# CA FINAL – NOVEMBER — 2018

## D.T.

**Test Code – F N J 7 0 2 9**

Branch () (Date:)

**(100 Marks)**

**Answer 1:**

**(A)**

**Computation of Total Income of LMN Private Ltd. for the A.Y.2018-19**

| | Particulars | | Amount ( Rs.) |
|---|---|---|---|
| **I** | **Income from house property** | | |
| | **[Rental income from commercial property]** | | |
| | Gross Annual Value*/Net Annual Value** | 4,30,000 | |
| | Less: Deduction under section 24(a) | | |
| | 30% of Net Annual Value | 1,29,000 | 3,01,000 |
| **II.** | **Profits and gains of business and profession** | | |
| | Profits from manufacturing business | | |
| | [See Working Note below] | 70,88,000 | |
| | Less: Set-off of losses from trading in derivatives in shares in a recognized stock exchange [allowed to be set-off against profits from the business of manufacturing as per section 70(1) since it is not speculative in nature [See Note below] | 1,80,000 | 69,08,000 |
| **III.** | **Capital Gains** | | |
| | Sale consideration | 52,00,000 | |
| | Less: Indexed Cost of Acquisition [ Rs. 50,00,000 × 272/254] | 53,54,331 | |
| | Long-term capital loss to be carried forward to A.Y.2019-20 for set-off against long-term capital gains, if any, in that year | (1,54,331) | |
| **IV** | **Income from Other Sources** | | |
| | Rent received from vacant land | 2,05,000 | |
| | Interest received on income-tax refund | 42,000 | |
| | Excess of issue price of shares over the fair market value of shares is taxable as per section 56(2)(viib) in the case of LMN Private Ltd., not being a company in which public are substantially interested | | |
| | [ Rs. 40 (i.e., Rs. 100 – Rs. 60) × 1,00,000 shares] | 40,00,000 | 42,47,000 |
| | **Gross Total Income** | | **1,14,56,000** |
| | **Less: Deductions under Chapter VI-A** | | |
| | **Deduction under section 80G** | | |
| | Donation to Swachh Bharat Kosh*** [qualifies for 100% deduction – assuming that the same has not been spent in pursuance of corporate social responsibility under section 135(5) of the Companies Act, 2013] | 70,000 | |
| | **Deduction under section 80GGB** | | |

| | | | |
|---|---|---|---|
| | Contribution to Political Party [Not allowable as deduction since the contribution is made in cash] | Nil | 70,000 |
| | **Total Income** | | **1,13,86,000** |

*Rent received has been taken as the Gross Annual Value (GAV) in the absence of information relating to Municipal Value, Fair Rent and Standard rent.

**Since the question does not contain information about municipal taxes paid, the net annual value is the same as the GAV.

*** Assumed to be paid by a mode other than cash

**Working Note:**

**Computation of profits and gains from the business of manufacturing**

| **Particulars** | | **Amount ( Rs.)** |
|---|---|---|
| **Net profit as per statement of profit and loss** | | **77,00,000** |
| **Add: Items debited but to be considered separately or to be disallowed** | | |
| **B(ii) Donation paid to Swachh Bharat Kosh, considered separately** [not an expenditure incurred wholly and exclusively for the manufacturing business. Hence, not allowable under section 37] | **70,000** | |
| **B(iii) Contribution to political party** [not an expenditure incurred wholly and exclusively for the manufacturing business. Hence, not allowable u/s 37] | 1,50,000 | |
| **B(iv) Payment to transport contractor** [As per section 194C(6), no tax is required to be deducted at source since the payment is to a transport contractor not having more than 10 goods carriages at any time during the previous year and he has given a declaration to that effect along with his PAN. Hence, disallowance under section 40(a)(ia) for non-deduction of tax at source is not attracted. Also, since payment is made by account payee cheque, no disallowance under section 40A(3) is attracted]. | **-** | |
| **B(v) Bonus to employees** [Since the payment is made after the due date of filing return of income, disallowance under section 43B is attracted] | 3,20,000 | |
| **B(vi) Provision for income-tax (including interest of Rs. 70,000 thereon)** [Not allowable as deduction. Disallowance under section 40(a)(ii) is attracted] | 4,20,000 | |
| **B(viii) Loss from trading in derivatives in shares in a recognized stock exchange [See Note below]** [Since loss from trading in derivatives in shares is not related to the business of manufacturing, the same is not incurred wholly and exclusively for this business, and hence, is not allowable as deduction under section 37 while computing profits from the business of | 1,80,000 | |

| | | |
|---|---|---|
| manufacturing] | | 11,40,000 |
| | | 88,40,000 |
| **Add: Cash Payment for purchase of raw material deemed as income** AI(4) [Since the provision for outstanding bill for purchase of raw material has been allowed as deduction during the P.Y.2016-17, cash payment in excess of Rs. 10,000 against such bill in the P.Y.2017-18 would be deemed as income of P.Y.2017-18 as per section 40A(3A)] | | 45,000 |
| | | 88,85,000 |
| **Less: Expenditure to be allowed** | | |
| B(i) & AI(1) Depreciation [Difference between the normal depreciation of Rs. 16.75 lakhs as per Income-tax Act, 1961 [See Note below] and depreciation charged to the statement of profit and loss of Rs. 11.75 lakhs]. | 5,00,000 | |
| **Note –** *Printers and scanners form an integral part of the computer system and they cannot be used without the computer. Hence, they are part of the computer system, they would be eligible for depreciation at the higher rate of 40% applicable to computers including computer software. However, EPABX is not a computer and is, hence, not entitled to higher depreciation@ 40%** | | |

| **Particulars** | **Rs.** |
|---|---|
| Depreciation computed as per Income- tax Act, 1961 | 18,00,000 |
| Less: Depreciation@40% wrongly provided in respect of EPABX = 40% of Rs. 5,00,000 | 2,00,000 |
| | 16,00,000 |
| Add: Depreciation@15% on EPABX = 15% of Rs. 5,00,000 | 75,000 |
| **Correct Depreciation as per Income- tax Act, 1961** | **16,75,000** |

| | | |
|---|---|---|
| **AI(2) Additional depreciation on new plant and machinery** Since plant and machinery was purchased only on 18.11.2017, it was put to use for less than 180 days during the year. Hence additional depreciation is to be restricted to 10% (i.e., 50% of 20%) of Rs. 34 lakhs.*** | 3,40,000 | |
| **AI(3) Audit Fees relating to P.Y.2016-17** [ Rs. 30,000, being 30% of audit fees of Rs. 1,00,000 provided for in the books of account of F.Y.2016-17 would have been disallowed due to non-deduction of tax at source. Since tax has been deducted in September, 2017 and paid on 6.10.2017, the amount of Rs. 30,000 is deductible while computing business income of P.Y.2017-18]. | 30,000 | |
| **B(vii) Contribution to University** [Contribution to a University approved and notified under section 35(1)(ii) would qualify for weighted deduction @150%. Since Rs. 1,00,000 has already been debited to the statement of profit and loss, the balance Rs. 50,000 has to be deducted while computing business income] | 50,000 | 9,20,000 |
| | | 79,65,000 |
| **Less: Items credited to statement of profit and loss, but not** | | |

| | | |
|---|---|---|
| **includible in business income.** | | |
| A(i) Rent received from vacant land [Chargeable to tax under the head "Income from other sources"] | 2,05,000 | |
| A(ii) Rent received from commercial property owned by the company [Chargeable to tax under the head "Income from house property"] | 4,30,000 | |
| A(iii) Interest received on income tax refund [Chargeable to tax under the head "Income from other sources"] | 42,000 | |
| A(iv) Profit on sale of unused land [Chargeable to tax under the head "Capital Gains"] | 2,00,000 | 8,77,000 |
| **Profits and gains from the business of manufacturing** | | **70,88,000** |

*CIT v. BSES Yamuna Powers Ltd (2013) 358 ITR 47 (Delhi)

** Federal Bank Ltd. v. ACIT (2011) 332 ITR 319 (Kerala)

***Balance additional depreciation of Rs. 3.40 lakhs can be claimed in the next year i.e., A.Y.2019-20

**Note:** As per section 43(5), an eligible transaction of trading in derivatives in shares in a recognized stock exchange is not a speculative transaction.

In this case, the company is engaged in the business of manufacturing and hence, the loss on account of trading in derivatives is not incurred wholly and exclusively in relation to such business and hence, has to be disallowed while computing profits from the business of manufacturing. Trading in derivatives in shares is also not incidental to the business of manufacturing. Therefore, it has to be assumed that the company is also carrying on the business of trading in derivatives in shares in addition to its manufacturing business.

In this case, the loss has to be disallowed at the first instance while computing income from the business of manufacturing since it is not wholly and exclusively incurred for the said business and thereafter, loss from trading in derivatives has to be set-off against the profits from manufacturing business applying the provisions of section 70(1) permitting inter-source set-off of losses.

**(B)**

As per section 9(1)(vii)(b), income by way of fees for technical services payable by a resident is deemed to accrue or arise in India, except where the fees is payable, inter alia, in respect of services utilized in a business or profession carried on by such person outside India. In this case, since Ganga Ltd. utilizes the technical services for its business in Calcutta, the fees for technical services payable by Ganga Ltd. is deemed to accrue or arise in India in the hands of Mr. Tom Sawyer.

In accordance with the provisions of section 115A, where the total income of a non-corporate non-resident includes any income by way of royalty or fees for technical services other than the income referred to in section 44DA(1), received from an Indian concern in pursuance of an agreement made by him with the Indian concern and the agreement is approved by the Central Government, then, the special rate of tax at 10% of such fees for technical services is applicable. No deduction would be allowable under sections 28 to 44C and section 57 while computing such income.

Section 90(2) makes it clear that where the Central Government has entered into a DTAA with a country outside India, then, in respect of an assessee to whom such agreement applies, the provisions of the Act shall apply to the extent they are more beneficial to the assessee. Therefore, if the DTAA provides for a rate lower than 10%, then, the provisions of DTAA would apply.

(a) In this case, since India does not have a DTAA with Country A, of which Tom Sawyer is a resident, the fees for technical services (FTS) received from Ganga Ltd., an Indian company, would be taxable @10%, by virtue of section 115A.

(b) In this case, the FTS from Ganga Ltd. would be taxable @5%, being the rate specified in the DTAA, even though section 115A provides for a higher rate of tax, since the tax rates specified in the DTAA are more beneficial. However, since Tom Sawyer is a non-resident, he has to furnish a tax residency certificate from the Government of Country A for claiming such benefit. Also, he has to furnish other information, namely, his nationality, his tax identification number in Country A and his address in Country A.

(c) In this case, the FTS from Ganga Ltd. would be taxable @10% as per section 115A, even though DTAA provides for a higher rate of tax, since the provisions of the Act (i.e. section 115A in this case) are more beneficial.

If Mr. Tom Sawyer has a fixed place of profession in India, and he renders technical services through the fixed place of profession, then, by virtue of section 44DA, such income by way of fees for technical services received by Mr. Tom Sawyer from Ganga Ltd., India, would be computed under the head "Profits and gains of business or profession" in accordance with the provisions of Income-tax Act, 1961, since technical services are provided from a fixed place of profession situated in India and fees for technical services is received from an Indian concern in pursuance of an agreement with the non-resident and is effectively connected with such fixed place of profession. No deduction would, however, be allowed in respect of any expenditure or allowance which is not wholly and exclusively incurred for the fixed place of profession in India.

Mr. Tom Sawyer is required to keep and maintain books of account and other documents in accordance with the provisions contained in section 44AA and get his accounts audited by an accountant and furnish the report of such audit in the prescribed form duly signed and verified by such accountant along with the return of income.

It may be noted that the concessional rate of tax@10% under section 115A would not apply in this case.

**Answer 2:**

**(A)**

The issue under consideration is whether "premium" on subscribed share capital can be treated "capital employed in the business of the company" under section 35D to be eligible for increased deduction.

This issue came up before the Supreme Court in Berger Paints India Ltd v. CIT [2017] 393 ITR 113. The Supreme Court observed that the share premium collected by the assessee on its subscribed issued share capital could not be part of "capital employed in the business of the company" for the purpose of section 35D(3)(b). If it were the intention of the legislature to treat share premium as being "capital employed in the business of the company", it would have been explicitly mentioned. Moreover, Sl. No. IV(i) in Form MGT- 7 read with section 92 of the Companies Act, 2013[1] dealing with capital structure of the company provides the break-up of "issued share capital" and "subscribed share capital" which does not include share premium at the time of subscription. Hence, in the absence of the reference in section 35D, share premium is not a part of the capital employed. Also, section 52 of the Companies Act, 2013[2] requires a company to transfer the premium amount to be kept in a separate account called "securities premium account".

Accordingly, the amount qualifying for deduction under section 35D would be Rs. 30 lakhs, being 5% of Rs. 600 lakhs [i.e., Rs. 700 lakhs (-) share premium of Rs. 100 lakhs]. The deduction under section 35D for A.Y.2018-19 would be Rs. 6 lakhs, being 1/5th of Rs. 30 lakhs. The contention of the Assessing Officer is, therefore, correct.

[1]Corresponding to column III of the form of the annual return in Part II of Schedule V to the Companies Act, 1956 under section 159 .

[2]Corresponding to section 78 of the erstwhile Companies Act, 1956

**(B)**

**Tax treatment in the hands of the seller, Ms. Leena**

Section 50C provides that where the consideration received or accruing as a result of transfer of a capital asset, being land or building or both, is less than the value adopted or assessed or assessable by an authority of a State Government for the purpose of payment of stamp duty in respect of such transfer, the value so adopted or assessed or assessable shall be deemed to be the full value of the consideration received or accruing as a result of such transfer for computing capital gain.

In the instant case, Ms. Leena sold the residential flat at Pune to her friend Ms. Poorna for Rs. 12 lakhs, whereas the stamp duty value was Rs. 20 lakhs. Therefore, stamp duty value shall be deemed to be the full value of consideration for sale of the property. Since the period of holding does not exceed 24 months, the capital gain is short-term. Therefore, short-term capital gain arising to Ms. Leena for assessment year 2018-19 will be Rs. 15 lakhs (i.e., Rs. 20 lakhs - Rs. 5 lakhs).

**Tax treatment in the hands of the buyer, Ms. Poorna**

The taxability provisions under section 56(2)(x), includes within its scope, any immovable property, being land or building or both, received for inadequate consideration by an individual or HUF.

As per section 56(2)(x), where any immovable property is received for a consideration which is less than the stamp duty by an amount exceeding Rs. 50,000, the difference between the stamp duty value and the consideration shall be chargeable to tax in the hands of the recipient as income from other sources. The provisions of section 56(2)(x) would be attracted in this case, since the difference exceeds Rs. 50,000. Therefore, Rs. 8 lakhs, being the difference between the stamp duty value of the property (i.e., Rs. 20 lakhs) and the actual consideration (i.e., Rs. 12 lakhs) would be taxable in the hands of Ms. Poorna, under the head 'Income from Other Sources'.

As per section 49(4), the cost of acquisition of such property for computing capital gains would be the value which has been taken into account for section 56(2)(x). Accordingly, Rs. 20 lakhs would be taken as the cost of acquisition of the flat. Here again, the stamp duty value on the date of sale has to be considered since the same is higher than actual consideration. Therefore, on sale of the flat by Ms. Poorna, Rs. 12 lakhs (i.e. Rs. 32 lakhs – Rs. 20 lakhs) would be chargeable to tax as short-term capital gains in her hands for A.Y.

2018-19. Since this is a case covered by section 49(4) and not section 49(1), the period of holding of the previous owner, namely, Ms. Leena, will NOT be considered for determining whether the capital gain in short term or long term. Accordingly, the capital gain would be short-term, since the period of holding does not exceed 24 months.

**(C)**

(i) As per section 10(1), agricultural income is exempt from tax. The meaning and scope of agricultural income is defined in section 2(1A). According to Explanation 2 to section 2(1A), any income derived from any building from the use of such building for any purpose (including letting for residential purposes or for the purpose of any business or profession) other than agriculture shall not be agricultural income. It appears in this case that the house was occupied by tenants for residential purposes. Therefore, the rent of Rs. 60,000 from letting out of houses constructed on agricultural land for residential purposes shall not be treated as agricultural income by virtue of Explanation 2 to section 2(1A). Hence, such income would be chargeable to tax.

(ii) Explanation 3 to section 2(1A) provides that the income derived from saplings or seedlings grown in a nursery shall be deemed to be agricultural income, whether or not the basic operations were carried out on land. Accordingly, the income of Rs. 75,000 derived by Anand Nursery from the sale of seedlings grown without carrying out all the basic operations on land shall be treated as agricultural income and exempt from tax under section 10(1).

(iii) Section 10(26AAA) exempts the income which accrues or arises to a Sikkimese individual from any source in the State of Sikkim and the income by way of dividend or interest on securities. Therefore, the income of Mr. Gaitonde from a business located in Sikkim and interest income on the securities/bonds of Government of Rajasthan shall not be subject to tax.

**(D)**

This issue came up before the AAR in, Nuclear Power Corporation of India Ltd. In Re, [2012] 343 ITR 220, wherein it was held that an advance ruling is not only applicant specific, but is also transaction specific. The advance ruling is on a transaction entered into or undertaken by the applicant. That is why section 245S specifies that a ruling is binding on the applicant,

**the transaction** and the Principal Commissioner or Commissioner of Income-tax and those subordinate to him, and not only on the applicant.

What is barred by the first proviso to section 245R(2) of the Act in the context of clause (i) thereof is the allowing of an application under section 245R(2) of the Act where "the question raised in the application is already pending before any Income-tax authority, or Appellate Tribunal or any court". The significance of the dropping of the words, "in the applicant's case" with effect from June 1, 2000, cannot be wholly ignored.

On the basis of this view expressed by the AAR in the above case, explaining the impact of the dropping of the words "in the applicant's case" with effect from 1.6.2000, a view can be taken that the AAR can reject the application made by Phi plc before the AAR on the ground that similar issue is pending before the Assessing Officer in respect of the same transaction i.e., provision of technical know to Beta Ltd.

**Note –** The issue relates to the admission or rejection of the application filed before the Advance Rulings Authority on the grounds specified in clause (i) of the first proviso to sub-section (2) of section 245R of the Income-tax Act, 1961.

The first proviso to section 245R(2) has been substituted by the Finance Act, 2000 with effect from 1.6.2000. Clause (i) of the first proviso, prior to and post amendment, reads as follows:

| **Prior to 1.6.2000** | **On or After 1.6.2000** |
|---|---|
| Provided that the Authority shall not allow the application **except in the case of a resident applicant** where the question raised in the application is already pending **in the applicant's case** before any income-tax authority, the Appellate Tribunal or any court; | Provided that the Authority shall not allow the application where the question raised in the application is already pending before any income-tax authority or Appellate Tribunal or any court. |

The words "except in the case of a resident applicant" and "in the applicant's case" has been removed in clause (i) of the first proviso with effect from 1.6.2000. However, the Explanatory Memorandum to the Finance Act, 2000, explaining the impact of the substitution, reads as follows "It is proposed to substitute the proviso to provide that the Authority shall not allow the application when the question raised is already pending in the applicant's case before any income-tax authority, Appellate Tribunal or any court in regard to a non-resident applicant and resident applicant in relation to a transaction with a non-resident". Therefore, according to the intent expressed in the Explanatory Memorandum, the AAR shall not allow the application both in the case of resident and non-resident applicant if the question raised is already **pending in the applicant's case** before any income-tax authority. Thus, as per the Explanatory Memorandum, it is possible to take a view that even post-amendment, the Authority shall not allow the application where a question is **pending in the applicant's case** before any income-tax authority. Thus, an alternative view is possible on the basis of the AAR ruling in Ericsson Telephone Corporation India AB v. CIT (1997) 224 ITR 203, which continues to hold good even after the amendment, if we consider the intent expressed in the Explanatory Memorandum. **Accordingly, based on this view, the AAR can allow the application made by Phi plc, even if the question raised in the application is pending before the Assessing Officer in Beta Ltd.'s case.**

**Answer 3:**

**(A)**

The issues under consideration are:

(1) whether a firm can be a partner of another firm;

(2) whether the CIT (Appeals) has the power to change the status of assessee.

These issues came up before the Madras High Court in Mega Trends Inc. v. CIT (2016) 388 ITR 16. The Court observed that since a partnership firm is a relationship between persons who have agreed to share the profits of the business carried on by all or any of them acting for all, and the term "persons" can connote only natural persons. Since some of the partners are other firms, the assessment cannot be carried out as a firm, as per the Supreme Court's ruling in Dhulichand Laxminarayan v. CIT (1956) 29 ITR 535.

**The contention of the Commissioner (Appeals) that a firm cannot be a partner of another firm is, therefore, correct.**

In Mega Trends Inc's case, the Madras High Court further observed that, under section 251(1), the powers of the first appellate authority are co-terminous with those of the Assessing Officer and the appellate authority can do what the Assessing Officer ought to have done and also direct him to do what he had failed to do. If the Assessing Officer had erred in concluding the status of the assessee as a firm, it could not be said that the Commissioner (Appeals) had no jurisdiction to go into the issue. The appeal was in continuation of the original proceedings and unless fetters were placed upon the powers of the appellate authority by express words, the appellate authority could exercise all the powers of the original authority.

The High Court thus, held that the power to change the status of the assessee is available to the assessing authority and when it is not used by him, the appellate authority is empowered to use such power and change the status. The Court relied on a full bench decision of the Madras High Court in State of Tamil Nadu v. Arulmurugan and Co. reported in [1982] 51 STC 381 to come to such conclusion.

**Accordingly, applying the rationale of the Madras High Court ruling to the case on hand, the CIT (Appeals) has the power to change the status of the assessee.**

**(B)**

(i) Clause (i) of Explanation to section 92B amplifies the scope of the term "international transaction". According to the said Explanation, international transaction includes, inter alia, provision of scientific research services. Lambda Sicom is a specified foreign company in relation to XYZ Ltd. Therefore, the condition of XYZ Ltd. holding shares carrying not less than 26% of the voting power in Lambda Sicom is satisfied, assuming that all shares carry equal voting rights. Hence, Lambda Inc. and XYZ Ltd. are deemed to be associated enterprises under section 92A(2). Since the provision of scientific research services by Lambda Sicom to XYZ Ltd. is an "international transaction" between associated enterprises, transfer pricing provisions are attracted in this case.

(ii) Purchase of tangible property falls within the scope of "international transaction". Tangible property includes commodity. Cylo AG and Omega Ltd. are associated enterprises under section 92A, since Cylo AG is a holding company of Omega Ltd. Therefore, purchase of commodities by Omega Ltd., an Indian company, from Cylo AG, a German company, is an international transaction between associated enterprises, and consequently, the provisions of transfer pricing are attracted in this case.

(iii) Unit E is eligible for deduction@100% of the profits derived from its eligible business (i.e., the business of developing an infrastructure facility, namely, a highway project in this case) under section 80-IA. However, Unit F is not engaged in any "eligible business". Since Unit F has transferred steel to Unit E at a price lower than the fair market value, it is an inter-unit transfer of goods between eligible business and other business, where the consideration for transfer does not correspond with the market value of goods. Therefore, this transaction would fall within the meaning of "specified domestic transaction" to attract transfer pricing provisions, since the aggregate value of such transactions during the year exceeds a sum of Rs. 20 crore.

(iv) In this case, salary payment has been made to a related person referred to in section 40A(2)(b) i.e., relative (i.e., daughter) of Ms. Geetha, who is a director of Theta Ltd. However, with effect from A.Y.2018-19, section 92BA has been amended to exclude such transactions from the scope of "specified domestic transaction". Consequently, transfer pricing provisions would not be attracted in this case.

(v) The scope of the term "intangible property" has been amplified to include, inter alia, technical knowhow, which is a technology related intangible asset. Transfer of intangible property falls within the scope of the term "international transaction". Since Alcatel Lucent, a French company, guarantees not less than 10% of the borrowings of Y Ltd., an Indian company, Alcatel Lucent and Y Ltd. are deemed to be associated enterprises under section 92A(2). Therefore, since transfer of technical knowhow by Y Ltd., an Indian company, to Alcatel Lucent, a French company, is an international transaction between associated enterprises, the provisions of transfer pricing are attracted in this case.

**(C)**

**Computation of total income of Mysore Co-operative Society for A.Y.2018-19**

| **Particulars** | | **Rs.** | **Rs.** |
|---|---|---|---|
| **I** | **Income from house property** | | 75,000 |
| **II** | **Profits and Gains of Business or Profession** | | |
| | From processing with the aid of power | 40,000 | |
| | From collective disposal of labour | 20,000 | |
| | From other business | 72,000 | |
| | | | 1,32,000 |
| **III** | **Income from Other Sources** | | |
| | Interest received from another co-operative society | 12,000 | |
| | Dividend received from another co-operative society | 15,000 | 27,000 |
| | **Gross Total Income** | | **2,34,000** |
| **Less: Deduction under section 80P** | | | |
| | Interest and dividend from another co-operative society<br>[ Rs. 12,000 + Rs. 15,000] - fully deductible under section 80P(2)(d) | 27,000 | |
| | Income from collective disposal of labour – fully deductible<br>under section 80P(2)(a)(vi), assuming that the stipulated | | |

| | | | |
|---|---|---|---|
| | conditions are fulfilled. | 20,000 | |
| | Income from other business Rs. 72,000, deduction restricted to Rs. 50,000 under section 80P(2)(c)(ii) | 50,000 | 97,000 |
| | **Total Income** | | **1,37,000** |

**Note:** Since the gross total income exceeds Rs. 20,000, in case of a co-operative society engaged in manufacturing operations with the aid of power, income from house property is not eligible for deduction under section 80P(2)(f)

**(D)**

A company is typically financed or capitalized through a mixture of debt and equity. The manner in which company raises capital has a significant impact on the amount of profit it reports for tax purposes. This is due to the reason that tax legislations of countries typically allow a deduction for interest paid or payable in arriving at the profit for tax purposes while the dividend paid on equity contribution is not deductible. Therefore, the higher the level of debt in a company, and thus, the amount of interest it pays, the lower will be its taxable profit. For this reason, debt is often a more tax efficient method of finance than equity. Since in such a structure, equity financing is less, it is referred to as Thin Capitalization. Thin capitalization, thus, refers to the process of funding an entity by debt instead of equity with a view to take advantage of interest deduction benefits.

Multinational groups are often able to structure their financing arrangements to maximize these benefits. To prevent tax erosion on account of such arrangements, country's tax administrations often introduce rules that place a limit on the amount of interest that can be deducted in computing a company's profit for tax purposes. Such rules are designed to counter cross-border shifting of profit through excessive interest payments, and thus aim to protect a country's tax base. Under the initiative of the G-20 countries, the Organization for Economic Co-operation and Development (OECD) in its Base Erosion and Profit Shifting (BEPS) project had taken up the issue of base erosion and profit shifting by way of excess interest deductions by the MNEs in its Action Plan 4. The OECD has recommended several measures in its final report to address this issue. In view of the above, new section 94B has been inserted in the Income-tax Act, 1961, in line with the recommendations of OECD BEPS Action Plan 4, to provide that interest paid or payable by an entity to its non-resident associated enterprises shall be restricted to 30% of its earnings before interest, taxes, depreciation and amortization (EBITDA) or interest paid or payable to non-resident associated enterprises, whichever is less.

**Answer 4:**

**(A)**

When a loan is given by a closely held company, it is chargeable to tax as deemed dividend if the loan is given to:

(i) a shareholder (having 10% or more voting power in the company) or

(ii) a concern in which such shareholder is a member or partner and in which he has substantial interest (entitled to 20% of the income of such concern).

The issue under consideration in this case is whether loan to HUF by a closely held company is chargeable to tax as deemed dividend, where the share certificates were in the name of the Karta of the HUF but the annual return mentioned the HUF as a shareholder.

This issue came up before the Supreme Court in Gopal & Sons (HUF) v. CIT (2017) 391 ITR 1, wherein it was observed that, in either scenario, section 2(22)(e) would be attracted. If the HUF was the shareholder, as it held more than 10% voting power, the provisions of section 2(22)(e) would be covered under (i) above. If the Karta was the shareholder, the HUF would be the concern in which the Karta is a member, and hence, the case would be covered under (ii) above.

As per Explanation 3 to section 2(22)(e), "concern" has been defined to mean a HUF, or a firm or an AOP or a BOI or a company. The Supreme Court, accordingly, held that the loan to HUF is to be assessed as deemed dividend under section 2(22)(e).

Applying the rationale of the above Supreme Court ruling to the case on hand, the loan given by Best Fertilizers (P.) Ltd. to Aakash HUF would be deemed as dividend under section 2(22)(e).

**(B)**

| **Particulars** | **Rs.** | **Rs.** |
|---|---:|---:|
| Treatment of Mrs. G in a Government hospital | | - |
| Treatment of Mr. G's father (75 years and dependant) abroad | 50,000 | |
| Expenses of staying abroad of the patient and attendant | 30,000 | |
| | 80,000 | |
| Less: Exempt up to limit specified by RBI | 75,000 | 5,000 |
| Medical premium paid for insuring health of Mr. G | | - |
| Treatment of Mr. G by his family doctor | 5,000 | |
| Treatment of Mr. G's mother (dependant) by family doctor | 8,000 | |
| Treatment of Mr. G's sister (dependant) in a nursing home | 3,000 | |

| | | |
|---|---|---|
| | 16,000 | |
| Less: Exempt upto Rs.15,000 | 15,000 | 1,000 |
| Add : Treatment of Mr. G';s grandfather in a private clinic | | 12,000 |
| Add : Treatment of Mr. G's brother (independent) | | 6,000 |
| **Taxable value of perquisite** | | **24,000** |

**(C)**

(a) As per the first proviso to section 143(3), in the case of an institution approved under, inter alia, section 10(23C)(vi), which is required to furnish the return of income under section 139(4C), the Assessing Officer shall not pass an order of assessment under section 143(3) without giving effect to the provisions of section 10, unless he is of the view that the activities of the institution are being carried on in contravention to the provisions of that section and:

(1) he has intimated the Central Government or the prescribed authority, which had earlier approved the concerned institution, about the contravention of the relevant provisions by the institution; and

(2) the approval granted to such institution has been withdrawn or notification in that respect has been rescinded.

Therefore, in the aforesaid case, the Assessing Officer can pass an assessment order without giving exemption under section 10 to Teachwell Education, which is an educational institution approved under section 10(23C)(vi), only if he has intimated the contravention made by Teachwell Education to the Central Government or the prescribed authority, as the case may be, and its approval under section 10(23C)(vi) is withdrawn.

(b) As per Explanation 1 to section 153, in case the Assessing Officer intimates the contravention of provisions of section 10(23C)(vi) to the Central Government or the prescribed authority, the period commencing from the date of intimation of such contravention by the Assessing Officer and ending on the date on which the copy of the order of withdrawing the approval under section 10(23C)(vi) is received by the Assessing Officer, shall be excluded for computing the period of limitation for completing the assessment.

Further, in case the time limit available to the Assessing Officer for passing an assessment order, after such exclusion, is less than 60 days, such remaining period of assessment shall be deemed to have been extended to 60 days.

Therefore, the Assessing Officer will get the above mentioned additional time for completing the assessment of Teachwell Education.

**(D)**

**(a) Principle of Contmporanea Expositio**

A treaty's terms are normally to be interpreted on the basis of their meaning at the time the treaty was concluded. However, this is not a universal principle.

In Abdul Razak A. Meman's (2005) 276 ITR 306, the AAR observed that "there can be little doubt that while interpreting treaties, regard should be had to material contemporanea expositio. This proposition is embodied in article 32 of the Vienna Convention and is also referred to in the decision of the Hon'ble Supreme Court in K. P. Varghese v. ITO [1981] 131 ITR 597.

**(b) Teleological Interpretation**

In this approach the treaty is to be interpreted so as to facilitate the attainment of the aims and objectives of the treaty. This approach is also known as the 'objects and purpose' method.

In case of Union of India v. Azadi Bachao Andolan 263 ITR 706, the Supreme Court observed that "the principles adopted for interpretation of treaties are not the same as those in interpretation of statutory legislation. The interpretation of provisions of an international treaty, including one for double taxation relief, is that the treaties are entered into at a political level and have several considerations as their bases."

One instance is where the Apex Court agreed with the contention of the Appellant that "the preamble to the Indo-Mauritius DTAA recites that it is for 'encouragement of mutual trade and investment' and this aspect of the matter cannot be lost sight of while interpreting the treaty.

**Answer 5**

**(A)**

**Computation of taxable income of Medicare Trust for A.Y. 2018-19**

| **Particulars** | | **Rs.** |
|---|---|---|
| Income from running of hospitals | 1,08,00,000 | |
| Income from medical college [exempt u/s 10(23C)(iiiad)] | Nil | |

| | | |
|---|---|---|
| Donation other than anonymous donation of Rs. 2,00,000 taxable @30% ( Rs. 3,00,000, being reduced by 5% of Rs. 8,00,000 or Rs. 1,00,000, whichever is higher)10 [ Rs.8,00,000 – Rs.2,00,000] | 6,00,000 | 1,14,00,000 |
| Less: 15% of income of Rs. 114 lakhs accumulated or set apart under section 11(1)(a) | | 17,10,000 |
| | | 96,90,000 |
| Less: Amount applied for the purposes of hospital | | 93,50,000 |
| | | 3,40,000 |
| Add: Amount accumulated for extension of a hospital but not spent deemed to be income under section 11(3) ( Rs. 20 lakhs – Rs. 15 lakhs) (See Note 1 below) | | 5,00,000 |
| | | 8,40,000 |
| Add: Anonymous donation taxable @30% under section 115BBC (See Note 2 below) | | 2,00,000 |
| **Total Income** | | **10,40,000** |
| **Tax on total income** | | |
| Tax on anonymous donation of Rs. 2 lacs at 30% (See Note 2 below) | | 60,000 |
| Tax on other income of Rs. 8,40,000 at normal rates | | |
| Upto Rs. 2,50,000 | Nil | |
| Over Rs. 2,50,000 up to Rs. 5,00,000 @ 5% | 12,500 | |
| Over Rs.5,00,000 upto Rs.8,40,000@20% | 68,000 | 80,500 |
| | | 1,40,500 |
| Education cess @2% | | 2,810 |
| Secondary and higher education cess@1% | | 1,405 |
| **Tax payable** | | **1,44,715** |
| **Tax payable (rounded off)** | | **1,44,720** |

[10] A view is taken that 15% of Rs. 1 lakh, representing anonymous donations exempt from applicability of 30% tax, is also eligible for retention/accumulation without conditions in line with other voluntary contributions. A contrary view may also be possible due to the language used in section 13(7).

**Notes:**

(1) Section 11(3) provides that if the income accumulated for certain purpose is not utilized for the said purpose within the period (not exceeding 5 years) for which it was accumulated, or in the year immediately following the expiry thereof, then the unutilised amount is deemed to be the income of the charitable institution for the previous year immediately following the expiry of the period of accumulation. In the instant case, Medicare Trust accumulated Rs. 20,00,000 in the previous year 2011-12 for extension of one of its hospitals for a period of 5 years. Period of accumulation thus expired on 31.3.2017. The assessee has spent Rs. 15,00,000 out of accumulated sum of Rs. 20,00,000 up to 31.3.2017. Therefore, the unutilised amount of Rs. 5,00,000, which is not utilized in the P.Y.2017-18 also, is deemed to be income of the previous year 2017-18 (A.Y. 2018-19).

(2) Only the anonymous donations in excess of the exemption limit specified below would be subject to tax@30% under section 115BBC.

The exemption limit is the higher of the following –

(1) 5% of the total donations received by the assessee [i.e., Rs. 40,000 (5% x Rs. 8 lakhs)]; or

(2) Rs. 1 lakh.

Therefore, in this case the exemption would be Rs. 1 lakh.

The total tax payable by such institution would be –

(1) tax@30% on the anonymous donations exceeding the exemption limit as calculated above [i.e., tax@30% on Rs. 2,00,000, being Rs. 3,00,000 – Rs. 1,00,000)]; and

(2) tax on the balance income i.e., total income as reduced by Rs. 2,00,000, being the aggregate amount of anonymous donations in excess of Rs. 1 lakh.

**(B)**

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 before an Assessing Officer on the date on which the application is made.

A proceeding for assessment or reassessment or recomputation 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. Amit 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.

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. Amit 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. Amit -

(i) immunity from prosecution for any offence under the Income-tax Act, 1961 / Wealth-tax Act, 1957, where the proceedings for such prosecution have been instituted on or after the date of receipt of application under section 245C; and

(ii) 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. Amit, if he approaches the Settlement Commission.

**Note:** Where a notice under section 148 is issued for any assessment year, a proceeding under section 147 shall be deemed to have commenced on the date of issue of such notice and the assessee can approach the Settlement Commission for other assessment years as well, even if notice under section 148 for such other assessment years has not been issued but could have been issued on date. However, a return of income for such other assessment years should have been furnished under section 139 or the response to notice under section 142.

**(C)**

Since Mr. Ganesh is an individual resident of two Contracting States, namely, Country M and Country N, the UN Model Convention provides for a series of tie-breaker rules to determine single state of residence for him:

**(i)** **Permanent Home:** The first test is based on where he has a permanent home. Permanent home would mean a dwelling place available to him at all times continuously and not occasionally and includes place taken on rent for a prolonged period of time. Any place taken for a short duration of stay or for temporary purpose, may be for reasons such as short business travel, or a short holiday etc. is not regarded as a permanent home.

**(ii)** **Personal and economic relations:** If that test is inconclusive for the reason that he has permanent home available to him in both Contracting States, he will be considered a resident of the Contracting State where his personal and economic relations are closer, in other words, the place where lies his centre of vital interests. Thus, preference is given to family and social relations, occupation, place of business, place of administration of his properties, political, cultural and other activities of the individual.

**(iii)** **Habitual abode:** In the following distinct and different situations, preference is given to the Contracting State where he has an habitual abode:

- The case where he has a permanent home available to him in both Contracting States and it is not possible to determine in which one he has his centre of vital interests;
- The case where he has a permanent home available to him in neither Contracting State.

**(iv)** **National:** If he has habitual abode in both Contracting States or in neither of them, he shall be treated as a resident of the Contracting State of which he is a national.

**(v)** **Competent Authority:** If he is a national of both or neither of the Contracting States, the matter would be left to be considered by the competent authorities of the respective Contracting States.

**Answer 6:**

**(A)**

**Computation of total income of Mr. Ranjit for A.Y.2018-19**

| **Particulars** | **Rs.** | **Rs.** |
|---|---|---|
| **Income from House Property [House situated in Country Q]** | | |
| Gross Annual Value* | 3,20,000 | |
| Less: Municipal taxes (assumed as paid in that country) | 12,000 | |
| Net Annual Value | 3,08,000 | |
| Less: Deduction under section 24 – 30% of NAV | 92,400 | |
| | | 2,15,600 |
| **Profits and Gains of Business or Profession** | | |
| Income from profession carried on in India | 6,20,000 | |
| Less: Business loss in Country Q set-off** | 70,000 | |
| | 5,50,000 | |
| Royalty income from a literary book from Country P | | |
| (after deducting expenses of Rs. 30,000) | 4,90,000 | 10,40,000 |
| **Income from Other Sources** | | |
| Agricultural income in Country P | 82,000 | |
| Dividend received from a company in Country Q | 97,000 | |

| | |
|---|---|
| | 1,79,000 |
| **Gross Total Income** | **14,34,600** |
| **Less: Deduction under Chapter VIA** | |
| Under section 80QQB – Royalty income of a resident from literary work*** | 3,00,000 |
| **Total Income** | **11,34,600** |

*Rental Income has been taken as GAV in the absence of other information relating to fair rent, municipal value etc.

**As per section 70(1), inter-source set-off of income is permitted.

***Doubly taxed income includes only that part of income which is included in the assessees total income. The amount deducted under Chapter VIA is not doubly taxed and hence, no relief is allowable in respect of such amount – CIT v. Dr. R.N. Jhanji (1990) 185 ITR 586 (Raj.).

**Computation of tax liability of Mr. Ranjit for A.Y.2018-19**

| **Particulars** | **Rs.** |
|---|---|
| Tax on total income [30% of Rs. 1,34,600 + Rs. 1,12,500] | 1,52,880 |
| Add: Education cess@2% | 3,058 |
| Secondary and higher education cess @ 1% | 1,529 |
| | **1,57,466** |
| Less: Rebate under section 91 (See Working Note below) | 66,313 |
| Tax Payable | 91,153 |
| Tax payable (rounded off) | 91,150 |

| **Working Note: Calculation of Rebate under section 91** | **Rs.** | **Rs.** |
|---|---|---|
| Average rate of tax in India [i.e., Rs. 1,57,466 / Rs. 11,34,600 x 100] | 13.88% | |
| **Average rate of tax in Country P** | **12%** | |
| **Doubly taxed income pertaining to Country P** | | |
| Agricultural Income | 82,000 | |
| Royalty Income [ Rs. 5,20,000 – Rs. 30,000 (Expenses) – Rs. 3,00,000 (deduction under section 80QQB)]** | 1,90,000 | |
| | 2,72,000 | |
| Rebate under section 91 on Rs. 2,72,000 @12% [being the lower of average Indian tax rate (13.88%) and foreign tax rate (12%)] | | 32,640 |
| **Average rate of tax in Country Q** | **15%** | |
| **Doubly taxed income pertaining to Country Q** | | |
| Income from house property | 2,15,600 | |
| Dividend | 97,000 | |
| | 3,12,600 | |
| Less: Business loss set-off | 70,000 | |
| | **2,42,600** | |
| Rebate under section 91 on Rs. 2,42,600 @13.88% (being the lower of average Indian tax rate (13.88%) and foreign tax rate (15%)] | | 33,673 |

| Total rebate under section 91 (Country P + Country Q) | 66,313 |
|---|---|

**It is assumed that the royalty earned outside India has been brought into India in convertible foreign exchange within a period of six months from the end of the previous year.

**Note:** Mr. Ranjit shall be allowed deduction under section 91, since the following conditions are fulfilled:-

(a) He is a resident in India during the relevant previous year (i.e., P.Y.2017-18).

(b) The income in question accrues or arises to him outside India in foreign countries P and Q during that previous year and such income is not deemed to accrue or arise in India during the previous year.

(c) The income in question has been subjected to income-tax in the foreign countries P and Q in his hands and it is presumed that he has paid tax on such income in those countries.

(d) There is no agreement under section 90 for the relief or avoidance of double taxation between India and Countries P and Q where the income has accrued or arisen.

**(B)**

(i) **TDS on landing and parking charges:** The landing and parking charges which are fixed by the Airports Authority of India are not merely for the "use of the land". These charges are also for services and facilities offered in connection with the aircraft operation at the airport which include providing of air traffic services, ground safety services, aeronautical communication facilities, installation and maintenance of navigational aids and meteorological services at the airport [Japan Airlines Co. Ltd. v. CIT / CIT v. Singapore Airlines Ltd. (2015) 377 ITR 372 (SC)]. Thus, tax is not deductible under section 194I which provides deduction of tax for payment in the nature of rent.

Hence, tax is deductible @2% under section 194C by the airline company, Wings Ltd., on payment of Rs. 15 lacs made towards landing and parking charges to the Airports Authority of India for the previous year 2017-18.

**(ii)** **TDS on services of overseas agent outside India:** An overseas agent of an Indian company operates in his own country and no part of his income accrues or arises in India. His commission is usually remitted directly to him and is, therefore, not received by him or on his behalf in India. The commission paid to the non-resident agent for services rendered outside India is, thus, not chargeable to tax in India.

Since commission income for contacting and negotiating with artists by Mr. John, a non-resident, who remains outside India is not subject to tax in India, consequently, there is no liability for deduction of tax at source. It is assumed that the commission equivalent to Rs. 1 lakh was remitted to Mr. John outside India.

**(iii)** **TDS on rent for building and machinery:** Tax is deductible on rent under section 194-I, if the aggregate amount of rental income paid or credited to a person exceeds Rs. 1,80,000. Rent includes payment for use of, inter alia, building and machinery.

The aggregate payment made by Mac Ltd. to Ramesh towards rent in P.Y.2017-18 is Rs. 1,85,000 (i.e., Rs. 1,35,000 for building and Rs. 50,000 for machinery). Hence, Mac Ltd. has to deduct tax@10% on rent paid for building and tax@2% on rent paid for machinery.

**(iv)** **TDS on compensation for compulsory acquisition:** Tax is deductible at source @10% under section 194LA, where payment is made to a resident as compensation or enhanced compensation on compulsory acquisition of any immovable property (other than agricultural land).

However, no tax deduction is required if the aggregate payments in a year does not exceed Rs. 2,50,000.

Therefore, no tax is required to be deducted at source on payment of Rs. 2,45,000 to Mr. X, since the aggregate payment does not exceed Rs. 2,50,000.

Since the definition of immovable property specifically excludes agricultural land, no tax is deductible at source on compensation paid for compulsory acquisition of agricultural land.

**(C)**

Chapter VIII of the Finance Act, 2016, "Equalisation Levy", provides for an equalisation levy of 6% of the amount of consideration for specified services received or receivable by a non-resident not having permanent establishment in India, from a resident in India who carries out business or profession, or from a non-resident having permanent establishment in India.

"Specified Service" means

(1) online advertisement;

(2) any provision for digital advertising space or any other facility or service for the purpose of online advertisement and

(3) any other service as may be notified by the Central Government.

However, equalisation levy shall not be levied-

- where the non-resident providing the specified services has a permanent establishment in India
- the aggregate amount of consideration for specified service received or receivable during the previous year does not exceed Rs. 1 lakh.
- where the payment for specified service is not for the purposes of carrying out business or profession

**(i) Where PQR Inc. has no permanent establishment in India**

In the present case, ABC Ltd. is required to deduct equalisation levy of Rs. 30,000 i.e., @6% of Rs. 5 lakhs, being the amount paid towards online advertisement services provided by PQR Inc., a non-resident having no permanent establishment in India. Non-deduction of equalisation levy would attract disallowance under section 40(a)(ib) of 100% of the amount paid while computing business income.

**(ii) Where PQR Inc. has permanent establishment in India**

Equalisation levy would not be attracted where the non-resident service provider (PQR Inc., in this case) has a permanent establishment in India. Therefore, the ABC Ltd. is not required to deduct equalisation levy on Rs. 5 lakhs, being the amount paid towards online advertisement services to PQR Inc, in this case.

However, tax has to be deducted by ABC Ltd. at the rates in force under section 195 in respect of such payment to PQR Inc. Non-deduction of tax at source under section 195 would attract disallowance under section 40(a)(i) of 100% of the amount paid while computing business income.