SUGGESTED SOLUTION

CA FINAL NOV'19

SUBJECT- DIRECT TAX LAWS AND INTERNATIONAL TAXATION

Test Code – CFN 7259

BRANCH - () (Date :)

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PART A : MULTIPLE CHOICE QUESTIONS

ANSWER 1 : MULTIPLE CHOICE QUESTIONS (2*10 =20 marks)

1. **A**
2. **A**
3. **D**
4. **B**
5. **A**
6. **A**
7. **C**
8. **D**
9. **C**
10. **D**

ANSWER 2 : MULTIPLE CHOICE QUESTIONS (1*10 =10 marks)

1. **D**
2. **A**
3. **D**
4. **D**
5. **D**
6. **C**
7. **C**
8. **C**
9. **D**
10. **C**

PART B : DISCRIPTIVE TYPE QUESTIONS

ANSWER : 1

	Particulars	**Note No.**	**Amount (Rs.)**
	Net Profit as per Profit & Loss A/c.		50,00,000
Add :	**Items disallowed or considered separately**		
(a)	Amount Contributed to the Employees Welfare Trust	1	1,50,000
(b)	Amount paid for college free and hostel expenses of close relative of director	2	15,00,000
(c)	Installation of Traffic Signal	3	-
(d)	Gift articles distributed to various dealers under sales incentive scheme	4	-
(e)	Travelling Expenses of wife of M.D.	5	-
(f)	Exchange Fluctuation on payment to supplier of machinery	6	3,00,000
(g)	Employers contribution PF.	7	-
(h)	Employee contribution towards PF for the month of March 2019 deemed as income	7	-

(i)	Payment to contractor for repairing work	8	25,000
(j)	Interest paid in February 2019 and March 2019	9	-
(k)	Sum received on transfer of Carbon Credit	10	1,00,000
Less : (a)	Depreciation on Rs. 3,00,000 @ 15%	6	(45,000)
(b)	Audit Fees (Rs. 5 Lakh × 30%)	11	(1,50,000)
(c)	Employees contribution to PF	7	-
	Total income		68,80,000
	Tax u/s 115BBG @ 10% × 1,00,000		10,000
	Tax on Balance Total Income @ 30% [68,80,000 – 1,00,000]		20,34,000
			20,44,000
Add :	Health & Education Cess @ 4%		81,760
	Total Tax Liability		21,25,760

(8 MARKS)

Note : 1 Employees contribution to unrecognized Employee Welfare Fund is specifically disallowed u/s 40A(9).

Note 2 : The expenditure incurred by the company is in respect of personal expenditure of relative of a director hence, it cannot be said to have been incurred for the purpose of the business/ profession of the assessee & accordingly not allowed as deduction u/s 37(iv)

Note 3 : The expenditure incurred is on account of business expediency. ∴such expenditure is for the purpose of business / profession. Further the expenditure incurred is not forming part of the capital field of the assessee. ∴ It shall be allowed as deduction u/s 37(1).

Note : 4 : The expenditure is towards improving the profitability of business hence it is for the purpose of business / profession of assessee & accordingly allwed u/s 37(1).

Note : 5 : It is a customary practice of the spouse of the MD accompanying him to business tours, the said expenditure is for the purpose of business / profession & accordingly allowed u/s 37(1).

Note : 6 : As per Section 43A exchange rate fluctuation on foreign currency loan taken to acquire the asset from the foreign country shall be capitalized in the P.Y. in which the loan has been repaid. Hence the deduction taken in the book shall be disallowed. Further, since, the amount would be added back to cost of machinery, depreciation shall be claimed @ 15% on that amount.

Note : 7 Apex Court in the case of Rajasthan State Beverages Corporation Ltd. [2017] 84 taxmann.Com 185(SC) has held that amount claimed on payment of PF and ESI having been deposited on or before due date of filing of returns, same could not be disallowed under section 43B or under section 36(1) (va).

Note : 8 Where expenditure exceeds Rs. 10,000 and the aggregate of payment on a single day exceeds Rs. 10,000 being made otherwise than by way of an account payee cheque / demand draft shall be disallowed u/s 40A(3).

Note : 9 TDS has been deducted at the time of payment of interest & deposited before the due date of filing of ROI. Provisions of Section 40(a)(ia) shall not be applicable.

Note : 10 As per Section 115BBG, where the total income of the assessee includes any income from transfer of Carbon Credit, Such income shall be taxable at the concessional rate of 10% on the gross amount of such income. No expenditure or allowance in respect of such income shall be allowed.

Note : 11 As per Section 40(a) (ia), if tax is not deducted or deposited before due date of filing ROI, then 30% expenditure shall be disallowed, such expenditure shall be allowed in the year in which tax is deposited with the government.

(6 MARKS)

ANSWER : 2(A)

Particulars		Amount (Rs.)
(I) Indian income		5,00,000
(II) Foreign Income		
(a) IFHP		
Rental income earned in UK (£ 10,000* Rs. 85) (Note 1)		8,50,000
Less : Standard deduction u/s 24(a) @ 30%		(2,55,000)
		5,95,000
(b) PGBP		
Income from profession ($ 3,000 * Rs. 62) (Note 1)		1,86,000
(c) IFOS		
Interest earned in USA ($5,000 * Rs. 62) (Note 1)		3,10,000
GTI		**15,91,000**
Computation of tax liability		
Tax liability		2,89,800
Add : cess @ 4%		11,592
Total Indian tax liability		**3,01,392**
Tax credit u/s 90 (Lower of Indian rate of tax or foreign tax rate)	**18.94%**	
(a) Average rate of Indian tax (3,01,392/15,91,000 * 100)		
(b) For rental income earned in UK	**10%**	**(90,000)**
Tax deducted in UK (£ 1,000/ £ 10,000 * 100)		
Therefore, FTC = £ 1,000 * Rs. 90 (Note 4)		
(c) For Income from Profession in USA	**10%**	**(17,400)**
Tax paid in USA ($ 300/ $ 3,000 * 100)		
Therefore, FTC = $300 * Rs. 58 (Note 4)		
(d) For interest on deposits in USA	**10%**	**(30,000)**
Tax paid in USA ($ 500/ $5,000 *100)		
Therefore, FTC = $500* Rs. 60 (Note 4)		
Total tax payable		**1,63,992**

(7 MARKS)

Notes :

1. Rule 115 states that for conversion of any income derived in foreign currency and considered under the head 'PGBP', 'IFOS' and 'IFHP' – TTBR as on last day of P.Y. is to be taken for converting into Indian currency.
2. Since India has entered into DTAA with USA and UK, tax credit would be available to Mr. DS u/s 90.
3. As per Rule 128, tax credit needs to be computed country wise and source wise
   It shall be LOWER OF :
   (a) Tax payable under Act
   (b) Foreign tax payable
4. Credit shall be determined by conversion of the currency of payment to foreign tax at the telegraphic transfer buying rate on the last day of the month immediately preceding the month in which such tax has been paid or deducted.

(3 MARKS)

ANSWER : 2(B)

Tax as per normal provision @ 30% (Rs. 1 Lakh & 30%) …… (A)	30,000
Tax as per Mat u/s 115JB @ 18.5% (Rs. 1,90,000 * 18.5%) …… (B)	35,150
Tax to be paid (Higher of A or B) …….. (C)	35,150
MAT Credit for subsequent years	5,150
Less : FTC …….. (D)	(32,000)
Tax to be paid (C – D)	3,150
MAT credit to be carry forward restricted to	3,150

Note : Thus to the extent MAT is actually paid less, no credit for the excess MAT will be available.

(4 MARKS)

ANSWER : 3(A)

Computation of total income of the institution for the A.Y. 2019-20

Particulars	Rs. (in crores)
Fees received	14.00
Less : 15% (exempt even if not spent for the objects of the institution)	2.10
	11.90
Less : Accumulated for specified purpose **(See Note 2)**	4.00
Balance to be spent	7.90
Actual amount spent on construction of computer science lab **(See Note 1)**	0.50
Actual amount spent on purchase of land for cricket field **(See Note 1)**	2.00
Total Income	**5.40**

Notes:

(1) The institution must utilise 85% of its income within the previous year for the objects of the institution. The institution can apply its income either for revenue expenditure or for capital expenditure provided the expenditure is incurred for promoting the objects of the institution. Land acquired and meant for use as cricket field for students is a capital expenditure incurred for promoting the objects of the institution and hence, eligible for deduction. Likewise, the amount spent on construction of computer science laboratory is also eligible for deduction.

(2) Section 11(2) provides that a trust/institution can accumulate or set apart its income for a specified purpose by furnishing statement in prescribed format to the concerned Assessing Officer. However, the period for which the funds can be accumulated cannot exceed 5 years. The amount so accumulated should be invested in the specified forms and modes. In this case, the institution has to furnish statement in Form 10 on or before the due date of filing return of income to the Assessing Officer, stating the purpose for which the income is being accumulated or set apart and the period for

which the income is being accumulated or set apart, which shall, in no case, exceed five years. Further, the institution has to invest Rs. 4 crore in the specified forms and modes.

(8 MARKS)

ANSWER : 3(B)

1. **Associated Enterprise :** In this case, Duplex Inc holds stake of 30% in Duplex Ltd. Assuming it also has 30% of voting power in Duplex Ltd. Accordingly, both are associated enterprise within the meaning of section 92A.
2. **International transaction :**
   Sale of goods to a non-resident associated enterprise would fall within the meaning of international transaction, Accordingly, the provisions of transfer pricing would apply and the price is required to be computed with regard to Arm's length price (ALP).
3. **Determine of ALP :** Since, in the instant case there are only 4 comparable, the range concept shall not apply & ALP shall be determined using Arithmetic Mean.
4. **Use of multiple year data :** Since, in the instant case, CUP method is used, the concept of multiyear data would not apply. Accordingly, only the data of the current year i.e. P.Y. 2018 – 19 is to be considered. Data pertaining to P.Y. 2017 – 18 is irrelevant.
5. **ALP as per Arithmetic mean :**
   = (Rs. 10,000 + Rs. 10,990 + Rs. 9,900 + Rs. 10,330)/4
   = Rs. 10,305 / unit

If the transaction price is within the tolerance limit of 3% of transaction price and ALP, then that shall be accepted as ALP.

However, in the instant case, the difference between the transaction price and ALP is greater than 3% of transaction price, i.e. Difference between TP and ALP = Rs. 10,305 – Rs. 9,700 = Rs. 605 and 3% of transaction price. i.e. Difference between TP (Rs. 9,700) = Rs. 291.

According, transfer pricing adjustment is required.

Computation of adjusted total income :

Particulars	**Amt. (Rs.)**
Total income	7,50,000
Add : TP adjustment [(10,305 – 9,700) * 500]	3,02,500
Total Income as determined	10,52,500

(6 MARKS)

ANSWER : 4(A)

Defaults & Consequences

Failure to deduct tax on Rs. 60,000 @ 10% u/s 194J	**Failure to deposit tax of Rs. 13,000**
Interest @ 1% per month for 8 months (Rs. 6,000* 1% * 8m = 480)	Interest @ 1.5% per month for 4 months (Rs. 13,000* 1.5%* 4m = 780)
Therefore, Total Interest payable u/s 201(1A) = 480 + 780 = Rs. 1,260	

(3 MARKS)

ANSWER : 4(B)

Section 206(C)(1F) requires every person, being a seller, who receives any amount as consideration for sale of a motor vehicle of the value exceeding Rs. 10 lakhs, to collect tax from the buyer @ 1% of the sale consideration.

However, this provision applies only in respect of transactions of retail sales and does not apply on sale of motor vehicles by manufacturers to dealers.

Therefore, Zeet Ltd. is not required to collect tax at source from Amin Co. (P) Ltd. on receipt of consideration for sale of motor cars. However, if Amin Co. (P) Ltd. is not a dealer of motor cars but has acquired the same for the purpose of plying cars on hire, Zeet Ltd. is required to collect tax of Rs. 44,000 [Rs. 11,00,000 $\times$ 4 $\times$ 1%] at source at the time of receipt of sale consideration.

Note : Payment of Rs. 66,00,000 [Rs. 1,10,00,000 (-) Rs. 44,00,000]has been made for the remaining 7 motor cars. It is assumed that equal sum of Rs. 9,42,857 [Rs. 66,00,000 $\div$ 7] has been paid in respect of each car. Accordingly, since the consideration for each car does not exceed Rs. 10 lakh, no tax has to be collected at source at the time of receipt of consideration on sale of these cars.

(3 MARKS)

ANSWER : 4(C)

Answer	Reason
Tax Evasion	An air conditioner fitted at the residence of a director as per the terms of his appointment would be a furniture qualifying for depreciation@10%, whereas an air conditioner fitted in a factory would be a plant qualifying for a higher depreciation@15%. The wrong treatment unjustifiably increases the amount of depreciation and consequently, reduces profit and consequent tax liability. Treatment of air-conditioner fitted at the residence of a director as a plant fitted at the factory would tantamount to furnishing of false particulars with an attempt to evade tax.

(2 MARKS)

ANSWER : 4(D)

1. XYZ & Co. & C & Co are deemed to be AEs as the condition of one enterprise, being a foreign firm, holding not less than 10% interest in another enterprise, being an Indian firm, is satisfied. Therefore provision of contract R & D services relating to software development by C & Co., an Indian firm, to XYZ & Co. a foreign firm, is an international transaction between AEs, and consequently, the provisions of transfer pricing are attracted in this case.

C & Co. should have declared an operating profit margin of not less than 24% in relation to operating expense, to be covered within the safe harbor rules. However, since C & Co. has declared an operating profit margin of only 28.57% $\left(i.e.\frac{20}{70}\times 100\right)$, the same is in accordance with the circumstances mentioned in Rule 10TD. Hence it should binding on the Income – tax Authorities to accept the transfer price declared by C & Co.

2. ABC Inc., a foreign company, guarantee 15% of the total borrowings of D Ltd. , an Indian company. Since ABC Inc. guarantees not less than 10% of the total borrowings of D Ltd., ABC Inc. and D Ltd. are deemed to be associated enterprises. Therefore, provisions of contract R & D services relating to generic pharmaceutical drug by D Ltd., an Indian company, to ABC Inc., a foreign company, is an International transaction between associated enterprises, and consequently, the provisions of transfer pricing are attracted in this case.

Provision of contract R & D services in relation to generic pharmaceutical drug is an eligible international transaction. Since D Ltd. is providing such services to a non – resident associated enterprise and has exercised a valid option for safe harbor rules, it is an eligible assesse.

Irrespective of the aggregate value of transactions entered into in the P.Y. 2018 – 19, D Ltd. should have declared an operating profit margin of not less than 24% in relation to operating expense, to be covered within the scope of safe harbor rules. In this case, since D Ltd. has declared an operating profit margin of 30% $\left(i.e.\frac{9}{30}\times 100\right)$, the same is in accordance with the circumstance mentioned in Rule 10TD. Hence, the Income – tax Authorities shall accept the transfer price declared by D Ltd. in respect of such international transaction.

The safe harbor rules shall not apply in respect of eligible International transactions entered into with an AE located in a notified jurisdicational area.

(6 MARKS)

ANSWER : 5(A)

Section 264(4)(c) provides that the Commissioner shall not revise an order which has been made the subject of an appeal to the Commissioner (Appeals). This bar remains unaffected by the scope of the appeal to the Commissioner (Appeals).
Therefore, the fact that the relief claimed in the application filed by the assesse under section 264(1) was not the subject matter of appeal to the Commissioner (Appeals) does not alter the position that the order of assessment was the subject of the appeal.

The word 'order' in section 264(4)(c) refers to be order appealed against an not to the relief claimed in appeal. Therefore, the Commissioner has no power to revise any order under section 264, if the order has been made subject to an appeal to the Appellate Tribunal, even if the relief claimed in the revision is different from the relief claimed in the appeal.

It was so held by the Supreme Court in Hindustan Aeronautics Ltd. v. CIT (2000) 243 ITR 808.
In view of this, the Commissioner cannot exercise his powers under section 264 to revise the order of assessment and allow the deduction claimed by Arihant Ltd. in his application.

(4 MARKS)

ANSWER : 5(B)

Notice u/s 142(1)	Notice u/s 143(2)
1. Notice to file ROI/ produce books of accounts/ other information.	1. Notice for making assessment under section 143(3).
2. There is no time limit for issue of this notice	2. This notice shall be served within 6 months from the end of the F.Y. in which the return is filed.
3. This notice can be served irrespective of whether ROI is filed by assesse or not.	3. This notice can be issued only if ROI if filed. Filing of ROI is sine – qua – non for service of this notice.

4. Notice u/s 142(1) and u/s 143(2) can be issued to the assesse simultaneously.
5. **Failure to comply :** Failure to comply with the notice u/s 143(2) shall attract a **penalty of Rs. 10,000** u/s 272(A) (1)(d) as well as best judgment assessment u/s 144.

Notice : As per section 292BB, where an assesse has appeared in any proceedings of co – operated in any enquiry relating to an assessment or reassessment, it shall be deemed that any notice required to be served upon him, has been duly served upon him in time in accordance with the provision of the Act and such assesse shall be precluded from raising any objection in any proceedings or enquiry that the notice was (a) not served upon him or (b) not served upon him in time (c) served upon him in an improper manner. However, the above provision shall not be applicable where the assesse has raised such objection before the completion of such assessment or reassessment, i.e., where a notice is not issued validity, but the assesse appears once in any proceedings, he cannot then plea that the notice was not validly served upon him, unless he raises such objection before completion of assessment.

(4 MARKS)

OR

ANSWER : 5(B)

The issue under consideration is whether interest liability under section 234B would arise in the absence of specific direction for payment of interest in the assessment order. Interest under section 234B is attracted for non – payment of advance tax or shortfall payment of advance tax.

As per the provision of section234B, the moment an assessee who is liable to pay advance tax has failed to pay such tax or where the advance tax paid by the assessee is less than 90% of the assessed tax, the assessee becomes liable to pay simple interest @ 1% per month or part of the month.

Levy of interest under section 234B is automatic when the conditions of section 234B are met and the income – tax computation sheet / form is part of the assessment order. It was so held by the Gauhati High Court in the case of CIT v. Assam Mineral Development Corporation Ltd. (2010) 320 ITR 149.3

The contention of the firm, Bhola & Co., that it could not be fastened with the liability to interest under section 234B in the absence of the direction for payment such interest in the assessment order is, therefore, not valid, assuming that interest under section 234B has been computed for determining the tax liability as per the income – tax, computation sheet annexed to the assessment order. Interest liability under section 234B would arise, even in the absence of specific direction for payment of interest in the assessment order.

(4 MARKS)

ANSWER : 5(C)

The issue under consideration is whether the Settlement Commission can pass an order making addition to the income on the basis of difference in gross profit rate adopted, which was neither an issue in the application nor in the report of the Commissioner of Income – tax.
Section 245D(4) Provides that the Settlement Commission, after examination of records and the report of the Commissioner and after examining such further evidence as may be placed before it or obtained by it, may, in accordance with the provision of the Act, pass such order as it thinks fit.

Further, section 245D(5) provides that the materials brought on record before the settlement Commission shall be considered by the Members of the concerned Bench before passing any order under section 245D(4).

“Consideration” means independent examination of the evidence and material brought on record before the Settlement Commission by the members and application of mind thereto with a view to independently assess the materials and evidence, whether adduced by the applicant of by the Commissioner, and come to a conclusion by themselves.

This view has been upheld in case of Supreme Agro foods P Ltd. v. Income – tax Settlement Commission (2013) 353ITR 385 (P &H)

The Settlement Commission, therefore, has to consider the material brought on record before it and "consideration" means independent examination of the evidence and material on record.
In this case, since the material was available before the settlement Commission and such material has been taken into consideration for returning a finding which is relevant for determining the undisclosed income of the applicant, the addition made on the basis of difference in gross profit rate adopted is justified.

Therefore, **the order of the Settlement Commission is valid**.

(3 MARKS)

ANSWER : 5(D)

(1)	(2)	(3)	(4)	
Non compliance of section	**Penalty under section 271FA**	**Period**	**Quantum of penalty under section 271FA**	
			(2) × (3)	**(Rs.)**
285BA(1)	Rs. 500 per day of continuing default	1.6.2019 to 31.10.2019	153 days × Rs. 500	76,500
285BA(5)	Rs. 1,000 per day of continuing default	1.11.2019 to 15.11.2019	15 days × Rs. 1,000	15,000
				91,500

(3 MARKS)

ANSWER : 6(A)

(a) Section 92D of the Act provides that taxpayers, who have entered into an international or specified domestic transaction, must keep and maintain information and contemporaneous documents as provided under Rule 10D.
(b) The documentation is required to be maintained if the **aggregate value of international transaction exceeds Rs. 1 crore.**
(c) Information and documentation should be contemporaneous and should exist latest by the specified date. i.e. 30th November.
(d) The specified information and document are required to be maintained by the taxpayer for a period of 8 years from the end of the relevant AY.
(e) Fresh documentation need not be maintained separately in respect of each tax year, unless there is any significant change in the nature or terms of international transactions, in the assumptions made. etc.

(4 MARKS)

ANSWER : 6(B)

GAAR may, prima facie, apply, when the following twin conditions are satisfied :

- Main purpose of the arrangement being tax benefit, and
- Existence of tainted benefit.

As per the tax treaty between India and Country "A", there is no tax on capital gains either in the Source country or in Country "A". Consequently, the capital gains arising to Y Pvt. Ltd. is not taxable in India.

The arrangement of routing investment through Country "A' would result in a tax benefit. Since there is no business purpose in incorporating a company Y Pvt. Ltd. (100% subsidiary of YAN Ltd.) in Country "A", it can be said that the main purpose of the arrangement is to obtain a tax benefit.

On the question of whether the arrangement has any tainted element, it is evident that there is no commercial substance in incorporating Y Pvt. Ltd. as it does not have any effect on the business risk of YAN Ltd. or cash flow of YAN Ltd.

Additionally, the fact that all rights of shareholders of Y Pvt. Ltd. (designated as Permitted Transferee) are being exercised by YAN Ltd. instead of Y Pvt. Ltd., indicates that Y Pvt. Ltd. lacks commercial substance.

As the twin conditions of main purpose being tax benefit and existence of a tainted element are satisfied, GAAR may be invoked in this case.

(4 MARKS)

ANSWER : 6(C)

(a) As per section 192, tax is deductible at source by any person who is responsible for paying any income chargeable under the head 'Salaries.' However, under sub – section (2A) of that section, the employee will be entitled to relief under section 89 and consequently he will be required to furnish to the person responsible for making the payment, such particulars in the prescribed form (i.e. form No. 10E). The person responsible for making the payment shall compute the relief and take into account the same while deducting tax at source from salary.

(b) Under Section 194B, the person responsible for paying by way of winnings from any card game and other game in an amount exceeding Rs. 10,000 shall at the time of payment deduct income – tax at 30%. Therefore, tax of Rs. 3 lakh has to be deducted at source from the prize money of Rs. 10 lakh payable to the winner.

(c) Section 194 – I, which governs the deduction of tax at source on payment of rent, exceeding Rs. 1,80,000 per annum is applicable to all taxable entities except individuals and HUFs, who were not subjected to tax audit under section 44AB in the immediately preceding financial year. Section 196, provides exemption in respect of payments made to Government from application of the provisions of tax deduction at source.

Therefore, no tax is required to be deducted at source by State Bank of India from rental payments to the Government.

(d) If the cameraman is an employee of the T.V. Company, the provisions of section 192 will apply. However, if he is a professional, TDS provisions under section 194 – J will apply. Tax at 10% will have to be deducted at the time of credit of Rs. 80,000 or on its payment, whichever is earlier.

(e) Under section 194G, the person responsible for paying to any person stocking, distributing, purchasing or selling lottery tickets shall at the time of credit of the commission or payment thereof, whichever is earlier, amounting to more than Rs. 15,000, deduct income – tax at source @ 5%.

Accordingly, tax @ 5% under section 194G amounting to Rs. 1,100 has to be deducted from commission payment of Rs. 22,000 to the agent of the State Government.

(f) The payment by way of winnings from horse race is governed by section 194BB. Under this section, the person responsible for payment shall, at the time of payment, deduct tax at source @ 30%, if the payment exceeds Rs. 10,000.

Accordingly, tax @ 30% amounting to Rs. 1,50,000 has to be deducted from the winnings of Rs. 5 lakh payable to the winner of the race.

(6 MARKS)