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CA FINAL

SUBJECT-DIRECT TAX LAWS

Test Code – FNJ 7382

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- NOTES: (1) WORKING NOTES SHOULD FORM PART OF ANSWERS.
 (2) INTERNAL WORKING NOTES SHOULD ALSO BE CONSIDERED BY PAPER CHECKER.
 (3) NEW QUESTION SHOULD BE ON NEW PAGE

Division A – Multiple Choice Questions

1. (i) (C) (1 Mark)
 (ii) (C) (1 Mark)
 (iii) (D) (1 Mark)
 (iv) (C) (1 Mark)
 (v) (D) (1 Mark)
2. (C) (1 Mark)
3. (D) (1 Mark)
4. (A) (1 Mark)
5. (D) (1 Mark)
6. (A) (1 Mark)
7. (D) (2 Marks)
8. (C) (2 Marks)
9. (C) (2 Marks)
10. (A) (2 Marks)
11. (A) (2 Marks)
12. (B) (2 Marks)
13. (D) (2 Marks)
14. (B) (2 Marks)
15. (D) (2 Marks)
16. (B) (2 Marks)

ANSWER : 1

M/s Hind Udyog
Computation of Total Income for Assessment Year 2020 – 21

Particulars	Rs.	Rs.
Net Profit as per Profit & Loss Account		28,75,000
Add : Items to be disallowed / considered separately/ Added as income		
(i) Provision for periodical wage revision. It is allowable expense since it is based on fair estimation of wages and reasonable certainty. It is also a permissible expense as per ICDS.	Nil	
(ii) Sales proceeds of import entitlements. It is taxable under section 28 as business income. Since it is already credited to Profit & Loss account, therefore, no adjustment is required.	Nil	
(iii) Penalty for delayed filing of returns under GST Act. Applying the ratio of CIT v. Swadeshi Cotton Mills Co. Ltd., penalty for infraction of law is disallowed in computing the business income. However, interest on delay in deposit of GST is an allowable expense since it is compensatory in nature. CIT v. Westend Indian State Motors (Raj)	5,300	
(iv) Free air ticket for achieving the target of purchase, is perquisite in course of business, therefore, taxable under section 28 as business income.	2,00,000	

	Since it is not credited to Profit & Loss Account, the same is to be added to the income.		
(v)	Interest paid to Mr. X as Karta of HUF is not disallowed under section 40(b) as per Explanation to section 40(b) as per Explanation to section 40(b). It is assumed that 18% is the market rate of interest and hence, section 40A(2) is not invoked.	Nil	
(vi)	As per Explanation to section 32(1), if an assessee makes capital expenditure on a building not owned by him but for which he has tenancy/ lease rights, then the capital expenditure on building will be treated as deemed building. Since building is used for more than 180 days, depreciation shall be allowed at full rate. Cost of building of Rs. 10 lakhs debited to Profit & Loss Account shall be added back. However, depreciation on building @ 10% is an allowable expense. Rs. 10,00,000 minus Rs. 1,00,000 = Rs. 9,00,000 is adjusted.	9,00,000	
(vii)	Loss on purchase and sale of shares being speculation loss shall not be allowed to be set – off and therefore added back. It is assumed that these are not in derivative segment.	3,00,000	
		14,05,000	
			42,80,300
Less : Permissible deductions/ Items to be reduced from business income			
(a)	Instalments of funded interest allowed under section 43B as per CBDT circular	1,60,000	
(b)	30% of audit fees would have been disallowed in previous year 31.3.2019 since TDS was not deducted during the Previous year 31.03.2019. The same shall be allowed in current year under section 40(a)(ia) when TDS is deducted & paid.	75,000	
(c)	Dividend to be considered separately under the head Income from other sources. Assuming that it is credited to profit & loss account.	11,00,000	
(d)	Profit from warehouse for storage of agricultural produce to be treated separately under section 35AD. Assuming that it is credited to profit and loss Account.	15,00,000	
(e)	Profit from warehouse for storage of edible oil is not covered under section 35AD. Assuming that it is credited to profit & loss Account, no adjustment required. However, depreciation on its same shall be allowed @ 10%.	1,20,000	
		29,55,000	
Business Profit under Section 35AD		15,00,000	
Less : Deduction section 35AD		23,00,000	
Loss to be carried forward and set off against profit of specified business under section 35AD		(8,00,000)	
Profit and Gains of Business or Profession			13,25,300

Income from Other Sources		
Dividend Income	11,00,000	
Less : Exempt under section 10(34)	10,00,000	
Income from Other Sources		1,00,000
Total Income		14,25,300

(14 MARKS)

ANSWER : 2(A)

Asha Memorial Trust
Assessment Year 2020 – 21

Particulars	Amount (Rs.)
Receipt from running Hospital	14,25,000
Donations excluding anonymous donations	2,75,000
Total Receipts	17,00,000
Less : 15% of 17,00,000 under section 11(1)	2,55,000
Less : Applied for charitable purpose under section 11(1) [see Note]	13,00,000
	1,45,000
Add : Amount not spent under section 11(2) taxable under section 11(3) since it is not spent upto 31.3.2020	1,50,000
Income taxable at Normal Tax Rate	2,95,000
Anonymous donations taxable under section 115BBC (Rs. 3 lakh minus Rs. 1 lakh)	2,00,000
Tax on Rs. 3,95,000 at normal rates	7,250
Tax on Rs. 2,00,000 @ 30% under section 115BBC	60,000
	67,250
Add : Health & Education Cess @4%	2,690
Total Tax	69,940

Note : As per Finance Act, 2018, section 40A(3) shall apply to the trust while computing application of income under section 11(1)(a). Rs. 5,00,000 is disallowed under section 40A(3) and shall not be regarded as application of income. Needless to mention that contractor shall pay penalty of Rs. 5,00,000 as per section 269 ST read with section 271DA.

(6 MARKS)

(B)

- (i) As per section 194A, tax has to be deducted at source @ 10% from interest on the compensation amount awarded by the Motor Accidents Claims Tribunal at the time of payment, if the amount of interest payment or the aggregate amount of such interest payments during the financial year exceeds Rs. 50,000.

In the present case, since the amount of Rs. 80,000 towards interest on compensation is only credited to the account of the payee by the Motor Accidents Claims Tribunal, no tax is deductible at source.

- (ii) As per section 194LA, tax has to be deducted @ 10% on any sum paid to a resident in respect of compensation on account of compulsory acquisition of any immovable property (other than agricultural land), where the amount of payment or aggregate amount of such payments during the financial year exceeds Rs. 2,50,000.

Thus, in the present case, tax is deductible @ 10% on Rs. 3,00,000 i.e., Rs. 30,000 being the amount paid to Mr. B, a resident in India, on account of compulsory acquisition of residential building for laying railway tracks.

- (iii) As per section 192(2B), XYZ Ltd. is required to deduct tax at source at the time of payment of income under the head under the head "Salaries" after considering the information

furnished by Ravi Kumar for the financial year 2019 – 20 in respect of income under any other head of income but not loss, except loss from house property.

Therefore, XYZ Ltd. is not required to consider the loss of Rs. 1 lakh from business activity for determining the TDS liability.

Particulars		Rs.
Income under the head Salaries		6,00,000
Less : Loss from house property		
Loss from self – occupied house at Mumbai	2,00,000	
Loss from let out property	2,00,000	
(Set – off of loss restricted to Rs. 2,00,000)		2,00,000
		4,00,000
Add : Interest income from Bank		3,20,000
Gross Total income		7,20,000
Less : Deduction under section 80TTA (It is assumed that at least Rs. 10,000 out of interest income represents interest from saving bank account]		10,000
Total Income		7,10,000
	Tax on Total Income :	Rs.
Upto Rs. 3,00,000		Nil
3,00,000 to 5,00,000 @ 5%		10,000
5,00,000 to 7,10,000 @ 20%		42,000
Add : Health & Education cess @ 4%		2,000
Tax liability on the income liable for TDS		54,080
Less : TDS on Bank Interest		31,000
TDS		23,080

(8 MARKS)

ANSWER : 3

(A)

(1) **Computation of MAT liability of Zanith Formulations Ltd. Under Section 115JB for A.Y. 2020 – 21.**

Particulars	Rs.	Rs.
Book profit after adjustment of items under section 115JB(2) [except brought forward business loss and unabsorbed depreciation]		52,26,000
Less : Brought forward business loss [Rs. 4,60,000 + Rs. 1,75,000]	Nil	
Unabsorbed depreciation [Rs. 4,90,000 + Rs. 2,20,000]	7,10,000	
[Since Zenith Formulations Ltd. is a company against which an application for corporate insolvency resolution process has been admitted by NCLT under section 7 of the Insolvency and Bankruptcy Code, 2016 the aggregate amount of loss brought forward and unabsorbed depreciation is allowed to be reduced from the book profit for the purposes of levy of MAT under section 115JB. However, the business losses of Rs. 6,35,000 which have been deducted while computing the book profits of assessment year 2018 – 19 and 2019 – 20 shall not be deducted again from book profits].		7,10,000
Book profit computed in accordance with Explanation 1 to section 115JB(2)		45,16,000
Add: Items credited to OCI that will not be reclassified to profit or loss :		
(i) Deferred gains on cash flow hedges	7,25,000	
(ii) Share of Other Comprehensive Income of Other Associates	3,20,000	
(iii) Re – measurement of post – employment benefit obligations.	4,45,000	
(iv) Revaluation surplus for assets Rs. 7,50,000		
[Book profit not to be increased by revaluation surplus for assets as per proviso to section 115JB (2A)]	Nil	
		14,90,000

Less : Items debited to OCI that will not be reclassified to profit or loss :		60,06,000
(a) Deferred costs of hedging	4,10,000	
(b) Changes in fair values of equity instruments Rs. 10,00,000 [Book profit not to decreased by changes in fair value of equity instruments as per proviso to section 115JB(2A)]	Nil	4,10,000
Add : One – fifth to Transition amount (Credit balance)		55,96,000
Transition amount	52,50,000	
Less : Amounts to be excluded from above		
Capital Reserve	8,00,000	
Transition difference in foreign operations	4,50,000	
	40,00,000	
One – fifth of Rs. 40,00,000		8,00,000
Book Profit for levy of MAT		63,96,000
MAT on book profit under section 115JB = 15% of Rs. 63,96,000		9,59,400
ADD: Health & Education cess @ 4%		38,376
MAT liability for A.Y. 2020 – 21]		9,37,776

(2) Computation of tax credit to be carried forward

Particulars	Rs.
MAT liability for A.Y. 2020 – 21 (rounded off)	9,97,776
Income – tax computed as per the normal provisions of the Act for A.Y. 2020 – 21	9,20,000
Since the income – tax liability computed as per the regular provision of the income – tax Act, 1961 is less than the MAT payable, the book profit would be deemed to be the total income and tax is leviable @ 15% : The total tax liability is Rs. 9,97,776.	
Computation of tax credit to be carried forward	
Tax payable for A.Y. 2020 – 21 on deemed total income	9,97,776
Less : Income tax payable as per the normal provisions of the Act	9,20,000
Tax credit in respect of tax paid on deemed income	77,776
[Can be carried forward for 15 Assessment Years i.e., upto A.Y. 2035 – 36]	

(8 MARKS)

(B) Determination of Gross Margin of Comparable Uncontrolled transaction i.e., of SAK of Ltd.

Particulars	Amt. in USD
Direct Cost (USD 100 × 8 hours × 15 days)	12,000
Indirect Cost (USD 200 × 8 hours × 15 days)	24,000
Total Direct and Indirect cost	36,000
Billing per month	70,000
Gross Margin being gross profit	34,000
Gross Margin to cost (%) (34,000 × 100/ 36,000)	94.44%
Adjustment for functional difference on account of cost of warranty	
Total Direct and Indirect cost	36,000
Add : Cost of warranty [1% of direct cost of USD 12,000]	120
Total cost	36,120
Billing per month	70,000
Margin after cost of warranty being profit margin [70,000 – 36,120]	33,880
Profit margin to cost (%) [after considering functional difference on account of cost of warranty [33,880 × 100/ 36,120]	93.80%

Computation of Arm's Length Price by applying Cost Plus Method

	ABC Inc (USD)
Direct Cost (USD 100 × 9 hours × 15 days)	13,500
Indirect Cost (USD 200 × 9 hours × 15 days)	27,000
Total Direct and Indirect cost	40,500

Add : Interest on loan of USD 1,00,000 borrowed for purchase of hardware [USD 3,000 [i.e., USD 1,00,000 @ 3%]/12]	250
Total cost	40,750
Profit margin by applying the margin of 93.80% of total cost of USD 40,750	38,224
Arm's length price of billing per month	78,974
Actual Billing per month	85,000

In the present case, since actual billing of USD 85,000 per month to the ABC Inc, an AE, is higher than the Arm's length price of USD 78,974 determined by applying cost plus method, no adjustment is to be made to the income of Amar P Ltd.

(6 MAKRS)

ANSWER : 4

(A) Computation of Taxable Income of Mr. Singh for Assessment Year 2020 - 21

Particulars	Amount (Rs.)	Amount (Rs.)
Income from House Property		
Gross Annual Value (higher of Expected Rent & Actual Rent)		3,00,000
Expected Rent (Lower of Fair Rent and Standard Rent)	2,50,000	
Actual rent	3,00,000	
Less : Municipal taxes paid by Mr. Singh during the year (including arrears) [Rs. 35,000 + Rs. 1,50,000]		1,85,000
Net Annual Value (NAV)		1,15,000
Less : Deductions under section 24 :		
(a) 30% of NAV	34,500	
(b) Interest on loan borrowed for major repairs	1,50,000	1,84,500
Arrears of rent taxable under section 25B	30,000	(69,500)
Less : Deduction @ 30%	9,000	21,000
Income under the head House property		(48,500)
Capital Gains		
Full value of consideration	30,00,000	
As per Section 50C, the full value of consideration would be the higher of :		
(i) Actual Consideration Rs. 25,00,000		
(ii) Stamp Duty Value (Rs. 3,90,000 / 13%) Rs. 30,00,000		
Less : Indexed cost of acquisition [Rs. 25,000 × 289/200]	36,125	
As per section 49(1), cost of acquisition of the residential house gifted by Mr. Singh's father to Mr. Singh would be the cost for which Mr. Singh's father acquired the asset. The indexation benefit is also available with effect from the previous year in which the previous owner held the asset. [CIT v. Manjula J. Shah (Bom.)]		
	29,63,875	
Less : Exemption under section 54(Rs. 15,00,000)		
As per Finance Act, 2019, if long term Capital Gains do not exceed Rs. 2 crores, the assessee has option to purchase or construct two residential houses in India. The option is available once in a lifetime.	15,00,000	
Less : Exemption under section 54EC		
Investment in bonds of NHAI within six months from the date of transfer. Where the payment for bonds has been made within the six – month period, exemption under section 54EC would be available even if the allotment of bonds was made after the expiry of the six months [Hindustan Unilever Ltd.]	10,00,000	
Income under the Head Capital Gains		25,00,000
Total Income		4,63,875

(8 MARKS)

(B)

Red Ltd. (Non – Resident Foreign Company)
Computation of Income and Tax Liability for Assessment Year 2020 - 21

Particulars	Computation of Income	Computation of tax Thereon
Profits and Gains of Business or Profession		
(a) Know how fees for providing technical know – how, manufacturing process and designs.	40,00,000	
Taxable @ 10% under section 115A		4,00,000
(b) Leasing charges or rentals for plant & machinery is taxable as royalty as per the definition of royalty	12,50,000	
Taxable @ 10% under section 115A		1,25,000
Income under the Head Profits and gains of Business or Profession	52,50,000	
Income from Other Sources		
Interest on debentures is not covered under section 115A since debentures have not been subscribed in foreign currency.	2,40,000	
Such interest taxable at normal rate of 40%		96,000
Long term Capital Gains		
Long term capital gains on sale of debentures	1,90,000	
Taxable @ 10% under section 112 assuming debentures are unlisted		19,000
Total Income	56,80,000	
Tax thereon		6,40,000
Add : 4% Health & Education cess		25,000
Total Tax liability		6,65,600

(6 MARKS)

ANSWER : 5

- (A) It is a generally accepted principle that the deeming provision of a particular section cannot be breathed into another section. Therefore, the deeming provision contained in section 80-IA(5) cannot override the provision of section 70(1).

In this case, X Ltd. had incurred loss in eligible business (power generation) on account of claiming depreciation of Rs. 120 lacs. Hence, section 80 - IA becomes insignificant, since there is no profit from which this deduction can be claimed.

It is thereafter section 70(1) comes into play, whereby an assessee is entitled to set sourer against income from another source under the same head off the losses from one of income. Accordingly, X Ltd is entitled to the benefit of set off of loss of Rs. 20 lacs (representing balance depreciation not set-off) pertaining to Unit N engaged in eligible business of power generation against profit of Rs. 70 lace of Unit Y carrying on non – eligible business, Therefore, the net profit of Rs. 50 lakhs would be taxable in the AY 2020-21.

However, once - set – off is allowed under section 70(1) against Income from another source under the same head, a deduction to such extent is not possible in any subsequent assessment year for computing total income. However, for computing deduction under section 80 - IA, this depreciation has to be deducted in subsequent year. Accordingly, in the Assessment Year 2021 – 22 the net profit of Unit N has to be reduced by Rs. 20 lacs for computing the profits eligible for deduction under section 80 -IA in that year.

The action of the Assessing Officer in not permitting set off of loss of eligible business against profits of non eligible business in this case is , therefore, not correct.

(6 MARKS)

- (B)** Section 264 provides that the Principal Commissioner or Commissioner has no power to revise any order which has been made the subject matter of an appeal to the Commissioner (Appeals), even if the relief claimed in the petition is different from relief claimed in appeal. The concept of total merger would apply in the case of section 264.

Section 154 provides that where any matter had been considered and decided in any proceeding by way of appeal or revision relating to an order, Assessing Officer may amend the order for rectification of mistake apparent from the record, in relation to a matter other than the matter which has been considered and decided. The concept partial merger would apply in the case of section 154.

In the present case, since the order passed by the Assessing Officer in respect of the addition of unexplained cash credit of Rs. 8 lakhs became the subject matter of an appeal to the Commissioner (Appeals), the assessee, AUM Enterprise cannot apply for revision under section 264 even if the subject matter of revision i.e., addition of 3 lakhs under section 40(a)(ia) is different from the subject matter of appeal.

However, AUM Enterprise can apply to the Assessing Officer for rectification of the order in respect of addition of 3 lakh under section 40(a)(ia), as this matter has not been considered and decided in any proceeding by way of appeal or revision.

In the view of above, the assessee, AUM Enterprise should seek rectification under section 154.

(4 MARKS)

- (C)** (i) As per section 234F, late fee of Rs.5,000 is leviable, if the return of income is furnished after the due date specified under section 139(1) but furnished on or before 31st, December of the assessment year. In other cases, late fee Rs. 10,000 is leviable.

Since Mr. Abhiram, an individual having total income of Rs. 13.25 lakhs, furnished his return of income for A.Y. 2020 – 21 on 12.3.2021 i.e., after 31st December 2020, late fee of Rs. 10,000 is leviable.

- (ii) Late fee of Rs. 5,000 or Rs. 10,000, as the case may be, leviable under section 234F cannot exceed Rs. 1000, if the total income does not exceed Rs. 5,00,000.

Accordingly, late fee not exceeding Rs. 1,000 is leviable in this case, since Mrs. Srisha's total income of Rs. 4,98,000 does not exceed Rs.5,00,000.

- (iii) As per section 271DA, penalty equivalent to the sum received in contravention of the provisions of section 269ST (i.e., receipt of a sum of Rs. 2 lakh or more in aggregate from a person in a day otherwise than by an account payee cheque/bank draft or use of ECS through a bank A/c) is leviable.

Accordingly, penalty of Rs. 2.50 lakhs is leviable on Mr. Robert for receiving a sum of Rs. 2.50 lakhs (being a sum in excess of Rs. 2 lakhs) by way of cash from Mr. Rajiv on 31.1.2020.

(4 MARKS)

ANSWER : 6

- (A)** An assessee may, at any stage of a case relating to him, make an application in the prescribed form and manner to the Settlement Commission under section 245C. "Case" means any proceeding for assessment which may be pending before an Assessing Officer on the date on which such application is made. Thus, the basic condition for making an application before the Settlement Commission under section 245C is that there must be a proceeding for assessment pending under section 143(3)/144/147/ 153A before an Assessing Officer on the date on which the application is made.

A proceeding for assessment or reassessment under section 147 shall be deemed to have commenced from the date on which a notice under section 148 is issued.

In this case, Mr. Rajneesh cannot approach the Settlement Commission merely due to his apprehension that assessment of earlier years may be reopened, since there is no case pending before an Assessing Officer under section 143(3)/144/147/153A.

Therefore, he has to wait for the Assessing Officer to issue notice under section 148. Thereafter, he can make an application to the Settlement Commission under section 245C, since, there would be a "case pending" before the Assessing Officer on that date.

Another basic condition to be satisfied for making an application is that the additional amount of income-tax payable on the income disclosed in the application should exceed Rs.10 lakh, and such tax and interest thereon which would have been paid had the income disclosed in the application been declared in the return of income should be paid on or before the date of making the application and proof of such payment should be attached with the application.

If the Settlement Commission is satisfied that Mr. Rajneesh has co – operated in the proceedings and made true and full disclosure of his income and the manner in which it has been derived, it may, subject to such conditions as it may think fit to impose, grant to Mr. Rajneesh –

- Immunity from prosecution for any offence under the Income – tax Act, 1961; and
- Immunity from imposition of penalty under the Income – tax Act, 1961, either wholly or in part, with respect to the case covered by the settlement

This is the benefit that may accrue to Mr. Rajneesh, if he approaches the Settlement Commission.

(4 MARKS)

(B)

(i) Issue Involved : The issue under consideration in this case is whether the Authority for Advance Rulings can reject an application for advance ruling on the ground that proceedings are already pending before an income – tax authority, where a notice under section 143(2) in pre – printed format has been served.

(ii) Provisions applicable : As per the proviso to section 245R(2), the Authority for Advance Rulings shall not allow the application where the question raised in the application is already pending before any income – tax authority.

(iii) Analysis : The facts of the case are similar to the facts in Hyosung Corporation v. AAR (2016), wherein the above issue came up before the Delhi High Court. The Court observed that mere issue of notice under section 143(2) in pre printed format will not amount to proceedings pending for the purpose of applying the proviso to section 245R(2). However, issue of notice under section 142(1) accompanied by a questionnaire before filing of the application by the assessee with the AAR would tantamount to 'proceedings pending' before an income – tax authority.

(iv) Conclusion : Thus, applying the rationale of the Delhi High Court ruling to the case on hand, the application for the assessment year 2020 – 21 cannot be rejected by the AAR since notice under section 142(1) issued for the assessment year 2020 – 21 after the date of filing of application will not result in the proceedings being 'already pending' before an Income – tax authority.

However, for the assessment years 2018 – 19 and 2019 – 20, the rejection of the application by AAR is tenable in law, since notice under section 142(1) along with detailed questionnaire was issued before the date of filing of such application.

(4 MARKS)

(C)

(i) The statement is False. As per section 241A, processing of return shall be done under section 143(1) even if case is selected for scrutiny under section 143(2).

Therefore, refund shall be granted under section 143(1) even if case is selected for scrutiny. But Assessing Officer has been given:

- power to withhold the refund
- upto the date on which assessment is made under section 143(3)
- only in cases where Assessing Officer is of the opinion that the grant of refund is likely to adversely affect the interest of revenue (e.g. massive tax evasion detected or assessee is a habitual tax offender).
- But in this case Assessing Officer has to take previous approval of CIT and has to record reasons as to how the grant of refund will affect the interest of revenue.

(ii) **The statement is True.** Section 142A provides that Assessing officer can make reference to Valuation Officer whether or not he is satisfied about the correctness or completeness of accounts of the assessee.

(iii) **The statement is True.** As per section 142(2A), the expenses of special audit and remuneration of the auditor (Accountant) shall be determined by the Commissioner or Chief Commissioner and expenses and remuneration so determined shall be paid by Central Government.

(iv) **The statement is True.** Section 139B defines "Tax Return Preparer" means an individual who has been authorized to act as Tax Return preparer under the notified scheme.

(4 MARKS)

(D) (a) The statement is correct.

It is the outcome of action taken by the taxpayer, none of which or combination of which, is illegal or forbidden by law.

International literature on the subject tends to describe it in the following ways :

- Tax avoidance involves the legal exploitation of tax laws to one's own advantage.
- Every attempt by legal means to prevent or reduce tax liability which would otherwise be attracted, by taking advantage of some provisions or lack of provisions in the law.
- An arrangement entered into solely or primarily for the purpose of obtaining a tax advantage.

Taxpayers consider it their legitimate right to arrange their affairs in a manner as to pay the least tax possible.

(2 MARKS)