ 35,50,000	Nil

Compute tax liability of the company.

[16]

Answer:

Computation of total income of Z Ltd. for the A.Y.2018-19 (as per other provisions of the Act)

Particulars	Details	Amount
Net profit as per books of accounts		1,23,80,000
Add: Expenditure disallowed but debited in P/L A/c		
Excess Depreciation	1,00,000	
Provisions for Contingencies	75,000	
Wealth Tax	50,000	
Provision for bad debts	40,000	
Proposed Dividend	1,00,000	
Provision for income tax	1,05,000	4,70,000
		1,28,50,000
Less: Amount credited to P/L A/c		
Exemption u/s 10(38)	1,00,000	
Revaluation Reserve	25,000	
General Reserve	65,000	
Dividend from domestic companies	35,000	2,25,000
		1,26,25,000
Less: Brought forward business loss		35,50,000
		90,75,000
Less: Unabsorbed Depreciation		65,00,000
Total Income		25,75,000

Computation of Book Profit of Z Ltd. for the A.Y.2018-19

Particulars	Details	Amount
Net profit as per books of accounts		1,23,80,000
Add:		
Provision for contingencies	75,000	
Proposed Dividend	1,00,000	
Provision for income tax	1,05,000	
Provision for Bad Debts	40,000	
Depreciation	5,00,000	8,20,000
		1,32,00,000
Less:		

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Depreciation (ignoring depreciation on revaluation)	4,50,000	
Amount transferred from Revaluation Reserve	25,000	
Amount transferred from General Reserve	65,000	
Dividend from domestic companies	35,000	5,75,000
Book Profit		1,26,25,000

Computation of tax liability of Z Ltd.:

Particulars	Amount
Total income as per other provisions of the Act	25,75,000
Tax on above @ 30% [A]	7,72,500
Book profit u/s 115JB	1,26,25,000
18.5% of book profit [B]	23,35,625
Tax [Higher of A & B]	23,35,625
Add: Surcharge [As total income is ₹ 1,26,25,000]	1,63,494
Tax & Surcharge	24,99,119
Add: Education Cess & SHEC @ 3%	74,974
Tax Liability (Rounded off u/s 288B)	25,74,090

4.(a) DEF is a real estate investment trust (REIT). It owns house properties in different parts of Maharashtra. Besides, it holds controlling interest in A Ltd. (A Ltd., an Indian company, is SPV created by DEF for the purpose of owning commercial properties). Annual income of DEF for the previous year 2017-18 is calculated as under:

	₹ in crore
Rental income from properties directly owned by DEF (computed)	7
Long-term capital gain on sale of land and buildings directly owned by DEF (computed)	20
Short term capital gain on sale of listed shares of A Ltd.	2
Short term capital gain on sale of land and buildings directly owned by DEF (computed)	8
Interest from A Ltd.	13
Dividend from A Ltd.	10
Total	60

DEF distributes ₹ 50 crore to its unit holders. X is one of the unit holders. He holds 10% units in DEF. Compute income in hands of DEF and X. [8]

(b) Critically comment with the help of a case law:

“Securities premium shall not be considered as a part of the capital employed for the purpose of sec. 35D.” [8]

Answer:

(a) Computation of total income and tax liability of DEF for the A.Y. 2018-19

Particulars	₹ in crore
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Rental income from properties directly owned by DEF [Exempt u/s 10(23FCA)]	Nil
Long-term capital gain on sale of land and buildings directly owned by DEF	20
Short term capital gain on sale of listed shares of A Ltd.	2
Short term capital gain on sale of land and buildings directly owned by DEF	8
Interest from A Ltd. [Exempt u/s 10(23FC)]	Nil
Dividend from A Ltd. [Exempt u/s 10(23FC)]	Nil
Total Income	30
Tax on above	
- Long term capital gain [(₹ 20 crore x 20%) x 115% x 103%]	4.738
- Short term capital gain covered u/s 111A [(₹ 2 crore x 15%) x 115% x 103%]	0.35535
- Short term capital gain on sale of land and buildings (₹ 8 crore x 35.535% being MMR)	2.8428
Total	7.93615

Computation of total income of X for the A.Y. 2018-19

Particulars	₹ in crore
Rental income from properties [₹ 5 crore x 7 / 60]	0.58
Long-term capital gain on sale of land and buildings [Exempt u/s 10(23FD)]	Exempt
Short term capital gain on sale of listed shares of A Ltd. [Exempt u/s 10(23FD)]	Exempt
Short term capital gain on sale of land and buildings [Exempt u/s 10(23FD)]	Exempt
Interest from A Ltd. [₹ 5 crore x 13 / 60]	1.08
Dividend from A Ltd.	Exempt
Total Income	1.66

(b)

Berger Paints India Ltd. -vs.- CIT (2017) (SC) —

The appellant is a Limited Company engaged in the business of manufacture and sale of various kinds of paints. A notice was issued by the A.O. to the appellant (assessee) under Section 143(2) of the Act which called upon the appellant to explain as to on what basis the appellant had claimed in the return a deduction under the head "preliminary expenses" amounting to Rs.7,03,306/- being 2.5% of the "capital employed in the business of the company" under Section 35D of the Act. The appellant (assessee) replied to the notice. The appellant (assessee) contended therein that it had issued shares on a premium which, according to them, was a part of the capital employed in their business. The appellant, therefore, contended that it was on this basis, it claimed the said deduction and was, therefore, entitled to claim the same under Section 35D of the Act. The A.O. did not agree with the explanation given by the appellant. He was of the view that the expression "capital employed in the business of the company" did not include the "premium amount" received by the appellant on share capital. The Commissioner (Appeals) has deleted the addition. However, the Tribunal reversed the view taken by the Commissioner (Appeals). The High Court concurred with the Tribunal.

The Apex Court observed that if the intention of the Legislature were to treat the amount of "premium" collected by the Company from its shareholders while issuing the shares to be the part of "capital employed in the business of the company", then it would have been specifically said so in the Explanation (b) of sub-section (3) of Section 35D of the Act. It was, however, not said. Non-mentioning of the words does indicate the legislative intent that the Legislature did not intend to extend the benefit of Section 35D to such sum.

The company's accounts do not show the reserve and surplus as a part of its issued, subscribed and paid up capital. It is taken as part of share holders fund but the same was not a part of the issued, subscribed and paid up capital of the Company.

Similarly, Companies Act which deals with the "issue of shares at premium and discount" requires a company to transfer the amount so collected as premium from the shareholders and keep the same in a separate account called "securities premium account". It does not anywhere says that such amount be treated as part of capital of the company employed in the business for one or other purpose.

Thus, securities premium shall not be considered as a part of the capital employed for the purpose of sec. 35D.

5.(a) Critically comment with the help of a case law:

"An Adjustment with respect to transfer pricing has to be confined to transactions with Associated Enterprises and cannot be made with respect to transactions with unrelated third parties". **[8]**

(b) Write brief note on ICDS – IX. **[8]**

Answer:

(a) CIT -vs.- M/s Thyssen Krupp Industries Private Ltd (2015)(Bom)

The assessee is in the business of execution of turnkey contracts involving design, manufacture, supply, erection and commissioning of sugar plants, cement plants, etc. During the subject Assessment Year, the assessee entered into international transactions with its Associated Enterprises (AE), as well as transactions with independent parties. The TPO proposed an addition on account of enhancement of profit margin on all transactions of the assessee. Aggrieved by the order, assessee filed an appeal with ITAT. The tribunal held that only transactions entered into by an assessee with its AE are subject to transfer pricing adjustment and not otherwise. Thus, allowing the assessee's appeal before it. Aggrieved by the order, the revenue filed an appeal with High Court.

The High Court dismisses revenue appeal by contending that as per Chapter X of the Act, redetermination of the consideration is to be done only with regard to income arising from International Transactions on determination of ALP. The adjustment which is mandated is only in respect of International Transaction and not transactions entered into by assessee with independent unrelated third parties, therefore this adjustment is beyond the scope and ambit of Chapter X of the Act.

(b) ICDS IX: Borrowing Costs:

Scope:

- ✿ The Standard deals with treatment of borrowing costs. However, the Standard does not deal with the actual or imputed cost of owners' equity and preference share capital.
 - Borrowing costs are interest and other costs incurred by a person in connection with the borrowing of funds and include:
 1. commitment charges on borrowings;
 2. amortised amount of discounts or premiums relating to borrowings;
 3. amortised amount of ancillary costs incurred in connection with the arrangement of borrowings;
 4. finance charges in respect of assets acquired under finance leases or under other similar arrangements.

Recognition:

- ✿ Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset shall be capitalised as part of the cost of that asset.
 - Qualifying asset means:
 1. land, building, machinery, plant or furniture, being tangible assets;
 2. know-how, patents, copyrights, trade marks, licences, franchises or any other business or commercial rights of similar nature, being intangible assets;
 3. inventories that require a period of 12 months or more to bring them to a saleable condition.

Borrowing Costs Eligible for Capitalisation:

- ✿ **Specific Borrowing:** The extent to which funds are borrowed specifically for the purposes of acquisition, construction or production of a qualifying asset, the amount of borrowing costs to be capitalised on that asset shall be the actual borrowing costs incurred during the period on the funds so borrowed.
- ✿ **Other than specific borrowing:** The amount of borrowing costs to be capitalised shall be computed in accordance with this formula: $A \times B / C$
 - A Borrowing costs incurred during the previous year except on specific borrowings
 - B
 - i. the average of costs of qualifying asset as appearing in the balance sheet of a person on the first day and the last day of the previous year
 - ii. in case the qualifying asset does not appear in the balance sheet of a person on the first day, half of the cost of qualifying asset; or
 - iii. in case the qualifying asset does not appear in the balance sheet of a person on the last day of the previous year, the average of the costs of qualifying asset as appearing in the balance sheet of a person on the first day of the previous year and on the date of put to use or completion, as the case may be,
 excluding the extent to which the qualifying assets are directly funded out of specific borrowings
 - C the average of the amount of total assets as appearing in the balance sheet of a person on the first day and the last day of the previous year, other than assets to the extent they are directly funded out of specific borrowings

Commencement of Capitalisation:

- ✿ The capitalisation of borrowing costs shall commence
 - In case of specific borrowing : from the date on which funds were borrowed
 - In case of other borrowing : from the date on which funds were utilised

Cessation of Capitalisation:

- ✿ Capitalisation of borrowing costs shall cease:

➤ In case of asset other than inventory	When such asset is first put to use
➤ In case of inventory	When substantially all the activities necessary to prepare such inventory for its intended sale are complete.

Disclosure:

- ✿ The following disclosure shall be made in respect of borrowing costs, namely:—
 1. the accounting policy adopted for borrowing costs; and
 2. the amount of borrowing costs capitalised during the previous year.

6.(a) Mahesh, aged 64 years, is resident and ordinarily resident in India. His income is ₹ 16,80,000 from a business in India and ₹ 5,45,000 from a business in a foreign country with

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whom India has agreement for avoidance of double taxation (ADT). According to the ADT agreement, income is taxable in the country in which it is earned and not in other country. However, in the other country, such income can be included for computation of tax rate.

According to the tax laws of the foreign country, Mahesh has paid ₹ 32,000 as tax in that country. During the previous year, Mahesh has paid ₹ 28,000 as tuition fee for his daughter in India and ₹ 90,000 as tuition fee for his son outside India for full time education. Mahesh has also received an interest of ₹ 48,000 on Government securities. Find out the tax liability of Mahesh for the assessment year 2018-19. [8]

(b) What are the key factors used to determine whether a jurisdiction is a tax haven? [8]

Answer:

(a) Computation of Total Income of Mahesh for the Assessment Year 2018-19

Particulars	₹
Business income in India	16,80,000
Interest on Government Securities	48,000
Gross Total Income	17,28,000
Less: Deduction u/s 80C	28,000
Total Income	17,00,000
Add: Foreign income to be included for rate purpose	5,45,000
Total	22,45,000
Tax on above	4,98,005
Less: Relief u/s 90 [₹ 5,45,000 x 22.18% ¹]	1,20,881
Tax Payable (Rounded off)	3,77,120

¹Average rate of tax = ₹ 4,98,005 / ₹ 22,45,000 x 100 = 22.18%

(b) Four key factors are used to determine whether a jurisdiction is a tax haven:

- Imposes no or only nominal taxes: Tax havens impose nil or only nominal taxes (generally or in special circumstances) and offer themselves, or are perceived to offer themselves, as a place to be used by non-residents to escape high taxes in their country of residence.
- Lack of transparency: Transparency ensures that there is an open and consistent application of tax laws among similarly situated taxpayers and that information needed by tax authorities to determine a taxpayer's correct tax liability is available (e.g., accounting records and underlying documentation). A lack of transparency in the operation of the legislative, legal or administrative provisions is another factor used to identify tax havens. The OECD is concerned that law should be applied openly and consistently, and that information needed by foreign tax authorities to determine a taxpayer's situation is available. Lack of transparency in one country can make it difficult, if not impossible, for other tax authorities to apply their laws effectively. 'Secret rulings', negotiated tax rates, or other practices that fail to apply the law openly and consistently are examples of a lack of transparency. Limited regulatory supervision or a government's lack of legal access to financial records is contributing factors.
- Lack of effective exchange of tax information with foreign tax authorities: Whether

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there are laws or administrative practices that prevent the effective exchange of information for tax purposes with other governments on taxpayers benefiting from the no or nominal taxation. Tax havens typically have laws or administrative practices under which businesses and individuals can benefit from strict rules and other protections against scrutiny by foreign tax authorities. This prevents the transmittance of information about taxpayers who are benefiting from the low tax jurisdiction.

- No requirement for a substantive local presence of the entity: The absence of a requirement that the activity be substantial is important because it suggests that a jurisdiction may be attempting to attract investment and transactions that are purely tax driven. It may also indicate that a country does not provide a legal or commercial environment or offer any economic advantages that would attract substantive business activities in the absence of the tax minimising opportunities it provides. The no substantial activities criterion was included in the 1998 Report as a criterion for identifying tax havens because the lack of such activities suggests that a jurisdiction may be attempting to attract investment and transactions that are purely tax driven. In 2001, the OECD's Committee on Fiscal Affairs agreed that this criterion would not be used to determine whether a tax haven was co-operative or unco-operative.

7.(a) Brain Inc. London has 35% equity in Salem Ltd. The company Salem Ltd. is engaged in development of software and maintenance of customers across the globe, which includes Brain Inc.

During the year 2017-18, Salem Ltd. spent 2000 man hours for developing and maintaining a software for Brain Inc. and billed at ₹ 1,000 per hour. The cost incurred for executing maintenance work to Brain Inc. for Salem Ltd. amount to ₹ 15,00,000. Similar such work was done for unrelated party Try Ltd. in which the profit was at 50%.

Brain Inc. gives technical support to Salem Ltd. which can be valued at 8% of gross profit. There is no such functional relationship with try Ltd.

Salem Ltd. gives credit period of 90 days the cost of which is 3% of the normal billing rate which is not given to other parties.

Compute ALP under cost plus method in the hands of Salem Ltd. and the impact of the same on the total income. [8]

(b) Compute penalty leviable u/s 270A in case of X Ltd from the following details:

Particulars	Total Income	Tax on Total Income	Book Profit	Tax on Book Profit
Return of income	80,00,000	24,72,000	2,00,00,000	40,77,770
Assessed income	1,20,00,000	39,67,560	2,10,00,000	42,81,659

[8]

Answer:

(a)

(A) Computation of Arm's Length Gross Profit Mark-up

Particulars	%
Normal Gross Profit Mark up	50.00

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Less: Adjustment for differences	
Technical support from Brain Inc [8% of Normal GP = 8% of 50%]	(4.00)
	46.00
Add: Cost of Credit to Brain Inc 3% of Normal Bill [3% × GP 50%]	1.50
Arm's Length Gross Profit mark-up	47.50

(B) Computation of Increase in Total Income of Brain Inc

Particulars	Amount
Cost of services	15,00,000
Arm's length Billed Value [Cost / [(100 – Arm's Length mark up)] [₹ 15,00,000 / (100% - 47.50%)]	28,57,143
Less: Billed amount [2,000 hours x ₹ 1,000 per hour]	20,00,000
Therefore, Increase in Total Income	8,57,143

(b) Computation of penalty

Particulars	Amount
Under-reported income	
Total income computed by the Assessing Officer	A 1,20,00,000
Total income as per return of income	B 80,00,000
Book profit computed by the Assessing Officer	C 2,10,00,000
Book profit as per return of income	D 2,00,00,000
Under-reported income [(A – B) + (C – D)]	50,00,000
Tax on under-reported income	
Tax on A	P 39,67,560
Tax on B	Q 24,72,000
Tax on C	R 42,81,659
Tax on D	S 40,77,770
Tax on Under-reported income [(P – Q) + (R – S)]	T 16,99,449
Penalty u/s 270A	
- Minimum (being 50% of T)	8,49,725
- Maximum (being 200% of T)	33,98,898

8. Write short note:

[4x4=16]

(a) Demerger u/s 2(19AA)

(b) Carry forward & Set off of losses on conversion into Limited Liability Partnership

(c) Factor for determining Most Appropriate Method

(d) Deduction of Head Office Expenditure in the case of Non-residents u/s 44C

Answer:

(a) Demerger u/s 2(19AA):

Demerger (in relation to companies) means the transfer, pursuant to a scheme of arrangement u/s 230 to 232 of the Companies Act, 2013, by a demerged company of its one or more undertakings to any resulting company in such a manner that:

- i. All assets and liabilities are transferred: All assets and liabilities of the undertaking, being transferred by the demerged company, immediately before the demerger, becomes the assets and liabilities of the resulting company.
- ii. Transfer at Book value: Assets and liabilities of the undertaking or undertakings being transferred by the demerged company are transferred at its book-value (without considering revaluation) immediately before the demerger.
Note: Any change in the value of assets consequent to their revaluation shall be ignored.
- iii. Consideration in shares: Resulting company issues, in consideration of the demerger, its shares to the shareholders of the demerged company on a proportionate basis except where the resulting company itself is a shareholder of the demerged company.
- iv. Common share-holders: Shareholders holding not less than 75% in value of the shares in the demerged company (other than shares already held therein immediately before the demerger, or by a nominee for, the resulting company or, its subsidiary) become shareholders of the resulting company or companies by virtue of the demerger, otherwise than as a result of the acquisition of the property or assets of the demerged company or any undertaking thereof by the resulting company.
- v. Going concern: Transfer of the undertaking is on a going concern basis.
- vi. Other specified condition: The demerger is in accordance with the conditions, if any, notified u/s 72A(5) by the Central Government in this behalf.

(b) Carry forward & Set off of losses on conversion into Limited Liability Partnership [Sec. 72A(6A)]:

Condition: Where a private company or unlisted public company is succeeded by a limited liability partnership fulfilling the conditions laid down in the proviso to sec. 47(xiiib).

Tax Treatment: The accumulated loss and unabsorbed depreciation of the predecessor concern shall be deemed to be the loss or allowance for depreciation of the successor firm for the purpose of previous year in which reorganisation of business was effected.

Taxpoint: Accumulated loss of such firm or concern can be carried forward for further 8 years.

Effect of non compliance of conditions given u/s 47(xiiib)

If any of the conditions laid down in the sec. 47(xiiib) are not complied with, the set off of loss or allowance of depreciation made in any previous year by the successor firm shall be deemed to be the income of the firm and chargeable to tax in the year in which such conditions are violated.

(c) Factor for determining Most Appropriate Method:

As per Rule 10C, the most appropriate method shall be the method which is best suited to the facts and circumstances of each particular international transaction or specified domestic transaction, and which provides the most reliable measure of an arm's length price in relation to the international transaction or specified domestic transaction. In selecting the most appropriate method, the following factors shall be taken into account:

1. the nature and class of the international transaction or specified domestic transaction;
2. the class or classes of associated enterprises entering into the transaction and the functions performed by them taking into account assets employed or to be employed and risks assumed by such enterprises;

3. the availability, coverage and reliability of data necessary for application of the method;
4. the degree of comparability existing between the international transaction or specified domestic transaction and the uncontrolled transaction and between the enterprises entering into such transactions;
5. the extent to which reliable and accurate adjustments can be made to account for differences, if any, between the international transaction or specified domestic transaction and the comparable uncontrolled transaction or between the enterprises entering into such transactions;
6. the nature, extent and reliability of assumptions required to be made in application of a method.

(d) Deduction of Head Office Expenditure in the case of Non-residents [Sec. 44C]

In case of a non-resident assessee, head office expenditure shall not be allowed (in computing the income chargeable under the head "Profits and gains of business or profession") in excess of the higher of the following amount:

- (i) an amount equal to 5% of the adjusted total income; or
- (ii) the amount of so much of the expenditure in the nature of head office expenditure incurred by the assessee as is attributable to the business or profession of the assessee in India,

Other Points:

- ⊗ Adjusted total income means the total income without giving effect to:
 - (1) Head-office expenditure u/s 44C; or
 - (2) Unabsorbed depreciation u/s 32(2); or
 - (3) The first proviso to sec. 36(1)(ix) i.e. capital expenditure on family planning; or
 - (4) Any loss carried forward u/s 72 or 73 or 74 or 74A; or
 - (5) The deductions under Chapter VIA;
- ⊗ Where the adjusted total income of the assessee is a loss, then (i) shall be computed at the rate of 5% of the average adjusted total income of the assessee.
- ⊗ Average adjusted total income means average of adjusted total income of 3 assessment years immediately preceding the relevant assessment year. However, where the total income of the assessee is assessable only for last 2 or 1 year(s), then average of last 2 or 1 year(s) shall be considered.
- ⊗ Head office expenditure means executive and general administration expenditure incurred by the assessee outside India, including expenditure incurred in respect of:
 - (1) rent, rates, taxes, repairs or insurance of any premises outside India used for the purposes of the business or profession;
 - (2) salary, wages, annuity, pension, fees, bonus, commission, gratuity, perquisites or profits in lieu of or in addition to salary, whether paid or allowed to any employee or other person employed in, or managing the affairs of, any office outside India;
 - (3) travelling by any employee or other person employed in, or managing the affairs of, any office outside India; and
 - (4) such other matters connected with executive and general administration as may be prescribed.