

FINAL EXAMINATION
GROUP III
(SYLLABUS 2016)
SUGGESTED ANSWERS TO QUESTIONS
JUNE 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
any five from Question No. 2 to Question No. 8

Section – A

1. (a) Choose the most appropriate alternative and give justification in brief/brief working for your answer: 2x10=20
- (i) Alpha Ltd., Mumbai has 27% shareholding in Beta Pte. Inc. of Singapore. Alpha Ltd. received ₹ 15 lakhs (converted in Indian rupee) by way of dividend in October, 2018. The dividend so received is taxable in the hands of Alpha Ltd. at
- (A) Nil, Fully exempt
(B) 10%
(C) 15%
(D) 30%
- (ii) Gama Traders is a partnership firm consisting of 4 equal partners. One partner retired on 31.03.2018. The firm has eligible brought forward loss of ₹ 4 lakhs relating to the assessment year 2017-18. The total income of the firm of the previous year 2018-19 before set off of the said brought forward loss is ₹ 7,20,000. The amount of brought forward loss eligible for set off would be
- (A) ₹4,00,000
(B) Nil
(C) ₹ 1,00,000

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- (D) ₹3,00,000
- (iii) The provisions of Alternate Minimum Tax (AMT) will be applicable when the adjusted total income of the individual taxpayer exceeds
- (A) ₹ 10,00,000
(B) ₹ 20,00,000
(C) ₹ 50,00,000
(D) ₹1,00,00,000
- (iv) Mr. Ram Chandran a resident individual (age 52) has income of ₹ 51,00,000 for the year ended 31.03.2019. His income-tax liability after marginal relief would be
- (A) ₹ 14,76,250
(B) ₹ 14,69,000
(C) ₹ 14,12,500
(D) ₹13,62,400
- (v) Y & Co. is a partnership firm which was dissolved on 31.03.2018. The return of income of the firm for the assessment year 2018-19 was filed on 31.08.2018. The return of income of the firm was selected for scrutiny assessment under section 143(3). The notice for scrutiny assessment under section 143(2) has to served on
- (A) all the partners.
(B) any working partner.
(C) any partner having long association.
(D) any partner.
- (vi) Sakshita Fertilisers P Ltd., is a manufacturer. A factory building has been constructed for ₹ 40 lakhs and occupied on 12.02.2018. Additional depreciation allowable for the said factory building is
- (A) Nil
(B) ₹ 4 lakhs
(C) ₹ 2 lakhs
(D) None of the above
- (vii) Mr Nyati has won a lottery prize. After deduction of tax, he received ₹7lakhs. He as spent ₹ 20,000 by way of purchase of lottery tickets and for collecting the prize money. The amount chargeable to tax in his hands in this regard is
- (A) ₹ 7 lakhs
(B) ₹ 10 lakhs
(C) ₹6.8 lakhs
(D) ₹9.8 lakhs

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- (viii) Mr. Janak's turnover during the year ended 31.03.2017 was ₹ 3 crores. He has paid a sum of ₹3 lakhs to an engineer for supervision of a residential house for his own occupation. The amount of tax to be deducted at source from such payment u/s 194-J is
- (A) ₹3 lakhs
(B) ₹ 3.3 lakhs
(C) ₹30,000
(D) Nil
- (ix) Mrs. Rakshita, a Cost Accountant has raised a fees bill on LMN P Ltd., for ₹ 3,00,000 and in addition, has charged separately IGST of 18% i.e. ₹54,000, the total amount of the bill being ₹ 3,54,000. The amount of tax to be deducted at source by LMN P Ltd., is
- (A) ₹30,000
(B) ₹30,900
(C) ₹35,400
(D) None of the above
- (x) Harivallabh Pvt. Ltd., has spent a sum of ₹ 10 lakhs towards meeting its corporate social responsibility (CSR) under the Companies Act, 2013. The amount of deduction available while computing the business income is
- (A) ₹ 10 lakhs
(B) ₹ 15 lakhs
(C) ₹12.5 lakhs
(D) Nil

Answer:

- (i) (C) 15%

Justification: When an Indian company receives income by way of dividend from a foreign company in which the Indian company holds 26% or more in nominal value of the equity share capital of the foreign company, the amount of dividend shall be taxable at 15%. The amount so received would be reduced from the total income of the Indian company and no expenditure is allowable against such dividend income.

- (ii) (D) ₹ 3,00,000

Justification: Section 78 says that where a change has occurred in the constitution of a firm and the firm has brought forward loss, the amount of such loss proportionate to the retired or deceased partner as exceeds his share of profits in the respective previous year shall not be eligible for set off. In this case, one partner has retired on 31.03.2018 and the brought forward loss will not be reduced since there is no share of profit for the partner in the previous year 2018-19.

- (iii) (B) ₹ 20,00,000

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Justification: Section 115JEE(2) says that the provisions of Chapter XII-BA dealing with Alternate Minimum Tax applicable for persons other than company will not apply if the adjusted total income of the taxpayer does not exceed ₹ 20 lakhs.

(iv) (B) ₹14,69,000

Justification: The tax on total income of ₹ 51 lakhs before cess@ 4% would be ₹ 14,76,250 and tax on income of ₹ 50 lakhs is ₹ 13,12,500 plus excess of income over ₹ 50 lakhs being ₹ 1 lakh would result in aggregate tax liability of ₹ 14,12,500. The marginal relief would be ₹64,250. The final tax payable hence would be ₹ 14,69,000.

(v) (D) any partner

Justification: As per section 283(2) where a firm is dissolved, notices under the Income-tax Act in respect of the firm may be served on any person who was a partner (not being a minor) immediately before its dissolution.

(vi) (A) Nil

Additional depreciation is available only in respect of eligible plant and machinery to a manufacturer and not in respect of factory building. Hence the amount is Nil.

(vii) (B) ₹ 10 lakhs

Gross winnings must be taxed. Since TDS rate is 30%, gross amount will be ₹ 10 lakhs. No expenditure is allowable from this amount.

(viii) (D) Nil

Where the house is meant exclusively for personal use, there is no need to deduct tax at source u/s 194-J.

(ix) (A) ₹ 30,000

CBDT has clarified that there is no need to deduct tax at source in respect of GST charged and shown separately in the bill Hence as per section 194-J, from the sum of ₹ 3 lakhs, .10% i.e. ₹ 30,000 is to be deducted.

(x) (D) Nil

Section 37 clearly enjoins that no deduction is available in respect of CSR expenditure incurred by a corporate assessee.

Section B

2. (a) Mrs. Malavika commenced the business of warehousing of food grains on 1st April, 2018.

The under-mentioned summarised data relating to the warehousing business are furnished to you:

Particulars	(₹in lakhs)
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Net profit from business	126.5
Capital expenditure on Land & Building (35+20) incurred on 19.05.2018	55
Warehouse building additional cost incurred towards above building (completed on 20.12.2018)	50

The assessee did not derive any other income during the year.

You are required to compute the total income and the tax payable by the assessee for the assessment year 2019-20. 8

(b) State whether 'business connection' is established as envisaged by section 9 of the Income-tax Act, 1961, in the under-mentioned situations: 2+2=4

(i) Jupier 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.

(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 Nelson Inc. for delivery of product to the Indian clients. MC is paid commission in this regard.

(c) On 20th Feb., 2019, Vaamana Textiles Pvt. Ltd., has given a trade advance of ₹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 ₹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) Since the assessee is eligible for deduction u/s 35AD, provisions of AMT will be applicable and its impact has to be seen.

Particulars	(₹ in lakhs)
Net profit from business	126.5
Less: Deduction u/s 35D (for warehouse business)	
Capital expenditure on land 35 lakhs not eligible	Nil
Warehouse building (₹20+₹50) lakhs(A)	70
Business income after above deduction	56.5
Less: Depreciation allowable (₹20L × 10% + ₹50L × 5%)	4.5
Chargeable business income/total income (B)	52
Tax on above (₹1,12,500 + 30% of ₹42L)	13.725
Add: SC at 10% as income exceeds ₹50L	1.373
	15.098
Add: Cess on above at 4%	0.604
Tax liability as per normal provisions	15.702
Alternate minimum tax	

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Adjusted total income (A)+(B)	122
AMT at 18.5%	22.57
ADD: SC at 15% as income exceeds ₹1 crore	3.386
	25.956
Add: cess at 4%	1.038
AMT	26.994

Since the regular income-tax is lower than the AMT,

- adjusted total income will be deemed to be the total income (₹ 122 lakhs) and
- the tax payable will be ₹ 26.994 lakhs.

(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 of 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 Indian 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, of any such shareholder, to the extent to which the company in either case possesses accumulated profits.

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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. King Metals (P) Ltd. reports a Net Profit ₹10,20,000 as per Statement of Profit and Loss for the year ended 31.03.2019. The following additional information is provided:**
- (i) Opening stock as on 01.04.2018 was ₹9,00,000 and the closing stock as on 31.03.2019 was ₹16,50,000. The opening stock was overvalued by 10% and the closing stock was undervalued by 10%.**
 - (ii) Dividend received from a foreign company credited to Statement of Profit and Loss ₹ 31,000. The company has 2% shareholding in the foreign company.**
 - (iii) The company sold a vacant land for ₹23 lakhs on 05.07.2018. The original cost of acquisition is ₹12 lakhs. The indexed cost of acquisition is ₹16,17,000. Profit on sale of vacant land has been credited to Statement of Profit and Loss. The company subscribed to REC bonds for ₹5,30,000 on 20.12.2018.**
 - (iv) The company made a provision for bad and doubtful debts @ 5% of debtors on the closing date. The debtors outstanding as on 31.03.2019 was ₹62 lakhs.**
 - (v) Depreciation debited to Statement of Profit and Loss ₹7,50,000. Depreciation allowable as per Income-tax Rules ₹6,55,000.**
 - (vi) Salary expenditure includes ₹3,60,000 paid to son of managing director who was no way connected with the business of the company. It also includes commission paid to a director's son 3% being ₹2,40,000 and whereas for other commission agents it was paid @2%.**
 - (vii) The company has paid term loan interest to SBI relating to previous year 2017-18 ₹ 2,10,000 in December, 2018. It has not paid term loan interest of ₹1,90,000 of the previous year 2018-19 during the year and proposes to make the payment only in January, 2020.**
 - (viii) The company took factory premises on lease and paid lease rent of ₹60,000 per month for 2 months to Mr. Akhil. No tax was deducted on such rent payment.**
 - (ix) Directors sitting fee of ₹50,000 was paid to 5 directors during the year. Tax was deducted for 2 directors and for the balance no tax deduction was made.**
 - (x) Provision for loss of subsidiary included in administrative expenses ₹2 lakhs.**
 - (xi) Amount credited to Statement of Profit and Loss by transfer from revaluation reserve amounts to ₹1,10,000.**

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(xii) Provision for gratuity debited to Statement of profit and loss ₹7 lakhs. Actual gratuity paid during the year debited to provision account ₹4 lakhs.

(xiii) A bad debt claim of ₹1,60,000 relating to the assessment year 2015-16 allowed in assessment was recovered and was credited to general reserve account.

You are required to compute the income of King Metals (P) Ltd. by giving brief explanations for each of the adjustments given above. 16

Answer:

Computation of Total Income of King Metals (P) Ltd for the Asst.Year 2019-20

	₹	₹
Profits and gains of business or profession		
Net Profit as per Statement of profit and loss		10,20,000
Add:		
Undervaluation of closing stock to be adjusted		1,83,333
Overvaluation of opening stock by 10% to be adjusted		81,818
Provision for bad and doubtful debts - disallowed		3,10,000
Depreciation debited to statement of profit and loss		7,50,000
Salary paid to son managing director having no nexus to the business of the company is not allowable under section 37		3,60,000
Excess commission paid to the director's son is liable for disallowance under section 40A(2).		80,000
Term loan interest debited to Statement of profit and loss of the previous year 2018-19 not allowable under section 43B.		1,90,000
Premises lease rent paid ₹60,000 per month for 2 months being ₹1,20,000. It is not liable for tax deduction under section 194-IB as the section will apply only to individual and HUF taxpayers. No adjustment is required.		Nil
Directors sitting fee paid without deduction of tax at source liable for disallowance @ 30% under section 40(a)(ia) [30% of ₹1,50,000]		45,000
Provision for loss of subsidiary company -disallowed		2,00,000
Provision for gratuity debited to Statement of profit and loss ₹7 lakhs not deductible in view of section 40A(7). However, the amount actually paid is eligible for deduction. The excess provision is disallowed.		3,00,000
Bad debt claim allowed in assessment year 2015-16 recovered during		1,60,000

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the year but credited to general reserve is chargeable to tax as income.		
		36,80,151
Less:		
Dividend received from foreign company excluded and to be taxed under the head 'other sources'	31,000	
Profit on sale of vacant land credited to Statement of profit and loss, to be considered under the head 'capital gains'	11,00,000	
Depreciation allowable as per Income-tax rules	6,55,000	
Interest on term loan of the previous year 2017-18 paid in December, 2018 deductible under section 43B	2,10,000	
Amount withdrawn from revaluation reserve and credited to Statement of profit and loss excluded	1,10,000	
		21,06,000
Income from Business		15,74,151
Capital Gain:		
Sale consideration	23,00,000	
Less: Indexed cost of acquisition	16,17,000	
	6,83,000	
Less: Exemption U/s54EC eligible for corporate taxpayers' also.	5,30,000	
		1,53,000
Income from Other Sources:		
Dividend received from foreign company		31,000
Total Income (Rounded off)		17,58,150

4. (a) State the 'due date' for filling the return of the assessment year 2019-20 in the following cases: 8

- (i) Rohan engaged in proprietary business with turnover of less than ₹ 50 lakhs and wants to file return of income under section 44AD.
- (ii) Vinod Raj (HUF) engaged in manufacture of automobile spare parts with gross turnover always exceeding ₹ 200 lakhs per annum, with Karta and two male members managing the business.
- (iii) Vashist & Co. a partnership firm engaged in turmeric brokerage business with gross receipt below ₹ 20 lakhs.

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- (iv) Nehra Trade (P) Ltd. engaged in trading business with loss of ₹2,60,000 and turnover of ₹82,40,000.
- (v) MNO Co. Ltd., Mumbai being subsidiary of Crowe Pte Inc. of Malaysia having transactions with the parent company of ₹440 lakhs during the year by way of export to the parent company.
- (vi) Welfare Charitable Trust registered under section 12AA having aggregate annual receipt of ₹6.20 crores and revenue expenditure of ₹4.10 crore and capital expenditure of ₹1.85 crores.
- (vii) Raghu working partner of Raghu Associates with working partner salary of ₹1 lakh per month and book of account of Raghu Associates is liable for tax audit under section 44AB.
- (viii) Dr. Ravi an orthopaedic surgeon with aggregate annual receipt from profession of ₹24 lakhs and maintaining books of account with income from profession of ₹11,40,000.

- (b) Laxmi Ltd transferred its Unit X to Amin Ltd. by way of slump sale on 31st December, 2018. The summarized balance sheet of Laxmi Ltd. as on that date is given below:

Liabilities	₹ in lakhs	Assets	₹ in lakhs
Share capital-paid up	2,000	Fixed Assets:	
Reserves and Surplus	950	UnitX	700
Liabilities:		UnitY	900
UnitX	400	UnitZ	1,200
UnitY	600	Other Assets:	
UnitZ	1,050	UnitX	650
		UnitY	750
		UnitZ	800
	5,000		5,000

From the information given below compute the capital gain arising from slump sale of Unit X: 8

- (i) Cost inflation index for the financial year 2007-08 is 129 being the year in which the Unit X was established. The cost inflation index for the financial year 2018-19 is 280.
- (ii) The lump sum consideration received for transfer of Unit X is ₹1,100 lakhs. Unit X owes ₹100 lakhs to the buyer Amin Ltd. in respect of raw materials purchased by it. This amount would be foregone by the buyer. In other words, the sale consideration is after set off of ₹100 lakhs.
- (iii) The fixed assets of Unit X includes a vacant land which was purchased in the financial year 2007-08 for ₹50 lakhs and it was revalued at ₹100 lakhs in the year 2018-19.

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- (iv) Other fixed assets reflected in the balance sheet ₹ 600 (₹ 700 lakhs less value of land) represents WDV of the assets as per books of account. The WDV of these assets under the Income-tax Act is ₹ 200 lakhs.

Answer:

4.(a) Determination of due dates for filing the return for Asst. Year 2019-20:

- (i) Since the assessee individual is offering income under section 44AD, the "due date" for filing the return of income under section 139(1) is 31st July, 2019.
- (ii) As the HUF engaged in business with turnover exceeding ₹200 lakhs, the books of account have to be audited under section 44AB and the "due date" for filing the return of income is 30th September, 2019.
- (iii) The partnership firm is engaged in turmeric brokerage. It is not eligible to opt for presumptive provisions contained in section 44AD. The "due date" for filing the return of income is 31st July, 2019 as the gross receipt is less than ₹100 lakhs.
- (iv) In the case of a company, whose accounts are required to be audited under the Companies Act, 2013, the "due date" for filing the return of income is 30th September, 2019 regardless of the turnover and income.
- (v) As the assessee has entered into international transaction with its associated enterprise, it is required to furnish report referred to in section 92E and hence the "due date" for filing the return of income is 30th November, 2019.
- (vi) The income of charitable trust before giving effect to provisions of section 11 and 12 exceeds the maximum amount which is not chargeable to income-tax and hence the accounts of the trust have to be audited. Since it is audited the "due date" for filing the return of income is 30th September, 2019.
- (vii) In the case of working partner of a firm whose accounts are liable for audit under section 44AB, the return of income of the working partner could be filed up to the "due date" as is applicable for the firm. Thus the "due date" is 30th September, 2019.
- (viii) As the assessee wants to declare income which is less than 50% of the gross receipt from profession, his books of account have to be audited under section 44AB and thus the "due date" for filing the return of income is 30th September, 2019.

(b) Computation of Net worth of Unit X

	₹ in lakhs
Book value of non-depreciable asset	
Land - ignoring the revaluation amount	50
Other assets	650
Depreciable assets - as per WDV	200
	900
Less: Liabilities of Unit X	300
Net worth of Unit X	600

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Computation of Capital gain on slump sale of Unit X	
Sale consideration	1,100
Less: Net worth	600
Long-term capital gain arising on slump sale	500

5. In the light of decided case laws, answer 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)]: 4x4=16

(a) Mr. Dhanapal, a resident individual, sold a house plot purchased 48 months back for ₹ 70 lakhs and invested the net sale proceeds in purchase of a residential house within 6 months from the date of sale. He does not own any other residential house. The new house, however, is in the name of his wife. The Assessing Officer refuses to grant exemption under section 54F on the ground that the new residential house is not in the name of the assessee.

Is the rejection justified?

(b) "Ghosh Group of Educational Institutions", running three famous colleges in Kolkata, claimed exemptions under section 10(23C). In all these three colleges, there is a net surplus after meeting all its expenses. The Assessing Officer (AO) rejected the claim for exemption on the ground that the presence of net surplus leads to the inference that the assessee-institution does not exist solely for educational purposes.

Is the rejection of the AO justified in law?

(c) Anustup Chandra Textiles Ltd., had borrowed a sum of ₹2 crores from a bank during the period when its business was being set up. From the surplus funds, it made short-term deposits and earned interest of ₹3 lakhs. The assessee claimed that it was not a revenue receipt but a capital receipt, since the interest was earned prior to commencement of business and in any case, the interest received would be offset by the interest paid on the loan borrowed. The Assessing officer negative the claim of the assessee.

Is the AO justified in his action?

(d) Vishal Hotels Ltd., runs a famous restaurant. Customers frequenting the same, add tips to be given to the servers in the food bill while making the payment. The tips so collected by the hotel is pooled and distributed to all the employees. The Assessing Officer of the TDS Ward has issued a notice stating that the assessee should deduct tax at source from the tips distributed to the employees, since the same is nothing but payment of salaries. Assessee seeks your advice.

Answer:

5.(a) Exemption u/s 54F:

Issue involved:

The issue under consideration in this case is whether exemption under section 54F can be denied to the assessee, if the net sale proceeds of a long term capital asset are invested

in a new residential house within the stipulated time limit but the said house is purchased in the name of his wife and not in his name.

Provisions applicable:

Section 54F requires purchase or construction of a residential property within the specified period. It does not require purchase of new residential house property in the name of the assessee himself. It only requires the assessee to purchase or construct a residential house within the stipulated time limit.

Analysis of the given issue:

In this case, Mr. Dhanapal had not purchased the new house in the name of a stranger or somebody who is unconnected with him, but had purchased it in the name of his wife. The entire investment for purchase of new residential house had come out of the sale proceeds of the plot belonging to Mr. Ankit and there was no contribution from his wife.

Therefore, having regard to the rule of purposive construction and the object of enactment of section 54F, Mr. Dhanapal is entitled to claim exemption u/s 54F in respect of utilization of sale proceeds of plot of land for investment in residential house property in the name of his wife.

Conclusion:

As a consequence, the action taken by the Assessing Officer in rejecting the claim for deduction under section 54F in the hands of Ankit due to the reason that he had invested the sale proceeds in purchasing a new residential house in the name of his wife rather than in his name, is not valid.

Reference may be made to the decision in CIT v. Kamal Wahal (2013) 351 ITR4.

(b) Exemption u/s 10(23C):

Issue involved:

The issue under consideration in this case is whether the AO is justified in rejecting the claim for exemption u/s 10(23C), on the ground that the assessee-institution does not exist solely for educational purposes.

Provisions applicable:

Section 10(23C)(iiiad) postulates three requirements, namely,

(i) the education institution must exist solely for educational purposes;

(ii) it should not be for purposes of profit; and

(iii) the aggregate annual receipts of such institution should not exceed the amount as may be prescribed.

Analysis of the issue:

The following tests would apply for determining whether an educational institution exists solely for education purposes and not for purposes of profit:

- (i) Where an educational institution carries on the activity of education primarily for educating persons, the fact that it makes a surplus does not lead to the

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conclusion that it ceases to exist solely for educational purposes and becomes an institution for the purpose of making profit;

- (ii) The predominant object test must be applied - the purpose of education should not be submerged by a profit making motive;
- (iii) A distinction must be drawn between the making of surplus and an institution being carried on "for profit". Merely because imparting of education results in making a profit, it cannot be inferred that it becomes an activity for profit;
- (iv) If after meeting expenditure, surplus arises incidentally from the activity carried on by the educational institution, it will not cease to be one existing solely for educational purposes.

The ultimate test is whether on an overall view of the matter in the concerned assessment year, the object is to make profit as opposed to educating persons.

Conclusion:

Therefore, the action of the Assessing Officer, rejecting the claim for exemption u/s 10(23C) not valid.

Reference may be made to the decision of the Apex Court in Queen's Educational Society v. CIT (2015) 372 ITR 699 (SC).

(c) Taxability of interest from deposits made out of borrowed funds:

Issue involved:

The issue under consideration is whether the interest income of ₹ 2 lakhs on short-term fixed deposits made out of the unspent amount of term loan disbursed to BSL Ltd., would be a capital receipt not chargeable to tax or a revenue receipt chargeable to tax.

Provisions applicable:

Interest which is chargeable to tax under the Income-tax Act, 1961 would be assessable under the head "Income from Other Sources",

- (i) if such income is not exempt, and
- (ii) is not chargeable to tax under any other head including "Profits and gains of business or profession.

Analysis of the issue:

Interest earned by the assessee is clearly its income and unless it can be shown that there is exemption under any provision of the Act, like section 10, such income will be taxable.

The fact that the source of income was borrowed money does not detract anything from the revenue character of the receipt.

The interest payable on funds borrowed for the business prior to commencement of such business can be capitalized. However, such interest payable cannot be adjusted against interest received on investment of surplus funds assessable under section 56 under the head "Income from Other Sources".

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In this case, since the assessee had deposited the amount of surplus funds available with it prior to commencement of business with the bank solely for the purpose of earning interest, such interest, in the absence of specific exemption in respect thereof, is chargeable to tax under the head "Income from Other Sources".

Conclusion:

Accordingly, the action of the AO is legally valid/ justified.

Reference may be made to the decision of the Allahabad High Court in PCIT vs. Sangam Power Generation Co. Ltd.

(d) TDS from tips collected by employer from customers:

Issue involved:

The issue under consideration in this case is whether "tips" received by the hotel-company from its customers and distributed to the employees fell within the meaning of "Salaries" to attract tax deduction at source under section 192.

Provisions applicable:

Section 192(1) requires any person responsible for paying any income chargeable under the head "Salaries" to deduct tax at source at the time of payment. If an employee receives income chargeable under a head other than "Salaries", section 192 does not get attracted at all.

Analysis of the issue:

- ✓ In respect of tips collected by the company from the customers and distributed to the employees, the person responsible for paying the employee is not the employer at all, but a third person, namely the customer.
- ✓ There is no vested right in the employee to claim any amount of tip from his employer. Tips are purely voluntary amounts that may or may not be paid by customers for services rendered to them.
- ✓ As income from tips would be chargeable in the hands of the employees as "Income from Other Sources", on account of such tips being received from customers and not from the employer, section 192 would not get attracted at all.
- ✓ Tips are received by the employer in a fiduciary capacity as trustee to their employees for service rendered to the customer. There is, therefore, no reference to the contract of employment when these amounts are paid by the employer to the employee. Due to this reason the tips received by the employees could not be regarded as profits in lieu of salary.
- ✓ The payments of collected tips included and paid by way of a credit card by a customer, would not be payments made "by or on behalf of" an employer. The contract of employment not being the proximate cause for the receipt of tips by the employee from a customer, such payments would be outside the scope of sections 15 and 17, and hence section 192 would not get attracted.
- ✓ Hence, such payments would not fall within the meaning and scope of the income chargeable to tax under the "Salaries".

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Conclusion:

Hence, the Assessing Officer is not correct in concluding that "tips" received by the hotel-company from its customers and distributed to the employees fell within the meaning of "Salaries" to attract tax deduction at source under section 192.

Reference may be made to the decision of the Apex Court in ITC Ltd. v. CIT (TDS) (2016) 384 ITR 14.

6. (a) Vishnu Polymers Ltd., is an Indian company having transactions which are subject to transfer pricing regulations. In June, 2018, the assessments for assessment years 2017-18 and 2018-19 were concluded after the due process under law:

In both the years, in respect of the transactions with its associated enterprises, the ALP had been determined in Euro. For the assessment year 2017-18, the primary adjustment, as translated into INR was ₹90 lakhs (for transactions with N Inc., Singapore) and for the AY 2018-19, the same being ₹2.4 crores (for transactions with PK Inc., Melbourne). The assessment order was passed on 12.06.2018. The assessee is inclined to accept the same and not prefer any appeal.

You are required to answer the following in the light of above:

- (i) How will the quantum of primary adjustment be treated in the books of the assessee vis-a-vis secondary adjustment? How will the aforesaid completed assessments impact the assessee?
- (ii) What steps are to be taken to prevent the secondary adjustment? Will there be any secondary adjustment in the hands of the assessee if the required steps are not taken? You are required to outline the concept involved. 8

- (b) Ramesh (age 61) an individual resident in India furnishes you particulars of income for the previous year 2018-19. He earned income in country M and India has not entered into double taxation avoidance agreement with that country.

Income from house property in country M	₹ 2,50,000
Business income in India	₹ 8,00,000
Dividend from company in country M	₹ 1,00,000
Royalty income country M (see note below)	₹ 4,00,000
Business income in country M	₹ 2,00,000
Income from house property in India	₹ 5,00,000
Donation to Prime Minister's National Relief Fund	₹ 50,000
Incurred medical expenses for his mother aged 85	₹ 60,000
Rate of tax in country M (no basic exemption limit)	20%

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Note : Ramesh disputed royalty income in country M but paid the tax on that income in June, 2019 after the appeal was decided by the appellate authority. The royalty income is charged to tax at concessional rate of 15% in country M.

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Answer:

6.(a) Secondary adjustment:

(i) Where a primary adjustment has been made by the AO, the same impacts the assessee, inter alia, when

- The same relates to an assessment year after 2016-17.
- The quantum of primary adjustment (PA) made in each year is above ₹1 crore.
- The same is accepted by the assessee.

In such a situation, the same will be treated as loan or advance given by the assessee to the associated enterprise (AE).

In the given case, since the quantum of PA made in the AY 2017-18 is below ₹1 crore, the same is to be ignored for secondary adjustment (SA) purposes. Only the PA made in AY 2018-19 will have to be considered.

(ii) If the SA is to be avoided, then

- The AE should repatriate the funds into India in foreign exchange
- within 90 days from the date of order.

If the same is not done, then interest will be deemed to accrue on such advance at the prescribed rate.

Interest would be calculated on such advance at the rate of six month LIBOR as on 30th September + 3%, since the international transaction is denominated in Euro.

(b) Computation of Total Income of Ramesh for the Asst. Year 2019-20

		₹
Income from house property - in country M		2,50,000
Income from house property - in India		5,00,000
Income from business - in India		8,00,000
Income from business - in country M		2,00,000
Dividend income - country M		1,00,000
Royalty income in country M		4,00,000
Gross Total Income		22,50,000
Less: Deduction U/s80D in respect of medical expenditure, for mother being very senior citizen ₹60,000 but limited to	50,000	
Deduction U/s80G in respect of donation paid Prime Minister's	50,000	

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National Relief Fund ₹ 50,000 @ 100%		
		1,00,000
		21,50,000
Tax thereon		4,55,000
Add: Cess @ 4%		18,200
		4,73,200
Less: Rebate U/s.91		1,70,000
Tax payable		3,03,200
In Round Figures		3,03,200
Average rate of income-tax in India $\frac{₹ 4,73,200 \times 100}{21,50,000}$		22%
Doubly tax income in country M		
Royalty income ₹ 4,00,000 × 15%	₹ 60,000	
Other income ₹ 5,50,000 × 20% (₹ 2,50,000 + ₹ 2,00,000 + ₹ 1,00,000)	₹ 1,10,000	
	₹ 1,70,000	
Average rate of tax = $\frac{₹ 1,70,000 \times 100}{9,50,000}$	17.89%	
Rebate U/s 91 @ 17.89% on ₹ 9,50,000		1,70,000

7. (a) A Co. Ltd. is an Indian company at Pune. It provides software development service to various customers and also to its associated enterprise B Co. Ltd. of Mumbai. It billed ₹ 2crores for the software development services rendered to B Co. Ltd. during the year 2018-19. The total costs (direct and indirect) incurred for executing the work was ₹ 175 lakhs. In the case of unrelated parties for similar services A Co. Ltd. earned a gross profit of 50% on costs.

The following distinguishing features are observed between the transaction with the related party (i.e.) B Co. Ltd. and other unrelated parties:

- (i) B Co. Ltd. provided technology support to A Co. Ltd. in the software development project assigned by it. In the case of unrelated parties the value of technology support expenditure for similar project would be ₹ 17,50,000.**
- (ii) A Co. Ltd. gave discount of 10% to B Co. Ltd. and this benefit is not given to outside customers.**
- (iii) A Co. Ltd. carried out marketing functions in respect of transaction with B Co. Ltd. and incurred ₹ 13,12,500. This marketing function is not normally provided by A Co. Ltd. to outside parties.**

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- (iv) A Co. Ltd. provided extended credit period and the cost of credit period is estimated at 2.5% of its cost. This extended credit period is given only because B Co. Ltd. is its associated enterprise.

State the most appropriate method to be adopted for determination of ALP and compute the arm's length gross profit mark up and how much of income has to be increased or decreased in the hands of A Co. Ltd. for the transactions carried out for B Co. Ltd. 8

- (b) State whether the following transaction attract transfer pricing regulations: 2x4=8
- (i) Bear Ltd., Delhi has 12 directors of which 7 directors are appointed by Lion Trade SA of France along with its subsidiaries located in US and Europe.
- (ii) DEF LLP, United Kingdom holds 28% voting power in PQR Ltd., Kolkata from 01.04.2019 though there were transactions exceeding ₹5 crores between them in the previous year 2018-19.
- (iii) Dizzy Ltd., Chennai exported semi-finished goods to its subsidiary company Tom Co. Ltd. of Colombo. The subsidiary Tom Co. Ltd. completed the processing and after packing them dispatched goods back to Dizzy Ltd. During the financial year 2018-19, the total value of goods dispatched by Dizzy Ltd. to Tom Co. Ltd. was ₹3 crores and processing charges paid was ₹50 lakhs.
- (iv) Karun (HUF) consists of Shir. Karun, two sons and a daughter. It is carrying on business at Kanpur. Both the sons are in USA owning share capital exceeding 50% in 2 companies. The HUF purchased raw materials in India and exported the same to both the companies in USA of sons of Karun.

Answer:

7.(a) Most appropriate method:

In this case the activity involved is provision of service to an associated enterprise. The direct and indirect costs of production incurred by the enterprise vis a vis the price charged for similar services to other outsiders is compared. The cost plus method is the most appropriate method for determination of ALP.

The amount of normal gross profit mark-up to costs arising from rendering services to unrelated enterprise in relation to a transaction is determined and the said normal gross profit mark-up is appropriately adjusted to take into account the functional and other differences if any between the international transaction and other transactions.

Determination of ALP gross profit mark-up

Gross profit mark-up in the case of unrelated parties	50%
Less: Technology support from related party (which is not availed from unrelated parties) (₹17.50 lakhs × 100 / ₹ 175 lakhs)	10%
	40%
Add:	
Discount to related party which is not given to unrelated parties	10%
Cost of credit to B Co Ltd	2.5%

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Marketing functions performed by A Co Ltd. for B Co Ltd.	
$\text{₹}13,12,500 \times 100 / \text{₹}175 \text{ lakhs} =$	7.5%
Arm's length gross profit mark-up	60%
	₹ in lakhs
Determination of arm's length price:	
Direct and indirect cost incurred by A Co Ltd.	175.00
Arm's length gross profit mark-up	105.00
Arm's length income	280.00
Less: Actual price charged	200.00
Income to be increased in the hands of A Co Ltd.	80.00

(b)

- (i) As per section 92A(2)(e) where more than half of the board of directors of the governing board of one enterprise is appointed by the other enterprise, they are deemed to be associated enterprises.

Since 7 out of 12 directors of Bear Ltd are appointed by Lion Trade SA of France, the relationship between Bear Ltd and Lion Trade SA, France, is that of associated enterprise and the transfer pricing regulations will apply.

- (ii) When one enterprise holds directly or indirectly not less than 26% of the voting power in the other enterprise, they are said to be associated enterprises.

However, in this case only from 01.04.2019 such relationship comes into existence. For the financial year 2018-19 that relationship does not exist and hence the transfer pricing regulations will not apply.

- (iii) Transfer pricing regulations are attracted when there is an international transaction between the assessee and an associated enterprise. Here the Indian company and its subsidiary are associated enterprises.

In this case the processing charges paid is an international transaction and therefore the transfer pricing regulation will apply.

- (iv) Where one enterprise is controlled by HUF and another enterprise is controlled by members of HUF or relatives of members from a company formed outside India, the relationship of associated enterprise is established between them.

In this case, the HUF is purchasing raw materials and exporting to USA to the companies were the coparceners of the HUF have more than 50% shareholding. Therefore, the relationship of associated enterprise is established in this case.

8. Write short notes:

4x4=16

(a) Significance of the PE in transactions governed by the Double Taxation Avoidance Agreements (DTAA)

(b) Tax Residency Certificate (TRC)

(c) Binding effect of Advance Pricing Agreement (APA)

(d) Scope and disclosure requirement for Revenue Recognition — ICDS IV

Answer:

(a) Significance of the PE in transactions governed by the Double Taxation Avoidance Agreements (DTAA):

Double Taxation Avoidance Agreements (DTAAs) generally contain an Article providing that business income is taxable in the country of residence, unless the enterprise has a permanent establishment (PE) in the country of source, and such income can be attributed to the PE.

Section 92F (iia) defines the term "Permanent Establishment" to include a fixed place of business through which the business of an enterprise is wholly or partly carried on. PE includes, a wide variety of arrangements shall also include: 1. a place of management; 2. a branch; 3. an office; 4. a factory; 5. a workshop; 6. a mine, an oil or gas well, a quarry or any other place of extraction of natural resources; 7. a warehouse in relation to a person providing storage facilities for others; 8. a farm, plantation or other place where agricultural, pastoral, forestry or plantation activities are carried on; 9. premises used as a sales outlet or for receiving or soliciting orders; 10. an installation or structure, or plant or equipment, used for the exploration for or exploitation of natural resources; 11. a building site or construction, installation or assembly project, or supervisory activities in connection with such a site or project, where that site or project exists or those activities are carried on (whether separately or together with other sites, projects or activities) for more than specified months (generally 6 months).

An enterprise shall not be deemed to have a permanent establishment merely by reason of: 1. the use of facilities solely for the purpose of storage or display of goods or merchandise belonging to the enterprise; 2. the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage or display ; 3. the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise; 4. the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise, or of collecting information, for the enterprise; or 5. the maintenance of a fixed place of business solely for the purpose of advertising, for the supply of information, for scientific research, or for similar activities which have a preparatory or auxiliary character, for the enterprise.

Section 9(1) (i) requires existence of business connection for deeming business income to accrue or arise in India. DTAAs however provide that business income is taxable only if there is a PE in India. It is well established that the beneficial provisions of the DTAA will prevail over the provisions of the Act. Therefore, in cases where transactions are covered by DTAAs, where there is no PE in India, business income cannot be brought to tax due to existence of business connection as per section 9(1)(i).

(b) Tax Residency Certificate (TRC):

If a tax treaty (double taxation avoidance agreement under section 90 & 90A), is applicable to a nonresident then the provisions of the Indian Income-tax Act, 1961 are applicable only to the extent they are more beneficial to it. With effect from 1st April 2013, treaty benefits shall be allowed to the non-residents subject to furnishing of a valid tax residency certificate (TRC) and information in Form 10F. The certificate referred to in section 90(4) and section 90A(4) to be obtained by an assessee, not being a resident in

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India, from the Government of the country or the specified territory and shall contain the following particulars, namely:-

- (i) Name of the assessee,
- (ii) Status (individual, company, firm etc.) of the assessee,
- (iii) Nationality (in case of individual),
- (iv) Country or specified territory of incorporation or registration (in case of others);
- (v) Assessee's tax identification number in the country or specified territory of residence or in case no such number, then, a unique number on the basis of which the person is identified by the Government of the country or the specified territory,
- (vi) Residential status for the purposes of tax,
- (vii) Period for which the certificate is applicable, and
- (viii) Address of the assessee in the country or specified territory outside India, during the period for which the certificate is applicable.

However the above information in Form No.10F is not required if such report is available in TRC. TRC containing above facts shall be duly verified by the Government of the country or the specified territory of which the assessee, claims to be a resident for the purposes of tax.

The assessee shall also keep and maintain such documents that are necessary to substantiate the information provided in Form No. 10F and an income tax authority may require the assessee to provide the said documents in relation to a claim by the said assessee of any relief under a double taxation avoidance agreement.

(c) Binding effect of Advance Pricing Agreement (APA):

Advance Pricing Agreement (APA) includes determination of Arm's Length Price (ALP) or specifies the manner in which ALP is to be determined. ALP can be determined as per any method prescribed under section 92C for determination of ALP along with necessary adjustments and variations. [Section 92CC(2)]. APA is binding on the person entering into international transaction (taxpayer) and the Commissioner of Income Tax including income-tax authorities' subordinate to him. APA is binding only in respect of transaction in relation to which the APA has been entered into, not binding if there is change in law or facts having a bearing on such APA. [Section 92CC(6)]. CBDT is empowered to declare an APA as void ab initio if APA has been obtained by fraud or misrepresentation of facts. [Section 92CC(7)]. Also as provided in the law, noncompliance with terms of APA including 'critical assumptions' may lead to cancellation of the APA. Transactions covered under APA are not subject to regular audit by Transfer Pricing Officer (i.e. TP assessment proceedings). APA is valid for a period specified in APA, but not to exceed 5 consecutive financial years [Section 92CC(4)], APA can be extended/renewed for further period of up to 5 years. Application for APA can be withdrawn any time before finalisation of terms of APA

(d) Scope and disclosure requirement for Revenue Recognition - ICDS IV:

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The Standard deals with the bases for recognition of revenue arising in the course of the ordinary activities of a person from:

- (1) the sale of goods;
- (2) the rendering of services;
- (3) the use by others of the person's resources yielding interest, royalties or dividends.
 - Revenue is the gross inflow of cash, receivables or other consideration arising in the course of the ordinary activities of a person from the sale of goods, from the rendering of services, or from the use by others of the person's resources yielding interest, royalties or dividends. In an agency relationship, the revenue is the amount of commission and not the gross inflow of cash, receivables or other consideration.
 - The Standard does not deal with the aspects of revenue recognition which are dealt with by other ICDS

Disclosure: Following disclosures shall be made in respect of revenue recognition:

- (1) in a transaction involving sale of goods, total amount not recognised as revenue during the previous year due to lack of reasonably certainty of its ultimate collection along with nature of uncertainty;
- (2) the amount of revenue from service transactions recognised as revenue during the previous year;
- (3) the method used to determine the stage of completion of service transactions in progress; and
- (4) for service transactions in progress at the end of previous year:
 - i. amount of costs incurred and recognised profits (less recognised losses) up to end of previous year;
 - ii. the amount of advances received; and
 - iii. the amount of retentions.