

**FINAL EXAMINATION**

**GROUP - III  
(SYLLABUS 2016)**

**SUGGESTED ANSWERS TO QUESTIONS**

**DECEMBER - 2019**

**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 Income Tax Assessment Year 2019 – 20, and the provisions referred to are the Income-Tax Act, 1961, unless stated otherwise.**

**Answer Question No. 1 which is compulsory and five questions out of 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**

**(i) Martin (age 62) resident in India received interest on fixed deposit with SBI of Rs. 45,000 for the year ended 31.03.2019. He does not have PAN. At what rate the bank must deduct tax at source?**

- (A) Nil**
- (B) 10%**
- (C) 20%**
- (D) 30%**

**(ii) Damage (P) Ltd. filed an application in March, 2019 for corporate insolvency resolution process, which was admitted by the adjudicating authority under Insolvency and Bankruptcy Code, 2016. The company has two full-time directors and a managing director. Who must sign the return of income of the company for the assessment year 2019-20?**

- (A) Any one of the full-time directors.**
- (B) The professional appointed by the said adjudicating authority.**
- (C) Liquidator of the company**
- (D) Managing director**

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- (iii) Shri Rajiv paid Rs. 1,20,000 by cheque on 05.01.2019 towards medical insurance premium for his parents who are senior citizens and not dependent on him. The premium was to provide health insurance cover for 3 years. How much is deductible under section 80D for the assessment year 2019 – 20?
- (A) Nil  
(B) Rs. 25,000  
(C) Rs. 40,000  
(D) Rs. 50,000
- (iv) Mahasakthi Sugars Co-operative Society is engaged in manufacture of jiggery from sugarcane cultivated by its members. What is the 'due date' for filing the return of income for the assessment year 2019-20 in order to be eligible for deduction under section 80-P?
- (A) Due date specified in section 139(1)  
(B) No specific date  
(C) 31<sup>st</sup> March, 2020  
(D) 31<sup>st</sup> December, 2019
- (v) During the course of survey in the premises of Jagan & Co. on 10.01.2019, stocks of goods purchased for Rs. 10 lakhs were found to be not recorded in the books of account. The firm has brought forward loss of Rs. 5 lakhs and incurred business loss of Rs. 2 lakhs for the year ended 31.03.2019 without considering the unaccounted stock. The tax liability of the firm including the said unaccounted purchase would be \_\_\_\_\_ (including surcharge and cess).
- (A) Rs. 3,12,000  
(B) Rs. 7,80,000  
(C) Nil  
(D) Rs. 93,600
- (vi) ABC Ltd. declared interim dividend in August, 2018 of Rs. 100 lakhs. The amount payable by way of dividend distribution tax would be
- (A) Rs. 31,20,000  
(B) Rs. 26,00,000  
(C) Rs. 17,47,200  
(D) Rs. 20,55,600
- (vii) A certificate issued by a registered valuer contained incorrect information. The CIT (Appeals) while giving appellate order can
- (A) Impose penalty of Rs. 1 lakh on registered valuer.  
(B) Not impose penalty on registered valuer  
(C) Impose penalty of Rs. 10,000 on registered valuer  
(D) Direct registered valuer to rectify the error.
- (viii) Tripti Charitable Trust registered under Section 12AA paid rent for premises at Rs. 30,000 per month by cash. It also did not deduct tax on salary paid to its manager amounting to Rs. 4,80,000 for the previous year 2018-19. The total income of the assessee would be increased by \_\_\_\_\_ because of the above said transactions.

- (A) Rs. 3,60,000
- (B) Rs. 5,04,000
- (C) Rs. 8,40,000
- (D) Rs. 2,52,000

(ix) X Co. Ltd. paid interest to its holding company Y Inc. of USA at 15% amounting to Rs. 200 lakhs. The total interest paid by X Co. Ltd. for the previous year 2018-19 was Rs. 500 lakhs. In determining arm's length price interest paid to Y Inc. was added back to the extent of Rs. 100 lakhs in the hands of X Co. Ltd. The EBITDA of X Co. Ltd. is Rs. 700 lakhs for the year ended 31<sup>st</sup> March, 2019. The amount of interest liable for disallowance in the hands of X Co. Ltd. would be \_\_\_\_\_.

- (A) Rs. 500 lakhs
- (B) Rs. 300 lakhs
- (C) Rs. 190 lakhs
- (D) Nil

(x) Madan Traders Ltd. Jaipur received Rs. 200 by way of dividend declared by Botham Co. Ltd. of UK in January, 2019. Madam, Traders Ltd. has 26% shareholding in Botham Co. Ltd. The tax liability of Madam Traders Ltd. on the dividend income would be

- (A) Nil
- (B) Rs. 62.4 lakhs
- (C) Rs. 34.944 lakhs
- (D) Rs. 43.0976 lakhs

**Answer:**

1. (i) (A) NIL

Brief answer: Since interest on SB and / or fixed deposit below Rs. 50,000 is not chargeable to tax in the case of senior citizens because of section 80TTB, no tax is deductible at source by the payer regardless of whether the recipient senior citizen has PAN or not.

(ii) (B) The professional appointed by the said adjudicating authority

Brief answer: As per sub-clause (c) of the proviso to section 140(c), in the case of a company which has made an application for corporate insolvency resolution process and which has been admitted by the adjudicating authority, the return of income must be signed by the professional who has been appointed by the said adjudicating authority.

(iii) (C) Rs. 40,000

Brief answer: As per section 80D(4A) when payment is made in lump sum to keep an insurance on the health of any person specified therein for more than a year, there shall be allowed for each of the relevant previous year, a deduction equal to the appropriate fraction of the amount. The proportionate fraction is Rs.40,000 i.e. Rs.1,20,000 /3.

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(iv) (A) Due date specified in section 139(1)

Brief answer: As per section 80AC from assessment year 2018-19 any deduction admissible under any provision of Chapter VI-A under the heading "C-Deductions in respect of certain incomes" shall not be allowed unless the assessee furnishes the return of income for such assessment year on or before the due date specified in section 139(1) of the Act.

(v) (B) Rs. 7,80,000

Brief Answer: As per section 115BBE any addition under sections 68, 69, 69A, 69B 69C or section 69D is chargeable to tax @ 60% plus surcharge @ 25% and HEC @ 4%. The effective rate is 78%. Further, sub-section (2) to section 115BBE says no deduction in respect of any expenditure or allowance or set off of any loss shall be allowed against such income.

(vi) (D) Rs. 20,55,600

Brief answer: As per section 115-O the dividend distribution tax is payable by ABC Ltd. on grossing up of dividend paid  $100/85 \times 100$  lakhs = 117.647 lakhs minus Rs. 100 lakhs = Rs. 17.647 lakhs. Add surcharge @ 12% = Rs. 2.118 lakhs. Add Health and Education cess @ 4% on 19.765 = Rs. 0.791 lakhs. Total liability = 17.647 lakhs + Rs. 2.118 lakhs + 0.791 lakhs = Rs. 20.556 lakhs.

(vii) (C) impose penalty of Rs. 10,000 on registered valuer.

Brief answer: As per section 271J the Assessing Officer or the CIT (Appeals) finds that the registered valuer has furnished incorrect information in any report or certificate, he may impose a penalty of Rs. 10,000 for each such report or certificate.

(viii) (B) Rs. 5,04,000

Brief answer: On rent paid exceeding Rs. 10,000 in contravention of section 40A(3) the entire expenditure so incurred will not be treated as application. Similarly, salary paid to manager of the trust Rs. 4,80,000 without tax deduction at source under section 192 would attract 30% disallowance. Thus rent Rs. 3,60,000 and salary Rs. 1,44,000 will not be treated as application of income by the trust. Thus the total income of the assessee would get enhanced by Rs. 5,04,000 for the above said transaction.

(ix) (D) Nil

Brief answer: Total interest paid Rs.500 lakhs including interest of Rs.200 lakhs paid to associated enterprise. The EBITDA of the company is Rs.700 lakhs. 30% thereon being Rs.210 lakhs. As the interest paid to associated enterprise is less than 30% of EBITDA, no interest is liable for disallowance. The correction option is (D).

(x) (C) Rs. 34.944 lakhs

Brief answer: In the case of an Indian company having income by way of dividend declared, distributed or paid by a specified foreign company, it is chargeable to tax at 15% plus surcharge @ 12% and cess @ 4%. The condition is that the Indian company must have 26% or more in normal value of the equity share capital of the foreign company. Since Madam Traders Ltd has 26% shareholding in Botham Co Ltd., it is eligible to pay concessional rate of tax.

**Section – B**

2. (a) **Vittal & Co.** is a partnership firm deriving income from an industrial undertaking whose income is eligible for deduction u/s 80-IA (8<sup>th</sup> year). During the year ended 31-03-2019, the firm derived an income of Rs. 5,00,000 from the industrial undertaking. The firm omitted to file the return of income on the ground that its total income being nil, no tax was payable by it.

The assessment was later completed on the basis of AMT provisions u/s 115JC, the income from the industrial undertaking being taken as Rs. 5,00,000.

Discuss whether any penalty leviable in this regard, and if so, specify the quantum. Will your answer remain the same if the assessable entity is an AOP instead of a firm? The AOP is one wherein the members and their shares are determinate and known. 8

- (b) State whether “business connection” is established as envisaged by section 9 of the Income – tax Act, 1961, in the under-mentioned situations:

(i) **Jupiter Pty Ltd., London (JPL)**, a non-resident company, has set up a liaison office at Kolkata, with the permission of the RBI, Indian customers, who are briefed of the products of JPL by the liaison office, interact directly with JPL for placing and processing of their orders. 2

(ii) **Madan & Co. (MC)**, is acting on behalf of **Nelson Inc., Sydney**, a non-resident company. MC can accept the order, negotiate the price and coordinate with MC for delivery of product to the Indian clients. MC is paid commission in this regard. 2

- (c) On 20<sup>th</sup> Feb., 2019, **Vaamana Textiles Pvt. Ltd.**, has given a trade advance of Rs. 50 lakhs to **Ms. Poorvisha**, a shareholder holding 30% of the equity shares and voting power in the company. On this date, the company has credit balance of Rs. 35 lakhs in the profit and loss account.

Ascertain the quantum of deemed dividend which is assessable in the hands of **Ms. Poorvisha**. 4

**Answer:**

2. (a) **Levy of penalty u/s 270A**

Penalty becomes leviable u/s 270A

It is a case of under-reporting of income.

Under-reporting is the amount of deemed total income assessed as per the provisions of section 115JC. In this case, it is Rs. 5,00,000.

Since there is no basic exemption limit, the whole of Rs. 5,00,000 will be taken as under reported income.

Taxable on the same is 31.2% of Rs. 5,00,000 i.e., Rs. 1,56,000.

Penalty leviable for under-reporting of income is 50% of above Rs. 78,000.

### When the assessee is an AOP

If the assessee were an AOP, the answer will be different.

Basic exemption limit of Rs. 2,50,000 has to be reduced to arrive at the amount of under reported income.

Under-reported income will be Rs. 5,00,000 – 2,50,000 = Rs. 2,50,000.

Tax on the same will be 10.4% of 2,50,000 = Rs. 26,000.

Penalty u/s 270A is 50% of above i.e., Rs. 13,000.

### (b) Business connection

(i) When a liaison Office is maintained solely for the purpose of carrying out activities which are preparatory or auxiliary in character, and such activities are approved by the Reserve Bank of India, then, no business connection is established.

Indian customers, who are briefed of the products of JPL by the liaison office, interact directly with JPL for placing and processing of their orders. The liaison office does not procure orders or process them. Hence there is no business connection as envisaged by section 9.

(ii) 'Business connection' shall include any business activity carried out through a person acting on behalf of the non-resident. For a business connection to be established, the person acting on behalf of the non-resident –

- must have an authority which is habitually exercised in India to conclude contracts on behalf the non-resident or;
- in a case where he has no such authority, but habitually maintains in India a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the non-resident, or
- habitually secures orders in India, mainly or wholly for the non-resident.

Here, MC can accept the order, negotiate the price and coordinate with MC for delivery of product to the India clients. Hence there exists a business connection in this situation.

### (c) Deemed dividend

Section 2(22)(e) provides that "dividend" includes any payment by a company in which public are not substantially interested, of any sum by way of

- advance or loan
- to a shareholder who is the beneficial owner of shares holding not less than 10% of the voting power,

or to any concern in which such shareholder is a member or a partner and in which he has a substantial interest or any payment by any such company on behalf, or for the individual benefit, or any such shareholder, to the extent to which the company in either case possesses accumulated profits.

Some Courts in the recent past has held that trade advances in the nature of commercial transactions would not fall within the ambit of the provisions of section 2(22)(e).

In view of the above, the CBDT has, vide circular 19/2017, dated 12.06.2017, clarified that it is a settled position that trade advances, which are in the nature of commercial transactions, would not fall within the ambit of the word 'advance' in section 2(22) (e) and therefore, the same would not to be treated as deemed dividend.

Hence, in the given situation there will not be any amount which is assessable as deemed dividend.

- 3. Barun Co. Ltd. is engaged in the business of manufacture of chemicals since June, 2005. The Statement of Profit and Loss for the year ended 31.03.2019 shows a Net Profit of Rs. 35,60,000 and aggregate turnover which never exceeded Rs. 25 crores. The following additional information is provided:**

- (a) Depreciation debited in the books Rs. 19,40,000 (it includes depreciation on revalued plant and machinery of Rs. 3,00,000). Amount of depreciation deductible under Income-tax Rules Rs. 13,15,000.
- (b) Interest payable to financial institutions Rs. 5,20,000 debited in the books but Rs. 3,90,000 was actually paid during the previous year and up to the date of filing the return of income under section 139(1).
- (c) Provision for doubtful debts Rs. 8 lakhs being 5% on debtors debited to Statement of Profit and Loss.
- (d) Expenditure towards issue of bonus shares Rs. 2 lakhs and alteration of memorandum of association for increasing the authorized capital Rs. 1 lakh. Both have been debited in the books as expenditure.
- (e) Purchase of agricultural produce being raw material for manufacture by making cash payment on 15.08.2018 Rs. 60,000 and on 26.01.2019 Rs. 40,000. Also, cash payments of Rs. 50,000 made for purchases of the previous year 2017-2018 on 03.05.2018.
- (f) Contract payments made during the year Rs. 5,10,000 to ABC Ltd., Chennai. Tax was not deducted at source in respect of the payments of Rs. 1,50,000.
- (g) Dividend from subsidiary company credited to Statement of Profit and Loss Rs. 90,000.
- (h) Provision for taxation Rs. 2 lakhs and proposed dividend Rs. 80,000 debited to Statement of Profit and Loss.

**Compute Total income and tax liability as per regular provision and under section 115JB (MAT Provision) for the assessment year 2019-20.**

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**Note: You have to deal with each and every item given above and provide brief reasons for treatment given.**

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**Answer:**

3.

### Computation of Income of Barun Co Ltd. for the Assessment Year 2019 -20

Net Profit as per Statement of Profit and Loss		35,60,000
Add:		
Depreciation debited		19,40,000
Interest payable to financial institutions is disallowed to the extent it is not paid up to the date of filing the return under section 139(1)		1,30,000
Provision for doubtful debts		8,00,000
Expenditure towards issue of bonus shares is allowed as there is no fresh inflow of funds or increase in capital employed. [CIT v. General Insurance Corpn. (2006) 286 ITR 232 (SC)]		Nil
Expenditure towards increasing the authorized capital is a capital expenditure to be disallowed (Punjab State Industrial Development Corpn Ltd. v. CIT (1997) 225 ITR 792 (SC)).		1,00,000
Purchase of agricultural produce on independence day and Republic Day are allowable and no disallowance under section 40A(3)		Nil
Cash payment made for purchases/expenditures claimed in the earlier year is liable for disallowance under section 40A(3A)		50,000
Contract payments without deduction of tax at source liable for disallowance @ 30% of Rs. 1,50,000		45,000
Provision for taxation and proposed dividend debited to Statement of Profit and Loss –added back.		2,80,000
		69,05,000
Less:		
Depreciation allowable as per Income tax rules	13,15,000	
Dividend from subsidiary company credited to profit and loss account – to be considered under the head 'other sources' and hence deducted now.	90,000	
It is exempt under section 10(34)		
		14,05,000
Total Income		55,00,000
Tax thereon @ 25% + 4% HEC		14,30,000



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### Computation of Book Profit of Barun Co. Ltd. u/s 115 JB for the Assessment Year 2019 – 20

Net Profit as per Statement of Profit and Loss	35,60,000
Add:	
Depreciation debited in the books to the extent it is attributable to revalued assets is liable for disallowance	3,00,000
Interest payable to financial institutions is not to be adjusted while computing book profit.	Nil
Provision for doubtful debts liable for add back under section 115JB	8,00,000
Expenditure towards issue of bonus shares is not liable for any adjustment under section 115JB	Nil
Expenditure towards increasing the authorized capital though a capital expenditure is not liable for any adjustment under section 115 JB.	Nil
Purchase of agricultural produce on independence day and Republic Day – on adjustment under section 115 JB	Nil
Cash payment made for purchases / expenditures claimed in the earlier year – not liable for any adjustment under section 115JB	Nil
Contract payments without deduction of tax at source liable for disallowance @ 30% of Rs. 1,50,000 under section 40(a)(ia) but no adjustment under section 115JB	Nil
Provision for taxation and proposed dividend debited to Statement of Profit and Loss – added back.	2,80,000
	49,40,000
Less:	
Dividend from subsidiary company credited to profit and loss account is exempt under section 10(34) and hence to be excluded while computing book profit under section 115JB	90,000
Book Profit under section 115JB	48,50,000
Tax thereon @ 18.5%	8,97,250
Add: Health and Education cess @ 4%	35,890
	9,33,140

4. (a) Vishwa & Co., a partnership firm has entered a net profit of Rs. 6.2 lakhs after debiting the following items:

	(Rs. in lakhs)
<b>(i) Depreciation as per books for the current year</b>	<b>2</b>
<b>(ii) Interest to partners at 15%</b>	<b>9</b>
<b>(iii) Remuneration to working partners</b>	<b>7</b>
<b>Additional information:</b>	
<b>(i) Depreciation for the current year as per Income-tax Rules, 1962</b>	<b>4</b>
<b>(ii) Unabsorbed depreciation of AY 2018-19 pertaining to a business which was discontinued</b>	<b>3</b>
<b>(iii) Brought forward business loss of AY 2018-19</b>	<b>5</b>
<b>(iv) Remuneration as per partnership deed to working Partners</b>	<b>8</b>
<b>(v) Interest to partners as per partnership deed 15%</b>	

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You are required to compute the total income for the firm, when the firm files its return of income on 30.07.2019.

Assuming that a best judgment assessment under section 144 is made, what will be the total income assessed? 8

(b) Padmaja Textiles Ltd., (PTL) has two separate divisions J and K. Division K was stated on 14.05.2010. The summarized financial position of the company as on 1<sup>st</sup> October, 2018 was as under:

	(Rs. in lakhs)
Share capital	1,200
Reserves and surplus	500
Loan creditors:	
Division J	400
Division K	300
Total	2,400
Represented by	
Fixed assets:	
Division J	800
Division K	
Goodwill	30
Vacant Land (Purchased on 02.03.2011)	170
Plant and Machinery (WDV)	400
Current assets:	
Division J	550
Division K	450
Total	2,400

On 01.10.2018, Division K was acquired by Virat Kohli Textile Pvt. Ltd., in a slump sale, the entire sale consideration of Rs. 310 lakhs being paid through RTGS.

The following additional information are available relating to the fixed assets of Division K:

- (i) All the plant and machinery were acquired 11 months back.
- (ii) The WDV of the plant and machinery of division K as per the Income-tax Act, 1961 was Rs. 350 lakhs.
- (iii) Apart from these, there are plant used in scientific research for which deduction had been availed u/s 35AD in the assessment year 2015-16. The fair market value of these items of plant is Rs. 12 lakhs.

Cost inflation index for FY 2010-11 is 167 and for FY 2018-19 is 280.

You are required to ascertain the capital gain, if any, arising from the slump sale. 8

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Answer:

4. (a)

### Computation of total income of Vishwa & Co., for the AY 2019-20

Particulars	Amount (Rs.)
Net profit before remuneration to working partners	6,20,000
Add: Depreciation as per books	2,00,000
Remuneration as per books	7,00,000
Adjustment for interest [Interest is allowable at 12% maximum same debited at 15% in books, hence difference is added back i.e., 9 – 7.2L]	1,80,000
Less: Depreciation as per sec 32 Unabsorbed depreciation of AY 2018 – 19 has to be added to current depreciation, as per the provisions of section 32(2).	7,00,000
Book profits as per section 40(b)	10,00,000
Less: Remuneration to working partners: Ceiling (First 3 lakhs 90% and 60% of balance). This is within the limit given in the partnership deed, hence allowable.	6,90,000
Business income before considering set off	3,10,000
Less: Brought forward business loss	5,00,000
Business income / Total income (Loss)	(1,90,000)

### When assessment is made u/s 144

Interest and remuneration to partners will not be allowed while making the assessment.

### Total income in case of best judgment assessment

Particulars	Amount (Rs.)
Net profit before remuneration to working partners	6,20,000
Add: Depreciation as per books	2,00,000
Remuneration as per books	7,00,000
Interest to members debited	9,00,000
Less: Depreciation as per sec 32 Unabsorbed depreciation of AY 2018-19 has to be added to current depreciation, as per the provisions of section 32(2).	7,00,000
Business income before b/wd losses	17,20,000
Less: Brought forward business loss	5,00,000
Business income/Total income	12,20,000

(b) Computation of capital gains arising from slump sale

Particulars	(Rs. in lakhs)
Sale consideration	310
Less: Net worth [See working below]	700
Long-term capital loss [Division K was stated on 14-05-2010]	390

**Working Note: Computation of net worth**

<b>Particulars</b>	<b>(Rs. in lakhs)</b>
Goodwill (at book value)	30
Land (at book value) [Indexation benefit not available]	170
Plant & machinery (at WDV)	350
Plant & machinery used in special business covered by sec 35AD [As per section 50B, the value of such plant for which deduction u/s 35AD had been availed in nil]	Nil
Current assets	450
Total value of assets of Division K	1,000
Less: Creditors	300
Net worth	700

**5. In the light of decided case laws, 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 the case law is NOT required]:** **4×4=16**

**(a) Sagoserve Cooperative Society was a cooperative society deriving income of Rs. 2 crore, for which deduction was allowed under section 80P(2)(d). The total income of the assessee was Rs. 3 crore. The Assessing Officer disallowed 40% of interest expenditure, invoking the provisions of section 14A. According to the AO, out of the aggregate income of Rs. 5 crore, Rs. 2 crore did not form part of the same. Is the disallowance made by the AO justified?**

**(b) Lavanya Syndicates Pvt. Ltd., owns several house properties, let out on commercial basis to various kinds of people like business houses, corporate entities, etc. One of the objectives of the company is to own and derive income from letting out various kinds of immovable property. The rental income derived was offered by the company as its business income. Various deductions for earning such income was claimed, as also depreciation on the buildings owned by the company.**

**The Assessing Officer treated the rental income as income from house property and granted deduction only u/s 24.**

**Discuss whether the treatment of the impugned income made by the company is correct.**

**(c) Mr. Pandurang sold a residential house property and invested whole of the long-term capital gain for purchasing of residential flat. The possession was not handed over by the builder to the assessee even after 3 years, even though the entire sale consideration had been paid.**

**The Assessing Officer refused to grant exemption u/s 54 on the ground that the prescribed condition for purchase of a residential house had not been complied with, in as much as the possession had not been handed over.**

**Judge the correctness of the action of the Assessing Officer.**

(d) **Bluesky Airlines, the assessee – company was operating an airlines in India. Payment of Rs. 34 lakhs was made during the year to the Airport Authority of India. The assessee deducted tax at source at 2% u/s 194-C. The AO contended that the same was for parking charges and being payment made for use of land, section 194-I will apply.**

**Is the contention of the Assessing Officer correct in law?**

(e) **The assessee was dealing in Indian Made Foreign Liquor (IMFL). It was purchasing IMFL in wholesale from the State Govt., and selling it for higher price in the market. The Department recovered documents during survey which showed that the assessee had sold IMFL at price higher than what had been sold. Addition was made u/s 68 for suppressed sales. The assessee objected to the same.**

**Is the objection sustainable?**

**Answer:**

**5. (a) Applicability of Section 14A**

**Issue involved**

The issue under consideration in this case is whether section 14A can be invoked to disallow expenditure relating to income covered by deduction under Chapter VIA.

**Provisions applicable**

Section 14A enjoins that no deduction shall be allowed in respect of expenditure relating to income which does not form part of the total income of the assessee.

**Analysis of the given issue**

In the given situation the income in question was not covered by any exemption under any of the clause of section 10.

This was an income which formed part of the gross total income of the assessee, for which deduction was availed u/s 80P(2)(d).

Section 14A is applicable only in respect of expenditure relating to income which is exempt under section 10 and not where the impugned income is one for which deduction is available under Chapter VIA.

**Conclusion**

The action of the Assessing officer invoking the provisions of section 14A in the given situation is incorrect.

Reference may be made to the decision in CIT vs Kribhco 349 ITR 18 (Del)

**(b) Business income or income from house property**

**Issue involved**

The issue under consideration whether the income derived by the company by letting out the properties owned by it is assessable as business income or as income from house property.

**Provisions applicable**

Where the income in question is one earned as a mere owner of the property, it will be income from house property covered by section 22. If the income is one derived from the business of the company, which included letting out the properties owned. It would be business income covered by section 28, for which various deduction under sections 29 to 44 will be available.

**Analysis**

Where there is a letting out of premises and collection of rents the assessment on property basis may be correct but not so, where the letting or sub-letting is part of a trading operation. The directing line is difficult to find; but in the case of a company with its professed objects and the manner of its activities and the nature of its dealings with its property, it is possible to say on which side the operations fall and to what head the income is to be assigned.

In the given case, the objects of the company include carrying of business of letting out properties. The income has not been earned as mere owner of the let out properties.

**Conclusion**

The contention of the assessee-company is hence correct.

Reference may be made to the decisions of the Apex Court the case of Chennai Properties and Investments Ltd. v. CIT [2015] 373 ITR 673 (SC), reiterated by the Apex Court in Rayala Corporation (P) Ltd. v. ACIT (2016) 72 taxmann. Com 149 (SC)

**(c) Exemption under section 54****Issue involved**

The issue involved is whether the exemption u/s 54 can be denied to the assessee on the ground that the possession of the new residential flat had not been handed over to him by the builder.

**Provisions applicable**

Exemption will be available under section 54, where the long-term capital gain derived by a resident individual/HUF is invested, inter alia, in purchase of another residential house within a period of 2 years from the date of transfer.

**Analysis of the issue**

In the given case the assessee had paid the entire sale consideration to the builder for purchase of the new residential house/flat. Thus he had complied with the required condition stipulated u/s 54 for grant of exemption.

There is no provision which prohibits exemption u/s 54 where the possession of the flat is not handed over to the assessee.

**Conclusion:**

The Assessing Officer is not justified in denying exemption u/s 54 to the assessee.

Reference may be made to the decision of the Karnataka High Court in CIT vs Sakuntala Devi 389 ITR 366 (Kar).

(d) **TDS u/s 194-C or 194-I?**

**Issue involved**

The issue involved is whether in respect of the payments made by the assessee (operating its airlines) to the AAI, tax deducted u/s 194-C or u/s 194-I?

**Provisions applicable**

As per section 194-C, where any payment is made by a company to another company for contractual services, tax has to be deducted at source at 2% of the payments.

As per section 194-I, in simple terms, where the payment is made for lease of land, tax has to be deducted under that section at the applicable rate, where such payment exceeds Rs. 1.8 lakhs per annum.

**Analysis of the issue**

The payment made by the assessee – airlines was not just for use of land alone, but for number of services like parking space, aero bridge, customer support services for passengers, etc. It was for a bundle of contractual services and not merely for use of the land for landing or parking.

Section 194-I can have applicable only where the payment is made, inter alia, for lease of land/building and not where variety of services are provided to the assessee.

**Conclusion**

As a result, section 194C will govern the issue and not section 194-I. The contention of the AO is incorrect.

Reference may be made to the decision of the Apex Court in Japan Airlines Co. Ltd. vs. CIT (2015) 60 taxmann. Com 71 (SC).

(e) **Unexplained cash credit**

**Issue involved**

The issue involved is whether the addition u/s 68 is justified in law.

**Provisions applicable**

Section 68 enjoins that where any sum is found credited in the books of an assessment maintained for any previous year, and the assessee offers no explanation about the nature and source thereof or the explanation offered by him is not, in the opinion of the Assessing Officer, satisfactory, the sum so credited may be charged to income-tax as the income of the assessee of that previous year.

**Analysis of the issue**

During survey it was found that the assessee – had sold 'IMFL' in excess of price shown in books of account and return. The Assessing Officer on basis of documents recovered made addition of income of the assessee on account of suppressed sales.

There was no restriction with respect to price for which liquor had to be sold by a person holding licence to run bars under the Aabkari Act. Since, the price was variable and sale suppression detected during survey was actual price for which liquor was sold, the addition made on account of sale suppression was to be sustained.

**Conclusion**

The assessee's contention is therefore incorrect and is not sustainable.

Reference may be made to the decision of the Kerala High Court in CIT v. Archana Trading Co. [2018] 257 Taxman 386 Ker).

6. (a) **Bharat Cellphones Ltd. (BCL) of Mumbai and Japan Mobiles Ltd. (JML) of Tokyo are associated enterprises. BCL imported 10,000 mobile handsets from JML for Rs. 15,000 per handset which are sold to unrelated parties in India for Rs. 20,000 per handset. BCL also imported similar mobile sets from Europe Ltd. (EL) of London which was sold with a gross profit margin of 25% on cost. JML offered quantity discount @ Rs. 2,000 per unit and whereas EL offered discount @ Rs. 800 per unit as quantity discount. The freight and customs duty paid for imports from EL had cost BCL Rs. 1,500 per unit. In respect of purchases from EL, the expenditure towards freight and customs duty was Rs. 500 per unit.**

**State the most appropriate method applicable in this case and determine the arm's length price and amount of increase in total income of BCL.** 8

- (b) **Compute the interest income to be disallowed under section 94B in the following cases:** 5

Particulars	Case I	Case II	Case III
	Rs. in lakhs		
Net Profit after deduction of the following items:	1,000	1,000	1,000
Interest to SBI	70	50	200
Interest to associated enterprise	200	110	320
Interest to unrelated parties	500	190	300
Depreciation	90	80	110
Provision for taxation	340	170	70
Proposed dividend	300	150	100

- (c) **State briefly whether the following actions would lead to establishment of PE in India:** 3

- (i) **A foreign company having a warehouse for storage of goods procured from suppliers in India for the purpose for export to various countries.**
- (ii) **Display of goods by a reputed car manufacturer in a trade fair at Delhi for the purpose of booking orders and supplying directly to the customers in India.**
- (iii) **Extracting oil in a river bed by a foreign company Elegant Inc. by entering into contract with a public sector undertaking in India.**



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Answer:

6. (a)

### Computation of arm's length price of BCL for the Assessment Year 2019-20

Since BCL is engaged in purchase of mobile handsets from associated enterprise and sale of those handsets in India without any value addition, resale price method is the most appropriate method for computation of arm's length price.		
Resale price of goods purchased from associated enterprise JML		20,000
Less: Adjustment for differences		
Normal gross profit margin @ 20% of sale price (25% on cost)	4,000	
Incremental quantity discount by JML (Rs. 2,000 – Rs. 800)	1,200	
Difference in purchase related expenses (Rs. 1,500 – Rs. 500)	1,000	6,200
Arm's length price		13,800

### Computation of Increase in total income of BCL

Price at which actually bought from JML	15,000
Less: Arm's length price per unit under resale price method	13,800
Decrease in purchase price per unit	1,200
Number of units purchased from JML	10,000
Increase in total income Rs. 1,200 × 10,000	120 lakhs

(b) **Computation of interest liable to be disallowed under section 94B**

Particulars	Case I	Case II	Case III
	Rs.in lakhs		
Net Profit after deduction of the following items:	1,000	1,000	1,000
<b>Add:</b>			
Interest to SBI	70	50	200
Interest to associated enterprise	200	110	320
Interest to unrelated parties	500	190	300
Depreciation	90	80	110
Provision for taxation	340	170	70
Proposed dividend	300	150	100
<b>EBITDA</b>	2,500	1,750	2,100
<b>Less:</b>			
Maximum amount of interest deductible under section 94B @ 30% of EBITDA or the actual interest paid whichever is less			
30% of EBITDA	750	525	630
Actual amount of interest paid to AE	200	110	320
<b>Disallowance u/s 94B</b>	<b>Nil</b>	<b>Nil</b>	<b>Nil</b>

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(c) **Taxability of certain income in India**

(i)	A foreign company maintaining a warehouse solely for the purpose of storage of goods shall not be deemed to have a permanent establishment in India. Thus the activity will not lead to taxation of income in India.
(ii)	Display of goods belonging to the enterprise in a trade fair in Delhi will not lead to establishment of PE in India. The display of goods in trade fair cannot lead to taxation of income in India for the supply of goods made subsequently.
(iii)	Extracting oil or gas in India will lead to establishment of PE in India. The extraction of oil in accordance with an agreement with PSU is liable to tax in India.

7. (a) **Mr. Rupesh is a resident and ordinary resident has furnished following particulars of income earned during the previous year relevant to the assessment year 2019-20:**

		In Rs.
(i)	Income from agriculture in Pakistan, received there but latter on Rs. 86,000 is remitted to India.	3,41,000
(ii)	Income from property in USA received outside India (out of this Rs. 92,000 is used in Canada for meeting education expenses of his son and Rs. 2,48,000 is latter remitted to India.	3,40,000
(iii)	Income from business in Iran which is controlled from New Delhi (Rs. 70,000 is received in India)	4,05,000
(iv)	Dividend paid by Indian Company on May 10, 2018 but received outside India	1,95,800
(v)	Profits from a business in New Delhi and managed from outside India (60% of profit is received outside India)	92,000
(vi)	Profits on sale of a building in India but received in Nepal	8,74,000
(vii)	Pension from a former employer in India, received in Iran	2,55,000
(viii)	Gift in foreign currency from a friend received in India on September 6, 2018.	80,000

Find out gross total income for the assessment year 2019 – 20.

8

(b) **Mr. Ron, a nonresident, is engaged in business of shipping and operating its ships in Indian ports during the previous year ending on March 31, 2019 had collected freight Rs. 100 lakhs (collected in US dollars) for the cargo booked for Paradeep Port from London and Rs. 45 lakhs for shipping goods from Mumbai. Besides above demurrages Rs. 20 lakhs and handling charges Rs. 10 lakhs also collected. The expenses of operating its fleets during the year for Indian ports were Rs. 110 lakhs (out of which two lakhs paid in cash). He has brought forward loss of Rs. 2 lakhs from trading business in India which is discontinued during the year 2017-18. He has opted for payment of tax under section 44B (presumptive scheme).**

**Compute taxable income and explain the basis taken for computation of such income.**

8

## SUGGESTED ANSWERS\_SYL2016\_DECEMBER2019\_PAPER 16

**Answer:**

7. (a)

### Computation of gross total income of Mr. Rupesh, a resident and ordinary resident of India for the AY 2019-20

	In Rs.
Income accrued and received outside India – Income from agriculture in Pakistan even if only Rs. 86,000 has been received.	3,41,000
Income from property in USA received outside India: Income received outside India (even if Rs. 92,000 spent in Canada the entire amount is taxable in India)	3,40,000
Income from business in Iran which is controlled from New Delhi: Taxable on receipt basis – Rs. 70,000 + Balance of Rs. 3,35,000 is also taxable as the assessee is resident	4,05,000
Dividend paid by India Company on May 10, 2018 but received outside India: Income deemed to accrue or arise in India is exempt from tax	---
Profits from a business in New Delhi and managed from outside India (60% of profit is received outside India): total amount is taxable as accrued outside India	92,000
Profits on sale of a building in India but received in Nepal: Income deemed to accrue and arise in India and taxable in India	8,74,000
Pension from a former employer in India, received in Iran: Income deemed to accrue and arise in India. Taxable after standard deduction of Rs. 2,15,000 (Rs. 2,55,000 – Rs. 40,000)	2,15,000
Gift in foreign currency from a friend received in India on September 6, 2018 is taxable as income from other sources and taxable	80,000
<b>Gross Total Income</b>	<b>23,47,000</b>

(b)

### Computation of Total Income Mr. Ron, a non-resident, for AY 2019-20 under section 44B.

	Rs. in lakhs
Freight collected for cargo booked for paradeep port from London	100.00
Freight collected for shipping goods from Mumbai	45.00
Demurrages and handling charges	30.00
<b>Total receipt</b>	<b>175.00</b>
Income from shipping business (7.5% of the amount received including demurrages and handling charges is deemed to be taxable income under section 44B) – Note – 1	13.125
Add: Disallowances of expenses under section 43A(3) – not applicable – refer Note – 1	---
<b>Total Income from business</b>	<b>13.125</b>
Less: Brought forward business loss	2.00
<b>Net Income</b>	<b>11.125</b>

## SUGGESTED ANSWERS\_SYL2016\_DECEMBER2019\_PAPER 16

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**Note: 1:** Section 44B overrides section 28 to 43A. it should be noted that accordingly deduction under this provisions are not applicable. So expenses are not deducted. However other provisions those relating to carry forward and set off of losses will be applicable. Hence, carry forward of Loss of Rs. 2 lakhs is deducted to arrive the taxable income.

**8. Write Short Notes on any Four:**

**4x4=16**

- (a) Capitalisation of Borrowing Costs under ICDS - IX
- (b) Consequences of Impermissible Avoidance Arrangement (section 98)
- (c) Assessment procedure under Black Money and Imposition of Tax Act.
- (d) Secondary adjustments in books of accounts under section 92CE in certain cases.
- (e) Filing of documents along with settlement petition before Settlement Commission.

**Answer:**

**8. (a) Capitalisation of Borrowing Costs under ICDS-IX**

ICDS-IX provides for capitalisation of borrowing cost which are as follows.

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 borrowing 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.

### **(b) Consequences of Impermissible Avoidance Arrangement (section 98)**

If an arrangement is declared to be an impermissible avoidance arrangement, then, the consequences, in relation to tax, of the arrangement, including denial of tax benefit or a benefit under a tax treaty, shall be determined, in such manner as is deemed appropriate in the circumstances of the case, including by way of but not limited to the following:

- (i) disregarding, combining or recharacterising any step in, or a part or whole of, the impermissible avoidance arrangement;
- (ii) treating the impermissible avoidance arrangement as if it had not been entered into or carried out;
- (iii) disregarding any accommodating party or treating any accommodating party and any other party as one and the same person;
- (iv) deeming person who are connected persons in relation to each other to be one and the same person for the purposes of determining tax treatment of any amount;
- (v) reallocating amongst the parties to the arrangement – (a) any accrual, or receipt, of a capital nature or revenue nature; or (b) any expenditure, deduction, relief or rebate;
- (vi) treating – (a) the place of residence of any party to the arrangement; or (b) the situs of an asset or of a transaction, at place other than the place of residence, location of the asset or location of the transaction as provided under the arrangement; or
- (vii) considering or looking through any arrangement by disregarding any corporate structure.

For this purpose:

- (i) any equity may be treated as debt or vice versa;
- (ii) any accrual, or receipt, of a capital nature may be treated as of revenue nature or vice versa; or
- (iii) any expenditure, deduction, relief or rebate may be recharacterised

### **(c) Assessment procedure under Black Money and Imposition of Tax Act.**

Sec. 10 and 11 of the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act provides the provisions related to assessment which are as follows.

- A. The Assessing Officer may, on receipt of an information from an income-tax authority or any other authority under any law for the time being in force or on coming of any information to his notice, serve on any person, a notice requiring him, on the specified date, to produce such accounts or documents or evidence as the Assessing Officer may require for the purposes of this Act.
- No separate return is required to be filed under this Act
  - There is no time limit for issuance of the aforesaid notice. The Assessing Officer may issue such notice any time on the basis of information.
- B. The Assessing Officer may, from time to time, serve further notices requiring the production of such other accounts or documents or evidence as he may require.
- C. The Assessing Officer may make such inquiry, as he considers necessary, for the purpose of obtaining full information in respect of undisclosed foreign income and asset of any person for the relevant financial year or years.
- D. The Assessing Officer, after considering such accounts, documents or evidence, as he has obtained, and after taking into account any relevant material which he has gathered and any other evidence produced by the assessee, shall by an order in writing, assess the undisclosed foreign income and asset and determine the sum payable by the assessee.
- E. Such order shall be made within 2 years from the end of the financial year in which the notice was issued by the Assessing Officer [Sec. 11]
- F. Best Judgment Assessment: If any person fails to comply with all the terms of the notice, the Assessing Officer shall, after taking into account all the relevant material which he has gathered, make the assessment of undisclosed foreign income and asset to the best of his judgment and determine the sum payable by the assessee. [Sec.10(4)]. Before making such an assessment, an opportunity of being heard is required to be given to the assessee.

### **(d) Secondary adjustments in books accounts under section 92CE in certain cases**

“Secondary adjustment” means an adjustment in the books of account of the assessee and its associated enterprise to reflect that the actual allocation of profits between the assessee and its associated enterprise are consistent with the transfer price determined as a result of primary adjustment, thereby removing the imbalance between cash account and actual profit of the assessee. The provisions are enumerated here-in-below:

- Where a primary adjustment to transfer price,;
  - (i) Has been made suo motu by the assessee in his return of income;
  - (ii) Made by the Assessing Officer has been accepted by the assessee;
  - (iii) Is determined by an advance pricing agreement entered into by the assessee u/s 92CC;
  - (iv) Is made as per the safe harbour rules framed u/s 92CB; or
  - (v) Is arising as a result of resolution of an assessment by way of the mutual agreement procedure under an agreement entered into u/s 90 or 90A for avoidance of double taxation, - the assessee shall make a secondary adjustment.

- **Exception:** Nothing contained in this section shall apply, if:
  - (i) the amount of primary adjustment made in any previous year does not exceed Rs. 1 crore; and
  - (ii) the primary adjustment is made in respect of an assessment year commencing on or before 01-04-2016.
  
- Where, as a result of primary adjustment to the transfer price, there is an increase in the total income or reduction in the loss, as the case may be, of the assessee, the excess money which is available with its associated enterprise, if not repatriated to India within the time as may be prescribed, shall be deemed to be an advance made by the assessee to such associated enterprise and the interest on such advance, shall be computed in such manner as may be prescribed.
  - Excess money means the difference between the arm's length price determined in primary adjustment and the price at which the international transaction has actually been undertaken;
  - Primary adjustment to a transfer price, means the determination of transfer price in accordance with the arm's length principle resulting in an increase in the total income or reduction in the loss, as the case may be, of the assessee.

### **(e) Filing of documents along with settlement petition before Settlement Commission.**

The application in the prescribed form (Form No. 34B) to the Settlement Commission should be accompanied by the following statements etc.

- Statement(s) containing computation of total income of the application for the assessment year or year(s) to which the application relates.
- Copies of manufacturing and/or trading account, statement of profit and loss / income and expenditure account/ any other similar account and balance sheet in respect of the relevant year(s).
- In the case of proprietary business or profession copies of personal account of proprietor in respect of the relevant year(s)
- In the case of a firm/AOP/BOI, copies of the personal accounts of the partners/members in respect of the relevant year(s).
- In the case of a partner of a firm/member of an AOP/BOI copies of the personal accounts of such partner/member in the firm/AOP/BOI in respect of the relevant year(s).
- Proof of payment of Settlement Application fee of Rs. 500/-.

Seven copies of the application along with the accompaniments as mentioned above have to be filed in the office of Settlement Commission. The application in Form No. 34B, the verification appended thereto, the Annexure and statements and documents enclosed therewith must be signed by the person authorised under section 140 to sign the return of income.