

**FINAL EXAMINATION**

**GROUP III**

**(SYLLABUS 2016)**

**SUGGESTED ANSWERS TO QUESTIONS**

**DECEMBER 2018**

**Paper- 16: Direct Tax Laws and International Taxation**

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 answers.*

*Working notes should form part of the relevant answers.*

*All questions relate to Income-Tax Assessment Year 2018-19 and the provisions referred to are those of the Income-Tax Act, 1961, unless stated otherwise.*

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

1. Find the most suitable alternative and give brief justification/working for your answer :

2x10=20

(i) Tax payable by a firm whose total income is Rs. 11 crores isRs. \_\_\_\_\_ crores.

(A) 3.7389

(B) 3.390

(C) 3.80688

(D) None of the above.

(ii) A businessman at Delhi is using a car exclusively for business purposes. As per Union Territory rule, his car can be used in Delhi only on alternate days. Car is the only asset in the block. Car has thus been used for only 50% of the number of days in the year. WDV of the car as on 1.4.2017 is Rs. 10 lakhs. Rate of depreciation is 15%. Depreciation allowable is Rs. \_\_\_\_\_.

(A) 75,000

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- (B) 1,50,000  
(C) 1,00,000  
(D) None of the above.
- (iii) Safe Harbour Rules are relevant in the context of  
(A) Maritime Law (Maintenance of sea harbours in a safe manner).  
(B) Customs Act, 1962  
(C) Transfer pricing.  
(D) None of the above.
- (iv) Mr. A acquired a house property on 12.3.1990 for Rs. 5 lakhs. He gifted the same to his brother on 16.5.1993, who gifted it to his son S on 22.7.2015, when the stamp valuation was Rs.12 lakhs. S sold the house on 14.5.2016 for Rs.24 lakhs, which was also the stamp duty value. For computing capital gain, the date of acquisition is  
(A) 1.4.1981  
(B) 12.3.1990  
(C) 16.5.1993  
(D) 22.7.2015
- (v) When total income of resident assessee, Mr. Ram (age 50) is Rs.50,65,000, his net tax liability (including cess) and after marginal relief would be \_\_\_\_\_.  
(A) Rs.14,18,830  
(B) Rs.13,31,000  
(C) Rs.13,70,930  
(D) Rs.12,84,500
- (vi) Mr. Cheema withdrew Rs. 2 lakhs out of his own contribution with National Pension System Trust. On the date of withdrawal, the balance in the account consisted of his own contribution of Rs.6 lakhs and Employer's contribution of Rs.8 lakhs. The amount of withdrawal liable to tax in the hands of Mr. Cheema would be  
(A) Nil  
(B) Rs.3,00,000  
(C) Rs.1,50,000  
(D) Rs.50,000
- (vii) Mahan Charitable Trust (registered under section 12AA) is engaged in running education institutions. It paid Rs.5 lakhs to Malar Charitable Trust (registered under section 12AA) as corpus donation out of its income of the previous year 2017-18. The

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amount of corpus donation is

- (A) Taxable in the hands of both the trusts.
- (B) Exempt in the hands of both the trusts.
- (C) deductible for prayer as application and taxable for the payee.
- (D) not deductible for prayer as application but exempt for payee.

(viii) Real Builders (A partnership firm) admitted income under section 44AD up to the assessment year 2017-18 resorted to determination of income as per regular provisions by getting the books of account audited for the assessment year 2018-19. The assessee firm cannot revert to presumptive provisions contained in section 44AD up to the assessment year \_\_\_\_\_.

- (A) 2023-24
- (B) 2024-25
- (C) Indefinitely
- (D) 2019-20

(ix) M/s. KLM Ltd. a company having international transactions of Rs. 7 crores related to purchase of raw materials from its subsidiary company. M/s. BL Inc., in USA. M/s. KLM Ltd. is required to keep and maintain certain information and documents under section 92D for period of \_\_\_\_\_ years.

- (A) five
- (B) eight
- (C) ten
- (D) fourteen

(x) In the assessment of Mr. Amar, the Assessing Officer has observed that he has purchased diamonds for Rs.18 lakhs on 1<sup>st</sup> October, 2017 which was not recorded in the books of account and he is unable to offer any explanation. Applicable rate of income tax leviable under section 115BBE is \_\_\_\_\_ plus surcharge and education cess as applicable.

- (A) 20%
- (B) 30%
- (C) 40%
- (D) 60%

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**Answer: 1**

(i) (C) 3.80688

Where the total income of a firm exceeds Rs 1 crore, surcharge of 12% is payable. Tax is Rs. 3.3 crore. SC at 12% is 0.396 cr. On 3.696cr, Cess at 3% is payable. Total amount is the tax due.

| Particulars                 | Working              | Rs. in Crore   |
|-----------------------------|----------------------|----------------|
| Tax on `11 crore            | Rs.11 crore x 30%    | 3.30000        |
| Add: Surcharge              | Rs. 3.30 crore x 12% | 0.39600        |
| Tax and Surcharge           |                      | 3.69600        |
| Add: Education Cess & SAHEC | Rs.3.6960 crore x 3% | 0.11088        |
| <b>Total taxpayable</b>     |                      | <b>3.80688</b> |

(ii) (B) Rs. 1,50,000

Where an asset is put to use during the year, there is no provision in the Act for proportionate disallowance, based on the number of days used. Hence full depreciation of Rs. 1,50,000 is to be allowed.

(iii) (C) Transfer pricing

Safe Harbour Rules were framed in the context of advance pricing agreements, relevant to transfer pricing provisions.

(iv) (B) 12-3-1990

The issue has to be seen in the light of the provisions of section 47 read with section 49. Where any asset is acquired through modes like gift, partition, etc. for determining the date of acquisition, one has to go back to the date when it was acquired in a mode other than these specified modes. Hence, the date of acquisition of Mr. A is relevant here. This view is supported by several decisions.

(v) (A) Rs. 14,18,830

Brief answer : When the income of an individual resident assessee exceeds Rs. 50 lakhs, surcharge @ 10% is payable. However, marginal relief is to be given. The excess tax payable by way of surcharge must not exceed the excess income less tax thereon. Excess income Rs. 65,000 less tax thereon is Rs. 19,500 and hence the surcharge levy is limited to Rs. 45,500 instead of 10%. The total tax liability on total income of Rs. 50,65,000 would be Rs. 13,32,000 + surcharge Rs. 45,500 + cess @ 3% which would be the final tax liability.

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(vi) (D) Rs. 50,000

Brief answer : As per section 10(12B) amount withdrawn from NPS trust to the extent it does not exceed 25% of the contributions made by the assessee is exempt from tax. The amount of withdrawal eligible for exemption would be Rs. 1,50,000 (25% of Rs. 6 lakhs) and excess of Rs. 50,000 is taxable.

(vii) (D) Not deductible for payer as application but exempt for payee

Brief answer : As per Explanation 2 to section 11 amount paid as contribution with a specific direction that it shall form part of the corpus of the trust, shall not be treated as application of the donor-trust. In the hands of donee-trust, the said corpus donation is exempt under section 11(1)(d).

(viii) (A) 2023-24

Brief answer : As per section 44AD(4) when a taxpayer declares profit under section 44D and subsequently departs from the presumptive provision and opts for regular provision, he is not eligible to claim the benefit of presumptive provision for 5 assessment years subsequent to the assessment year in which the profit has not been declared in accordance with section 44AD.

(ix) (B) Eight

Justification of correct answer : Section 92D of income tax act provides for keeping & maintaining information and documents in case the aggregate value of international transaction entered into exceeds Rs. 1 crore, which shall be available by the due date of submission of return of income. The information and document are specified in section 92D of income tax act. Since the company has entered into international transactions with its Subsidiary Company in USA for purchase of raw materials having aggregate value of Rs. 7 crores during the previous year 2017-18 is required to comply with the provisions of section 92D. This information and documents shall be kept and maintained for a period of eight years from the end of the relevant assessment year.

(x) (D) 60%

Justification of correct answer : Unexplained / unrecorded investment in diamond attracts provisions of section 69. When income is taxed under section 68 to 69D, tax is calculated as per provisions of section 115BBE. Rs. 18 lakhs would be taxable @ 60%.

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2. (a) M/s. NIACO Ltd., an Indian Company reports total income of Rs. 10,50,000 for the previous year ending March 31, 2018. Tax deducted at source by different payers amounts to Rs.24,450 and tax paid in foreign country on a doubly taxed income amounts to Rs. 10,000 for which the company is entitled to relief under section 90 as per DTAA. During the year the company pays advance tax on June 15, 2017 – Rs.40,000 ; on September 12, 2017 - Rs.65,000; on December 15, 2017 – Rs.1,00,000 and on March 15, 2018 - Rs.62,000. The company files its return of income for the assessment year 2018 – 19 on October 15, 2018. There is no international transaction and no transfer pricing provisions are applicable. Compute interest, if any, payable by the company under sections 234A, 234B and 234C. The due date for filing return of income is September 30, 2018.

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(b) State with brief reason, whether the following would fall in the category of tax planning, tax avoidance or tax evasion :8

- (i) Setting up of a liaison office in India by a foreign company, instead of a full fledged establishment to run its business activities in India ;
- (ii) Investment in bonds approved under section 54EC ;
- (iii) Claiming depreciation for business purposes for a solar power generation system installed in the residential premises of Proprietor ;
- (iv) A Hindu Undivided Family (HUF) engaged in business, paid salary to family members who were actually involved in day to day business activities of the HUF.

**Answer : 2(a)**

Computation of Interest Payable under section 234A, 234B & 234C – M/S. NIACO LTD.  
AY 2018-19

|  | In Rs.    |
|--|-----------|
| Total Income   | 10,50,000 |
| Tax on total income @30.9% (Income tax @30%+SC–Nil + EC & HEC @3%) | 3,24,450  |
| Less :- Double taxation relief                                     | 10,000    |
| Balance  | 3,14,450  |

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|   |                 |
|---|-----------------|
| Less : Tax Deducted at Source   | 24,450          |
| <b>Balance assessed tax</b>   | <b>2,90,000</b> |
| <p><b>Interest under section 234A :</b></p> <p>The due date of submission of return of income is September 30, 2018 &amp; actual date of submission is taken as October 15, 2018.</p> <p>The assessed tax is Rs. 2,90,000. Advance tax paid during the financial year is Rs. 2,67,000. Short fall of advance tax is Rs. 23,000 (Rs. 2,90,000 – Rs. 2,67,000)</p> <p>Interest on shortfall amount is Rs. 23,000 @ 1% per month for 1 month</p> | 230             |
| <p><b>Interest under section 234B :</b></p> <p>Advance tax paid during the financial year is Rs. 2,67,000 (i.e. Rs. 40,000 + Rs. 65,000 + Rs. 1,00,000 + Rs. 62,000). 90% of assessed tax of Rs. 2,90,000 is Rs. 2,61,000. Advance tax paid is not less than 90% during assessment year. So no interest under section 234B is not applicable.</p>   | Nil             |
| Interest under section 234C : (Rs. Nil + Rs. Nil + Rs. 375 + Rs. 230) – Note1   | 605             |

**Note- 1 : Calculation of interest on Shortfall of Advance Tax – u/s. 234C**

|   |         |
|---|---------|
| <p><b>First installment :</b> Advance tax paid up to June 15, 2017 – Rs. 40,000.</p> <p>12% of assessed tax – Rs. 34,800 (12% x 2,90,000).</p> <p>Interest under section 234C is not applicable for short payment as advance tax paid is not less than 12% of assessed tax.</p> | Nil     |
| <p><b>Second instalment :</b> Advance tax paid up to September 15, 2017 is Rs. 1,05,000. 36% of assessed tax is Rs. 1,04,400.</p> <p>Interest under section 234C is not applicable for short payment as advance tax paid is not less than 36% of assessed tax.</p>              | Nil     |
| <p><b>Third instalment :</b> Advance tax paid up to December 15, 2017 is Rs. 2,05,000. 75% of assessed tax is Rs. 2,17,500.</p> <p>There is a short fall of Rs. 12,500 (Rs. 2,17,500 – Rs. 2,05,000). So interest payable is Rs. 12,500 x 0.01 x 3 months).</p>                 | Rs. 375 |
| <p><b>Fourth instalment :</b> Advance tax paid up to March 15, 2018 is Rs. 2,67,000.</p> <p>100% of assessed tax is Rs. 2,90,000.</p> <p>There is a short fall of Rs. 23,000. So interest payable is Rs. 23,000 x 0.01</p>  | Rs. 230 |
| Total   | Rs. 605 |

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**Answer : 2(b)**

Tax planning/management/evasion

- (i) Setting up of a liaison office in India by a foreign company, instead of a full fledged establishment to run its business activities in India : This is an act of **tax planning**.

The underlying intention is to reap the benefit of the DTAA instead of coming under the clutches of section 9 of the Act, and to thus plan for lower tax in the long run.

- (ii) Investment in bonds approved u/s. 54EC : it is an act of **tax planning**. Investment in section 54EC bond is a genuine investment to reduce/mitigate incidence of tax on capital gain. Hence, it is tax planning.

- (iii) Claiming depreciation on an asset used for personal purposes as a business asset is an act of **Tax evasion**.

Depreciation is allowable only for assets used for business purposes. Even though the asset is installed at residence, showing it as a business asset and claiming depreciation with a view to evade tax, constitutes tax evasion.

- (iv) When HUF pays salary to members for their individual effort to take care of the affairs of the business, it is a fair compensation permissible in law. Such salaries paid are permissible deductions. Therefore, it is a case of **tax planning**.

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- 3. (a) Vimala Boilers Pvt. Ltd. furnishes the following summarized position of its statement of profit and loss and pertinent additional information thereto, for the year ended 31.3.2018.**

**[All amounts are Rs. in lakhs]**

|       |   |            |
|-------|---|------------|
| (i)   | <b>Net profit as per books</b>                              | <b>26</b>  |
| (ii)  | <b>Share income from an AOP</b>                             | <b>6</b>   |
|       | <b>Expenditure debited in books for earning such income</b> | <b>0.8</b> |
| (iii) | <b>Compounding fee paid to the Corporation authorities</b>  | <b>1.2</b> |
| (iv)  | <b>Provision for income-tax</b>                             | <b>2</b>   |
| (v)   | <b>Provision for loss of foreign subsidiary</b>             | <b>4</b>   |

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- (vi) CSR expenditure debited to statement of profit and loss 14
- (vii) Royalty received relating to business 6  
(Chargeable at 10%)
- (viii) The brought forward business loss and depreciation are as under (Rs. in lakhs):

| Particulars                  | As per books | As per Income Tax Act |
|------------------------------|--------------|-----------------------|
| Business loss for AY 2017-18 | 4            | 12                    |
| Unabsorbed Depreciation      | 3            | 11                    |

- (ix) The members as well as their shares in the AOP (in which the assessee is a member) are specific and determinate.

Compute Minimum Alternate Tax (MAT) payable by the company for the Assessment Year 2018-19. The company is not an Ind-AS compliant company.

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- (b) AKP is a public charitable trust created under a trust deed for providing relief to physically challenged persons and registered under section 12AA. The following are the particulars of receipts of the trust during the year ending March 31, 2018 :

| Particulars  | Rs. in lakhs |
|--|--------------|
| Income from properties held by trust (net)   | 15           |
| Income (net) from business (incidental to main objects)                            | 14           |
| Voluntary contributions from public (including the corpus donation of Rs. 7 lakhs) | 18           |

The trust applied Rs. 18 lakh towards various activities and programmes undertaken for the benefit of physically challenged persons during the year. The trust has also paid Rs. 8 lakh towards repayment of a loan taken two years back for the purpose of construction of its centre for training the handicapped persons in various handicraft works and sports.

Determine the tax liability, if any of the trust for the Assessment Year 2018-19 and also state how the trust can mitigate such liability.

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## Answer : 3(a)

Computation of book profits u/s. 115JB of Vimala Boilers Pvt. Ltd. for A.Y. 2018-19

|   | (Rs. in lakhs) |
|---|----------------|
| (i) Net profit as per books   | 26             |
| (ii) Share income from an AOP   | 0              |
| [This is not an AOP which pays tax at the maximum marginal rate<br>Hence no adjustment is required] |                |
| Expenditure debited in books for earning such income<br>[as above]                                  | 0              |
| (iii) Provision for income-tax  | 2              |
| [This is an item to be specifically added back for MAT]   |                |
| (iv) Provision for loss of foreign subsidiary   | 4              |
| [This is an item to be specifically added back for MAT]   |                |
| (v) CSR expenditure debited to P & L a/c  | 0              |
| [no need to add back this expenditure for MAT]  |                |
| (vi) Royalty received relating to business  | -6             |
| [To be considered separately, as it is taxed at special rate of 10%]                                |                |
|   | 26             |
| Less : Lower of B/fwd business loss or depreciation   | 3              |
| Book Profit   | 23             |

### Tax payable

|                                       |         |
|---------------------------------------|---------|
| Royalty at 10%                        | 0.6     |
| Other income at 18.5%                 | 4.25500 |
|                                       | 4.85500 |
| Add : Edu Cess and SAH Edu Cess at 3% | 0.14565 |
| Total tax as per MAT provisions       | 5.00065 |
| Rounded off                           | 5.00070 |

### Note:

Compounding fee paid to the Corporation authorities, which is in the nature of penalty, will be disallowed while computing income as per normal provisions, but will not have any impact in the computation of book profits as per MAT provisions.

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**Answer : 3(b)**

Computation Tax liability of AKP public charitable trust for the assessment year 2018-19

| Particulars   | Rs. in lakhs |
|---|--------------|
| Income from properties held by trust for charitable purposes                    | 15.00        |
| Income from business incidental to main objects of trust                        | 14.00        |
| Voluntary contributions (excluding corpus donations)                            | 11.00        |
| Total   | 40.00        |
| Less : 15% set apart for future   | 6.00         |
| Amount available for charitable purpose   | 34.00        |
| Less : Amount utilized for charitable purposes (Rs. 18,00,000 + Rs. 8,00,000)   | 26.00        |
| Net income  | 8.00         |
| Tax liability on Rs. 8,00,000 at tax rates applicable in the case of individual | 0.74675      |
| Rounded off   | 0.74680      |

The trust can mitigate the tax liability by accumulating the unspent income of Rs. 8 lakhs for any specific purpose for maximum period of 5 years as per section 11(2).

8

**4. (a) Answer the following with reference to assessment and reassessment provisions :**

**4 x 2 = 8**

- (i) **Mr. Bharadwaj (age 50) returned to India in April, 2016 after remaining outside India for 22 years. He continued to hold a bank account outside India during the financial year 2017-18. In September, 2018 the Assessing Officer wants to issue a notice under section 148 for the assessment year 2005-06 in order to tax a vacant land purchased (outside India) out of income chargeable to tax in India and which escaped assessment previously. Is the issue of notice valid in law ?**
- (ii) **A notice under section 143(2) was served on Mr. Imaan for the assessment year 2017-18 on 05.09.2018. State the time limit within which the assessment would be completed in his case.**

## **Suggested Answer\_Syl16\_Dec2018\_Paper\_16**

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- (iii) Can the Joint Commissioner issue directions to the Assessing Officer for completion of assessment in a particular case ? Is such direction binding on the Assessing Officer ?
- (iv) In the assessment order passed under section 143(3) dated 10.10.2018 for the assessment year 2016-17 there is an error apparent on record by not allowing set off of brought forward depreciation. The assessee wants to know the time limit for passing order of rectification under section 154. State.
- (b) ABC & Co. a partnership firm got converted into ABC Co. (P) Ltd. on 01.09.2017. It furnishes you the following details for the year ended 31<sup>st</sup> March, 2018.
- (i) Unabsorbed depreciation Rs.15 lakhs relating to assessment year 2012 – 13.
- (ii) Business loss Rs. 20 lakhs relating to assessment year 2010-11.
- (iii) Unadjusted AMT credit Rs.2 lakhs of the assessment year 2017-18.
- (iv) Written down value of assets under the Income-tax Act, 1961 [Section 43(6)] :
- Plant & Machinery (15%) Rs.20 lakhs (market value Rs. 25 lakhs)  
Plant & Machinery cost Rs.50 lakhs – deduction claimed under section 35 AD.  
Factory Building (10%) Rs.30 lakhs (market value Rs.50 lakhs)
- (v) Cost of land (acquired in 2008) Rs.50 lakhs (market value Rs.90 lakhs)
- (vi) Bad debt written off in assessment year 2013-14 Rs. 8 lakhs. Amount recovered in December 2017 from the debtor Rs.6 lakhs.

Explain the tax treatment of each of the items given above in the hands of the company on the assumption that all the conditions laid down in section 47(iii) are satisfied.

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## Answer : 4(a)

(i)

Section 149(1) provides for time limit of 16 years for reopening the assessment when the income in relation to the asset is located outside India is chargeable to tax and has escaped assessment.

Since Mr. Bharadwaj has bank account outside India which is still operative, the extended time limit 16 years will apply.

(ii)

Section 153 provides time limit for completion of assessment under section 143 or section 144

The time limit is 21 months from the end of the assessment year in which the income was first assessable.

Therefore, for the assessment year 2017-18, the time limit is available up to 31.12.2019

(iii)

Section 144A empowers the Joint Commissioner to issue guidance to the Assessing Officer for completing the assessment.

Such guidance is binding on the Assessing Officer and the assessment has to be made in the light of such guidelines only.

(iv)

Section 154 provides relief to the tax payer or to the Assessing Officer to rectify any error which is apparent on record. Therefore, the error of not allowing set off of brought forward depreciation is eligible for rectification under section 154.

The time limit is **4 years from the end of the financial year in which the order sought to be rectified was passed.**

The order was passed on 10-10-2018 only. Hence the time limit available to the assessee for filing rectification petition is **31-03-2023**

## Answer 4(b)

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|       |  |  |         |
|-------|--|--|---------|
| (i)   | <b>Unabsorbed Depreciation</b>                         | Unabsorbed depreciation of the firm is <b>eligible for set off</b> in the hands of successor company as though the depreciation belongs to the successor company   |         |
| (ii)  | <b>Business loss</b>                                   | Business loss of the predecessor is eligible for set off by the successor upto 8 years. In this case the loss was incurred in the assessment year 2010-11 and the assessment year 2018-19 would be the 8 <sup>th</sup> year for set off of the brought forward loss. <b>Brought forward business loss can thus be set off.</b>                                   |         |
|       |  | However, as the succession had taken place in the previous year 2017-18, the loss will be treated as if the loss so brought forward was incurred in a previous year in which the conversion took place.; as per section 72A(6) such loss is eligible for fresh period of 8 assessment years for carry forward and set off i.e. upto the assessment year 2025-26. |         |
| (iii) |  | The AMT brought forward by the firm is not eligible for credit upon conversion in to a company. However, the vice versa that a company when it converted into firm it is eligible for such credit. <b>The AMT credit of the firm hence would be lost.</b>  |         |
| (iv)  | Depreciation on assets :                               | Depreciation on plant and machinery would be apportioned between the predecessor and successor in the number of days of use during the previous year. The succession had taken place on 01.09.2017 and hence the depreciation would be allocated in 153 : 212 (days ratio) between the firm and the company.   |         |
|       |  | Firm   | Company |
|       | On plant and machinery Rs.20 lakhs x 15%= Rs. 3 lakhs: |  |         |
|       | Apportioned in the ratio of 153 : 212 ratio            | 125753   | 174247  |
|       | Plant and machinery of unit covered by section 35AD    | NIL  | NIL     |
|       | Factory Building Rs. 30 lakhs x 10% = Rs. 3 lakhs:     |  |         |
|       | Apportioned in the ratio of 153 : 212 ratio            | 125753   | 174247  |
|       | Total Depreciation                                     | 251506   | 348494  |
| (v)   | <b>Cost of land:</b>                                   | In the hands of successor company, the original cost of acquisition of the predecessor (firm) would be adopted as and when it is sold  |         |

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|      |  |
|------|--|
|      | by the successor-company.  |
| (vi) | <b>Bad debt recovery</b> : The amount of bad debt recovery of the successor is chargeable to tax in its hands as per section 41(4) |
|      |  |

5. Answer any four of the following [Your answer should be under the following heads : (i) Issue involved (ii) Brief discussion on provisions applicable to the issue (iii) Analysis of the issue involved, and (iv) Conclusion [Citation of case law is NOT required] :

4 x 4=16

- (a) Ram and Rahim were Executive Directors of Saraswati Tea Pvt. Ltd. In respect of a bank loan, they gave their personal guarantee. The assessee-company paid them guarantee commission of Rs.1 lakh each. The Assessing Officer feels that this is a disguised payment of dividend under section 2(22) and is not a commission which is deductible as business expenditure. He has disallowed the same. Is the action of the AO valid in law ?
- (b) Govinda and Vaamana were partners in a firm, which got dissolved consequent to the demise of Govinda. The firm had unabsorbed losses. Vaamana, who took over the business, has set off the said loss in his personal hands in the subsequent year. Such set off is not allowed by the Assessing Officer. Is his action correct ?
- (c) MNC Ltd. is engaged in this business of managing and operating hotels. The assessee allowed the employees to accept tips from customers. Some customers paid the bill and tips to the employees through credit card. The assessee, being employer collected the amounts and disbursed tips to the employees on monthly basis. The assessee did not deduct tax at source on the said payments as the amounts were not in the nature of salary. Does the action of the assessee satisfy the legal requirements ?
- (d) Dempo Ltd. transferred its factory building for Rs.65 lakhs. The company owned only one such building in the block of assets. The written down value of the factory building was Rs.13.95 lakhs. The company acquired the building 10 years ago for Rs.40 lakhs. It deposited Rs. 50 lakhs in REC bonds within one month after the transfer of factory building. The company claimed exemption under section 54EC. Is the claim of the company tenable in law ?

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(e) Jayakrishna Flour Mills Pvt. Ltd., has derived an income of Rs.1.2 crore from generation and distribution of electricity, using windmills. Such profits have been claimed as 100% deduction under section 80-IA. The assessee has paid interest of Rs.60 lakhs to a bank in respect of the term loans on the windmills. The Assessing Officer wants to invoke the provisions of section 14A in respect of such interest. Can he do so ?

**Answer : 5(a)**

**Allowability of commission paid to directors:**

**Issue involved**

The issue under consideration in this case is whether guarantee commission paid by a company to its employee directors is deductible as its business expenditure, where such guarantee was given by the employee directors to the bank for enabling credit facility to the company, and whether it can be contended that the same would have been payable as dividend had it not been paid as commission.

**Provisions applicable**

In the absence of any specific disallowance, expenditure incurred wholly and exclusively for the purpose of business has to be allowed under section 37. It has also to be seen whether such payment was a device used to outwit the provisions of section 115-O, which requires payment of dividend distribution tax.

**Analysis of the issue**

The directors of the company are employees of the company and are entitled to remuneration for the services rendered as employees. In this case, they also provided personal guarantee to banks, since it was a precondition laid down by the bank to provide financial assistance to the company. **This act of providing personal guarantee was clearly beyond the scope of their services as employees of the company.**

The assessee-company, in its commercial wisdom, passed a resolution resolving that the directors be paid commission for providing their personal guarantees for the financial assistance availed by the assessee-company from the bank. In such a case, the Assessing Officer only has to determine whether the transactions are real and genuine.

As regards section 36(1)(ii), the recipient directors were not entitled to receive the amount as commission in lieu of dividend. **Dividend is paid to all the shareholders and the**

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recipient directors were not the only shareholders of the company. The payment of commission, hence, cannot be taken as payment of dividend, since payment of dividend would result in payment to all the shareholders and not to shareholders holding prescribed percentage of the voting power/share capital in the company.

## Conclusion

Therefore, the action of the Assessing Officer, holding that if the amount was not paid to them as commission, the same would have been payable as dividend, and contending that the company avoided dividend distribution tax under section 115-O which was otherwise payable, is **not valid**.

Reference may be made to the decision in Controls & Switchgear Contractors Ltd. v. Dy. CIT (2014) 365 ITR 312.

**Answer : 5(b)**

## Set off of losses:

### Issue involved

The issue involved in this case is whether the loss suffered by an erstwhile partnership firm, which was dissolved, can be carried forward for set-off by the individual partner who took over the business of the firm as a sole proprietor, considering the succession as a succession by inheritance.

### Provisions applicable

Section 78(2) deals with carry forward of losses in case of succession of business. It provides that only the person, who has incurred the losses, and no one else, would be entitled to carry forward the same and set it off. **An exception provided thereunder is in the case of succession by inheritance.**

### Analysis of the issue

Upon dissolution, the partnership firm, ceased to exist. Also, the partnership firm, and the sole proprietorship concern are two separate and distinct units for the purpose of assessment. The income earned by the sole proprietor would include his share of loss as an individual but not the loss suffered by the erstwhile partnership firm in which he was a partner.

The exception given in section 78(2), permitting carry forward of losses by the successor in

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case of inheritance, is not applicable in the present case since the partnership firm was dissolved and ceased to continue. Taking over a business by a partner cannot be considered as a case of inheritance due to death as per the law of succession.

## Conclusion

The **action of the Assessing Officer** in disallowing the claim of set-off of losses suffered by the erstwhile partnership firm ST & Co. against the income earned as an individual proprietor is, therefore, **correct**.

Reference may be made to the decision in *Pramod Mittal v CIT* (2013) 356 ITR 456.

## Answer : 5(c)

### TDS on tips collected by a hotel from customers:

#### Issue involved

The issue is whether tax is required to be deducted at source under section 192 from the tip (collected from customers) distributed by the assessee-employer. In other words, it has to be seen whether the action of the assessee satisfies the legal requirements.

#### Provisions applicable

Section 192 provides that tax is to be deducted at source by the employer from salary at the time of payment, if the amount of salary (after permissible deductions under sections 80C, 80D, etc.) exceeds the maximum amount not chargeable to tax.

#### Analysis of the issue

The employer has collected the tips paid by the customers voluntarily and was not collected as a matter of right. Further the employment contract does not show the obligation to collect tips and disburse to employees.

There is no vested right in the employee to claim the amount of tips from the employer. It is voluntary payment which cannot be called as salary within the meaning of section 15.

When an **amount is received from a person other than employer, such payment cannot be charged to tax under the head "salaries"**. Therefore, the provision of section 192 does not get attracted.

## Conclusion

The **action of non-deduction of tax at source** from tips collected from customers and distributed to the hotel employees **satisfies the legal requirement**.

Reference may be made to the decision in *ITC Ltd vs. CIT (TDS)* 384 ITR 14 (SC)

## Answer : 5(d)

### Exemption u/s 54EC relating to depreciable assets

#### Issue involved:

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The issue is whether exemption under section 54EC can be claimed in respect of capital gain on transfer of depreciable capital asset computed under section 50 where the asset had been held for more than 24 months before transfer of such asset.

## **Provisions applicable**

As per section 54EC, where capital gain arises from transfer of any long- term capital asset and such capital gain or part thereof is invested in specified asset (which includes REC bonds) within 6 months from date of transfer, exemption is available up to maximum limit of Rs. 50 lakhs.

## **Analysis of the issue**

Under section 50, capital gain arising from transfer of depreciable asset shall be deemed to be capital gain. However, the deeming provision is limited to computation of capital gain and does not go beyond to deny the benefits of exemption under section 54EC or section 54F.

Where the asset forming part of the block was held for more than the specified period (24 months for building/ 36 months for other capital assets) and eligible to be categorized as long term capital asset, the benefit of exemption for investment of the long- term capital gain or sale proceeds as the case may be, contained in the applicable legal is allowable provision.

## **Conclusion**

Hence, the claim of the company is tenable in law.

Reference may be made to the decision in **CIT vs. Dempo Co Ltd (2016) 387 ITR 354 (SC)**

## **Answer : 5(e)**

**Applicability of Section 14 A to income for which deduction under Chapter VI A is available:**

### **Issue involved**

The issue under consideration is whether the **provisions of section 14A can be invoked in disallowing the expenditure incurred in respect of the income for which deduction is claimed under Chapter VI-A.**

### **Provisions applicable**

As per section 14A, expenditure incurred in relation to income which does not form part of the total income under the Act, will not be allowed in computing the total income of the

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assessee.

## Analysis of the issue

The words "do not form part of the total income under this Act" used in section 14A are significant and important. **Income which qualifies for deductions under section 80C to 80U has to be first included in the gross total income of the assessee and then allowed as a deduction.**

However, income referred to in Chapter III do not form part of the total income and therefore, as per section 14A, no deduction shall be allowed in respect of expenditure incurred by the assessee in relation to such income which does not form part of the total income.

Deduction under section 80P **covered in Chapter VIA is different from the exclusions/exemptions** provided under Chapter III.

## Conclusion

The **stand of the Assessing Officer in disallowing the expenditure** incurred with respect to income for which deduction under Chapter VI-A is claimed, by invoking the provisions of section 14A is, therefore, **not tenable in law.**

Reference may be made to the decision in CIT v.Kribhco (2012) 349 ITR 0618.

6. (a) Mr. Amin, a resident individual in India (age 42) furnishes you the following particulars of income for the previous year 2017 – 18 :

| Particulars   | Rs.       |
|---|-----------|
| (i) Income from business in India (computed)  | 11,00,000 |
| (ii) Dividend received from Company incorporated in Country X (gross)   | 2,00,000  |
| (iii) Royalty income from writing text book for schools in Country Y (gross)  | 6,00,000  |
| (iv) Expenditure incurred for authoring text book   | 50,000    |
| (v) Business loss in Country Y (gross)  | 2,50,000  |
| (vi) Health insurance premium paid by credit card for his father (age 67) a resident in India (His father is not dependent on Mr. Amin) | 31,000    |

The business loss in Country Y is eligible for set off against other income as per the Income-tax law of that country.

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Note : There is no DTAA between India and Country "X" and Country "Y" given above. The rate of tax in Country "X" and Country "Y" may be taken as 10% and 25% respectively (without any threshold exemption limit).

Compute the total income and tax payable by Mr. Amin in India for the Assessment Year 2018 – 19.

8

(b) Chetan (P) Ltd. located in Special Economic Zone (SEZ) since April, 2012 is engaged in manufacturing activity by importing raw materials from its holding company Bada Inc. of UK. The following details are furnished :

- Chetan (P) Ltd. imported goods for Rs.60 crores during the financial year 2017 – 18 from Bada Inc.
- Bada Inc. supplied similar raw materials to unrelated parties with a mark-up of 20%, whereas for Chetan (P) Ltd. it provided a mark-up of 25%.
- Chetan (P) Ltd. was allowed to use the brand name of Bada Inc. without any payment and whereas the unrelated parties cannot use such brand name in India. The annual cost of brand value is Rs.100 lakhs.
- Chetan (P) Ltd. was allowed credit period of 2 months, whereas for the unrelated parties, Bada Inc. allowed only 1 month as credit period. The interest cost may be taken as 12% per annum and the purchases were uniform throughout the year.
- The Assessing Officer referred the matter to Transfer Pricing Officer (TPO) for determination of Arm's Length Price (ALP).
  - (i) Compute the ALP of the transaction and adjustments to be made to the income of Chetan (P) Ltd.
  - (ii) What is the due date for Chetan (P) Ltd. for furnishing audit report under section 92E ?
  - (iii) If TPO had enhanced the income of Chetan (P) Ltd. by Rs.2 crores, will that enhanced amount of income be eligible for deduction under section 10AA ?
  - (iv) Will Chetan (P) Ltd. become liable for penalty for under-reporting of income

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based on the report of the TPO ?

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**Answer : 6(a)**

Computation of Total Income of Mr. Amin for A.Y. 2018 – 19

| Particulars  | Rs.      | Rs.             |
|--|----------|-----------------|
| <b>Profits and gains of Business or profession</b>   |          |                 |
| Income from business in India  |          | 11,00,000       |
| Loss from business in Country "Y"  | 2,50,000 |                 |
| Less : Set off against royalty income  | 2,50,000 |                 |
|  |          | NIL             |
| <b>Income from other Sources :</b>   |          |                 |
| Dividend from companies in Country "X"   | 2,00,000 |                 |
| Royalty income from Country "Y"  | 6,00,000 |                 |
| Less: Expenditure thereon  | 50,000   |                 |
|  | 5,50,000 |                 |
| Loss from business in Country "Y"  | 2,50,000 |                 |
|  | 3,00,000 |                 |
| Gross Total Income   |          | 16,00,000       |
| Less: Deduction under Chapter VI-A   |          |                 |
| <b>Section 80D</b>   |          |                 |
| Health insurance premium for father, senior citizen is deductible even though he is not dependent on the assessee. |          | 30,000          |
| <b>Section 80 QQB:</b>   |          |                 |
| As the assessee has authored text-book for schools in Country 'Y' hence it is not eligible for deduction.          |          | NIL             |
| <b>Total Income</b>  |          | 15,70,000       |
| Tax thereon  |          |                 |
| On Rs. 15,70,000   |          | 2,83,500        |
| Add: Cess @ 3%   |          | 8505            |
|  |          | <b>2,92,005</b> |
| Less : Rebate U/s. 91 (See working note)   |          | 74,180          |
| Total tax liability  |          | <b>2,16,210</b> |

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|   |               |
|---|---------------|
| Average rate of tax in India<br>Rs. 2,83,500 x 100 / Rs. 15,70,000 = 18.06%   |               |
| Average rate of tax in country x = 10%  |               |
| Doubly taxed income of country x = 2,00,000   |               |
| Rebate u/s. 91 would be 10% or average rate @ 18.06% - whichever is less.<br><b>10% on Rs. 2 lakhs = Rs. 20,000</b> | <b>20,000</b> |
| Doubly taxed income of country Y (after set off of business loss) = 3,00,000  |               |
| Rate of tax country Y = 25%   |               |
| Rebate u/s. 91 would be @ 18.06% or 25% whichever is less.<br><b>Rebate @18.06% on Rs. 3 lakhs = Rs. 54,180</b>     | <b>54,180</b> |
|   |               |
| Total rebate under section 91   | 74,180        |
| Total Marks   |               |

**Answer : 6(b)**

| (i) | Computation of income to be adjusted to the income of Chetan (P) Ltd.<br>for AY 2018-19   | Rs. in Lakhs |
|-----|---|--------------|
|     | Difference in mark up price between related parties and unrelated parties. The mark up was cost plus 25% for related party and whereas it was cost plus 20% for unrelated parties. The cost of goods to related party is Rs. 48 crores plus 25%. To the unrelated party it would have been 20%. Hence the adjustment would be 5% which means Rs. 48 crores x 5% = 2.40 crores being the extra expenditure incurred by Chetan (P) Ltd. in India. | (+ 240)      |
|     | Cost of brand value usage obtained by Chetan (P) Ltd. free of cost due to its association with Bada LLC. This would have been incurred if it were an unrelated party.   | (-) 100      |
|     | Interest on extended credit period obtained from associated enterprise. The purchases were uniform throughout the year. Hence the benefit of the cost of capital is Rs. 5 crores x 12% x 1/12 being the extra credit period enjoyed.  | (-) 5        |

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|       |  |         |
|-------|--|---------|
|       | Income to be adjusted in the hands of Chetran (P) Ltd. by apply CUP method of ALP determination.   | (+) 135 |
| (ii)  | <b>The due date for furnishing the report under section 92E is 30<sup>th</sup> November, 2018.</b>   |         |
| (iii) | <b>The income enhanced because of the order of TPO will not be eligible for deduction under section 10AA or under Chapter VI-A in view of second proviso to section 92C.</b> |         |
| (iv)  | <b>If the assessee has under-reported the income it is liable for penalty @ 50% of tax payable on under-reported income as per section 270A.</b>                             |         |
|       | <b>However, if the assessee has maintained information and documents as prescribed in section 92D, it would not be construed as under-reported income.</b>                   |         |
|       |  |         |

7. (a) (i) Under the provisions of the Income-tax Act, 1961 read with the Income-tax Rules, 1962, what is the meaning of Foreign Tax Credit (FTC) ?

2

(ii) To whom is FTC allowed and in which year ?

4

(iii) An assessee has to pay income-tax of Rs. 92 lakhs, surcharge of Rs.9.2lakhs, Education Cess& SAH CessRs.3,03,600 and interest under section 234B of Rs.9,78,700. Against which of these item/amounts is FTC available ?

2

(b) Kiwi LLC., is a foreign company incorporated in Singapore, Brightstars Inc. (BI), is a foreign company incorporated in Australia, Daffodils Pvt. Ltd. (DPL), is an Indian Company.

The Indian company has taken a loan of Rs.120 crore from Moonshine Inc., a foreign company, at the rate of 10% per annum on 1<sup>st</sup> October, 2017. The guarantee for this loan has been provided by BI. This is the only loan taken by DPL during the year.

Kiwi LLC, holds 27% of the voting power in BI as well as in DPL.

The net profit of DPL, after above interest and depreciation of Rs.1.8 crore, but before income-tax is Rs. 9.2 crore, for the year ended 31.3.2018. Income-tax liability for the year may be taken as Rs.1.2 crore.

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Is any disallowance warranted in respect of interest in the hands of DPL, as per the transfer pricing provisions, for the assessment year 2018-19 ? Append suitable notes.

8

**Answer : 7(a)**

## **Foreign Tax Credit [Rule 128]**

### **(i) Meaning of foreign Tax Credit.**

The foreign tax credit means :

- (a) In respect of a country or specified territory outside India with which India has entered into double taxation of income in terms of section 90 or section 90A, the tax covered under the said agreement ;
- (b) In respect of any other country or specified territory outside India, the tax payable under the law in force in that country or specified territory in the nature of income-tax referred to in clause (iv) of the Explanation to section 91.

### **(ii) Eligible assessee and year of credit.**

- An assessee, being a resident, shall be allowed a credit ; Same shall be for the amount of any foreign tax paid by him in a country or specified territory outside India, by way of deduction or otherwise ; Same is allowed in the year in which the income corresponding to such tax has been offered to tax or assessed to tax in India.
- In a case where income on which foreign tax has been paid or deducted, is offered to tax in more than one year, credit of foreign tax shall be allowed across those years in the same proportion in which the income is offered to tax or assessed to tax in India.

### **(iii) Eligible items for set off of FTC**

FTC shall be available against the amount of tax, surcharge and cess payable under the Act but not in respect of any sum payable by way of interest, fee or penalty.

Thus FTC can be used against IT, SC and education & SAH Cess. Rs.104.236 lakhs in total.

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**Answer : 7(b)**

## **Applicability of section 94B**

Kiwi LLC., holds 27% of the voting power in BI as well as in DPL, which is more than 26%. Hence BI and DPL will be deemed associated enterprises.

Where the debt is issued by a lender which is not associated but an associated enterprise either provides an implicit or explicit guarantee to such lender, such debt shall be deemed to have been issued by an associated enterprise (AE) and limited of interest deduction would be applicable.

- If an Indian company, being the borrower, incurs any expenditure by way of interest in respect of any debt issued by its non-resident associated enterprise (AE),and
- Such interest exceeds Rs. 1 crore, then,
- The interest paid or payable by such Indian company in excess of
  - 30% of its earnings before interest, taxes, depreciation and amortization (EBITDA) or
  - Interest paid or payable to associated enterprise,
  - Whichever is lower, shall not be allowed as deduction as per section 94B.

Hence DPL shall be deemed to have taken loan from BI, an AE. Restriction laid down in section 94B may come into play.

| Particulars                              | Rs. in crore |
|--|--------------|
| PBT, but after interest and depreciation | 9.2          |
| Add : Depreciation                       | 1.8          |
| Interest                                 | 6.0          |
| EBITDA                                   | 17.0         |

Permissible interest is lower of 30% of EBITDA, i.e. 30% of 17C, i.e. 5.1C or actual interest 6C. Hence 5.1C will be allowed as deduction.

Amount to be disallowed u/s. 94B is Rs. 0.9 crore (6-5.1)

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8. Write short notes on any four of the following :

4 x 4 = 16

- (a) **Scope of undisclosed foreign income and asset under the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015.**
- (b) **Fees prescribed for filing appeal before the Commissioner (Appeals)**
- (c) **Valuation of inventory as per ICDS in case of dissolution of firm.**
- (d) **Assessment of persons leaving India.**
- (e) **Impermissible Avoidance Arrangement.**

**Answer : 8(a)**

**Scope of Undisclosed Foreign income and Asset:**

Scope of total undisclosed foreign income and asset as per section 4 of the Black Money (undisclosed Foreign Income and Assets) and Imposition Act.

The total undisclosed foreign income and asset of any previous year of an assessee shall be :

- (i) The income from a source located outside India, which has not been disclosed in the return of income furnished under section 139 of the Income Tax Act ;
- (ii) The income from a source located outside India, in respect of which a return is required to be furnished under section 139 of the Income Tax Act, but no return has been furnished ;
- (iii) The value of an undisclosed asset located outside India.

Any variation made in the income from a source outside India in the assessment or reassessment of the total income of any previous year of the assessee under the Income

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Tax Act in accordance with the provisions of section 29 to section 43C (profits and gains from business or profession ) or section 57 to section 59 (income from other sources) or section 92C (transfer pricing) of the said Act shall not be included in the total undisclosed foreign income

To avoid double taxation, the income included in the total undisclosed foreign income and asset under the Black Money (undisclosed Foreign Income and Assets) and Imposition Act shall not form part of the total income under the Income Tax Act.

**Answer : 8(b)**

## **Fees prescribed for filing appeal before the CIT (A)**

In case of an appeal made to the Commissioner (Appeals), irrespective of the date of initiation of the assessment proceedings, the appeal shall be accompanied by a fee of :

|       | Situation   | Fees Rs |
|-------|---|---------|
| (i)   | Where the total income of the assessee as computed by the Assessing Officer is Rs. 1,00,000 or less               | 250     |
| (ii)  | Where the total income of the assessee computed as above is more than Rs. 1,00,000 but not more than Rs. 2,00,000 | 500     |
| (iii) | Where the total income of the assessee computed as above is more than Rs. 2,00,000                                | 1,000   |
| (iv)  | In any case other than (i), (ii) and (iii) above  | 250     |

**Answer : 8(c)**

## **Valuation of inventory in case of dissolution of firm as per ICDS**

ICDS II deals with valuation of inventories

ICDS II says that the value of inventory on the date of dissolution of the firm shall be valued at net realizable value (NRV), irrespective of whether the business of the firm is continued or not.

When a firm is dissolved and the surviving partners continue the business of the firm, the

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inventory need not be valued at net realizable value as per Supreme Court decision in the case of Sakthi Trading Co. v CIT (2001) 258 ITR 871 (SC).

As the ICDS specifically mandates the firm to adopt only NRV method of stock valuation on dissolution of firm, regardless of whether the business is continued or not, the stock valuation must be as per NRV method.

**Answer : 8(d)**

### **Assessment of persons leaving India**

Section 174 deals with persons leaving India.

Where it appears to the Assessing Officer that any individual may leave India during the current assessment year or shortly after its expiry and that he has no present intention of returning to India, the total income of such individual for the period from the expiry of the previous year for the assessment year up to the probable date of his departure from India shall be chargeable to tax in that assessment year.

The total income of each completed previous year or part of any previous year included in such period shall be chargeable to tax at the rate or rates in force in that assessment year. Separate assessments shall be made in respect of each such completed previous year or part of any previous year.

The AO may estimate the income of such individual for such period or any part thereof, where it cannot be readily determined in the manner provided in the Act.

For the purpose of making an assessment, the AO may serve a notice upon such individual requiring him to furnish, within such time, not being less than 7 days, as may be specified in the notice, a return in the same form and verified in the same manner as a return under section 142(1), setting forth his total income for each previous year and his estimated total income for any part of the previous year and the provisions of the Act shall, so far as may be, and subject to the provision of this section, apply as if the notice was a notice issued under section 142(1).

**Answer : 8(e)**

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## **Impermissible Avoidance Arrangement**

As per section 96, an impermissible avoidable arrangement means an arrangement, the main purpose of which is to obtain a tax benefit.

It –

- (a) Creates rights or obligations, which are not ordinarily created between persons dealing at arm's length ;
  
- (b) Results, directly or indirectly, in the misuse, or abuse, of the provisions of the Act;
  
- (c) Lacks commercial substance or is deemed to lack commercial substance under section 97 ;
  
- (d) Is entered into, or carried out, by means, or in a manner, which are not ordinarily employee for bona fide purposes.

An arrangement shall be presumed, unless it is proved to the contrary by the assessee, to have been entered into, or carried out, for the main purpose of obtaining a tax benefit.