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SUBJECT- DIRECT TAX

Test Code - FNJ 7303

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ANSWER : 1

1. C
2. C
3. D
4. D
5. D
6. D
7. D
8. C
9. B
10. D
11. B
12. C
13. C
14. D
15. D
16. B
17. C
18. C
19. A
20. D

ANSWER : 1

Computation of total income and tax liability of Mr. Gopal for A.Y. 2019-20

Particulars	Rs.	Rs.
Profits and gains from business and profession		
Income from sole proprietary concern in India	75,00,000	
Share of profit from a partnership firm in India of Rs. 25 lakhs, is exempt	Nil	
Business profit	75,00,000	
Less: Business Loss[5] in Country G (CGD 5000 x Rs. 70/CGD)	3,50,000	
		71,50,000
Income from Other Sources		
Agricultural income from tea gardens in Country G, is taxable in India (CGD 45000 x Rs. 70/CGD)		31,50,000

Gross Total Income		**1,03,00,000**
Less: Deductions under Chapter VI-A		
Under section 80C [deposit in PPF]	1,50,000	
Under section 80D	25,000	
[Medi-claim premium paid Rs. 28,000, restricted to		1,75,000
Total Income		**1,01,25,000**
Tax on total income		
Tax on Rs. 1,01,25,000 [(30% x Rs. 91,25,000) plus Rs. 1,12,500]		28,50,000
Add: Surcharge@15%, since total income exceeds Rs. 1 crore		4,27,500
		32,77,500
Less: Marginal Relief (See Working Note below)		58,750
		32,18,750
Add: HEC@4%		1,28,750
		33,47,500
Average rate of tax in India [i.e., Rs. 33,47,500/Rs. 1,01,25,000 x 100]	33.06%	
Average rate of tax in Country G [i.e., CGD 9000/CGD 45000]	20%	
Doubly taxed income [Rs. 31,50,000 – Rs. 3,50,000]	28,00,000	
Rebate under section 91 on Rs. 28,00,000 @20% (lower of average Indian tax rate and rate of tax in Country G)		5,60,000
Tax payable in India [Rs. 33,47,500 – Rs. 5,60,000]		**27,87,500**

(7 MARKS)

Note: Since Mr. Gopal is resident in India for the P.Y.2018-19, his global income would be subject to tax in India. He is eligible for deduction under section 91 since the following conditions are fulfilled:-

(a) He is a resident in India during the relevant previous year.

(b) Agricultural income accrues or arises to him outside India during that previous year.

(c) Such agricultural income is not deemed to accrue or arise in India during the previous year.

(d) The income in question i.e., agricultural income, has been subjected to income-tax in Country G in his hands and he has paid tax on such income in Country G.

(e) There is no agreement under section 90 for the relief or avoidance of double taxation between India and Country G, where the income has accrued or arisen

Working Note : Computation of Marginal Relief

(A) Tax payable including surcharge on total income of Rs. 1,01,25,000

Rs. 2,50,000 – Rs. 5,00,000@5%	Rs. 12,500	
Rs. 5,00,000 – Rs. 10,00,000@20%	Rs. 1,00,000	
Rs. 10,00,000 – Rs. 1,01,25,000@30%	Rs. 27,37,500	
Total	Rs. 28,50,000	
Add: Surcharge @ 15%	Rs. 4,27,500	Rs. 32,77,500

(B) Tax payable on total income of Rs. 1 crore [(Rs. 12,500 plus Rs. 1,00,000 plus Rs. 27,00,000) plus surcharge@10%] Rs. 30,93,750

(C) Excess tax payable (A)-(B) Rs. 1,83,750

(D) Marginal Relief (Rs. 1,83,750 – Rs. 1,25,000, being the amount of income in excess of Rs. 1,00,00,000) Rs. **58,750**

(7 MARKS)

ANSWER : 2

ANSWER : A

Computation of total income of M/s. HIG for the A.Y. 2019 – 20

Net profit as per profit & loss account		1,50,000
Add : Interest to partners on capital accounts for the period from 1.4.2018 to 30.9.2018 (Rs. 1,00,000 but deduction limited to 6 months only hence 50% thereof is deductible and the balance is added) **[Note(i)]**	50,000	
Interest to partners on current accounts from 1.4.2018 to 31.3.2019 – not authorized by the deed, hence disallowed **[Note(ii)].**	50,000	
100% of Rs. 25,000 paid towards purchase of television sets otherwise than by way of account payee cheque (being stock in trade, hence disallowed) **[Note (vi)]**	25,000	
Difference on account of valuation of closing stock – in – trade at market value (Rs. 65,000 less Rs. 60,000) **[Note (ix)]**	5,000	
Salary paid to working partners considered separately.	2,50,000	3,80,000
		5,30,000
Less : Additional depreciation on new machinery (Rs. 5,00,000 × 20%) = Rs. 1,00,000. Only 50% is allowable as deduction.**[Note (vii)]**		50,000
		4,80,000
Less : Interest received from bank on fixed deposits considered separately		25,000

		4,55,000
Less : Salary to working partners -		
(i) As per limit in section 40(b)		
On first Rs. 3,00,000@ 90%	2,70,000	
On the balance of Rs. 1,55,000@ 60%	93,000	
	3,63,000	
(ii) Salary actually paid	2,50,000	
Deduction allowed being (i) or (ii) whichever is less		2,50,000
		2,05,000
Less : Business loss relating to assessment year 2018 – 19 set off		50,000
Income from business		**1,55,000**
Income from other sources		
Interest received from bank on fixed deposits		25,000
Total Income		**1,80,000**

Explanation for the treatment of various items

(i) Interest to partners authorized by the partnership deed will be allowed as deduction only for the period beginning with the date of the partnership deed and not for any earlier period as per section 40(b)(iv).

Therefore, interest paid to the partners on the balances standing to the credit of their capital accounts from 1.10.2018 alone is eligible for deduction, since the partnership deed was executed only on 1.10.2018. Interest for the period prior to 1.10.2018 is not allowed.

(ii) The partnership deed of 1.10.2018 provides for payment of interest on balances in capital accounts of partners only. As such, the interest paid on the balances standing to the credit of the current accounts of partners is not allowable under section 40(b).

(iii) Since H is a partner in his individual capacity, interest paid to the Hindu Undivided Family of partner H does not attract disallowance under section 40(b)(iv).

(iv) Section 40A(3) provides for disallowances @ 100% of the expenditure incurred otherwise than by an account payee cheque/ account payee bank draft. Since the firm has made payment of Rs. 25,000 towards purchase of television sets by a crossed cheque and not by an account payee cheque, 100% of such expenditure would be disallowed.

(v) Gold jewellery valued at Rs. 30,000 received as gift from a manufacturer for achieving sales target is taxable under section 28(iv), being a benefit arising from business.

(vi) Depreciation on motor car bought and used exclusively for the purposes of business is allowable though not registered in the name of the firm in view of the ratio of the decision of the Supreme Court in Mysore Minerals Ltd.(1999).

(vii) The firm is entitled to additional depreciation @ 20% under section 32(1) (iia) in respect of the new machinery installed for manufacture of pens. Since the new machinery is put to use for less than 180 days during the relevant previous year, the additional depreciation is restricted to 50% of the prescribed rate of 20% i.e. it is restricted to 10%. The balance additional depreciation can be claimed in the immediately succeeding financial year.

(viii) Interest received from bank on fixed deposits made out of surplus funds is assessable under the head 'Income from other sources'. Hence, it is not taken into account for the purpose of computing book profit.

(ix) As per para 24 of ICDS II : Valuation of Inventories, closing stock has to be valued at net realizable value in the case of a dissolved firm. As such, the closing stock – in – trade of the firm has to be valued at the net realizable value.

(x) Net profit shown in the profit and loss account computed in the manner laid down in Chapter IVD as increased by the aggregate amount of the remuneration paid or payable to all the partners constitutes book profit as per Explanation 3 to section 40(b). Carry forward and set off of business loss is covered under Chapter VI. Hence, brought forward business loss relating to the assessment year 2018 – 19 is not considered for calculation of book – profit.

(xi) Section 45(4) is not applicable to the firm for the assessment year 2019 - 20, though the dissolution of the firm took place on 31.3.2019, as there was no transfer by way of distribution of capital assets during the relevant previous year. The distribution of the capital assets took place on 20.4.2019. The capital gains will, therefore, be assessable in the assessment year 2020 – 21.

(10 MARKS)

ANSWER : B

Section 245Q(3) of the Income-tax Act, 1961 provides that an applicant, who has sought for an advance ruling, may withdraw the application within 30 days from the date of the application. Since more than 30 days have elapsed from the date of application by Mr. Sakshat to the Authority for Advance Rulings, he cannot withdraw the application.

However, the Authority for Advance Rulings (AAR*),* in *M.K. Jain AAR No.644 of 2004*, has observed that though section 245Q(3) provides that an application may be withdrawn by the applicant within 30 days from the date of the application, this, however, does not preclude the AAR from permitting withdrawal of the application after the said period with its permission, if the circumstances of the case so justify.

(4 MARKS)

ANSWER : 3

ANSWER : A

(a) The first contention of Mr. Thomas is not correct.

Fourth proviso to section 139(1) requires every resident other than not ordinarily resident, who at any time during the previous year, holds as a beneficial owner or otherwise, any asset (including financial interest in any entity) located outside India ore has signing authority in any account located outside India or is a beneficiary of any asset located outside India, to file a return of income compulsorily whether or not he has income chargeable to tax, Mr. Thomas has a house property in Abu Dhabi and a bank account in the Bank of Abu Dhabi. Therefore, Mr. Thomas has to file his return of income mandatorily for the A.Y. 2019 – 20, even though his total income of Rs. 2,95,000, comprising solely of income from house property and bank interest, is less than the basic exemption limit of Rs. 3,00,000 applicable to a resident senior citizen.

(b) Mr. Thomas's second contention is also not correct.

Income chargeable to tax shall be deemed to have escaped assessment for the purpose of section 147, where a person is found to have any asset (including financial interest in any entity) located outside India. Accordingly, the Assessing Officer can serve a notice under section 148 on such assessee requiring him to furnish a return of income within the specified period, for the purpose of making an assessment, reassessment or re – computation under section 147.

Further, section 149 prescribes an extended time limit of sixteen years for issue of notice under section 148, in case income in relation to such assets located outside India has escaped assessment.

In this case, since Mr. Thomas has a house property located outside India in the P.Y. 2009 – 10, income is deemed to have escaped assessment for A.Y. 2010 – 11, Notice under section 148 issued to Mr. Thomas in April 2019 in respect of A.Y. 2010 – 11 is valid, since the extended time limit of sixteen years from the end of the relevant assessment year has not expired.

(4*2 = 8 MARKS)

ANSWER : B

Venus Inc. is a specified foreign company in relation to Mercury Ltd. Therefore, the condition of Mercury Ltd. holding shares carrying not less than 26% of the voting power in Venus Inc is satisfied. Hence, Venus Inc. and Mercury Ltd. are deemed to be associated enterprises as per section 92A(2). Therefore, provision of data processing services by Mercury Ltd., an Indian company, to Venus Inc., a foreign company, is an international transaction between associated enterprises, and consequently, the provisions of transfer pricing are attracted in this case.

Data processing services with the use of information technology falls within the definition of "information technology enabled services", and is hence, an eligible international transaction. Since Mercury Ltd. is providing data processing services to a non-resident associated enterprise and has exercised a valid option for safe harbour rules, it is an eligible assessee.

Since the aggregate value of transactions entered into in the P.Y.2018-19 exceeds ₹ 100 crore but does not exceed ₹ 200 crore, Mercury Ltd. should have declared an operating profit margin of not less than 18% in relation to operating expense, to be covered within the scope of safe harbour rules. In this case, since Mercury Ltd. has declared an operating profit margin of 20% $\left(\text{i.e.}\frac{16}{80}\times 100\right)$, the same is in accordance with the circumstance mentioned in Rule 10TD. Hence, the income-tax authorities shall accept the transfer price declared by Mercury Ltd in respect of such international transaction.

Therefore, Mercury Ltd. need not make any primary adjustment.

(6 MARKS)

ANSWER : 4

ANSWER : A

1. **First Loan of Rs. 15,000 (Cheque) – No violation :** As the amount of Rs. 15,000 deposited on 01.05.2018 does not exceed Rs. 20,000, there is no violation under any of the clauses of Section 269SS.
2. **Second Loan of Rs. 17,000 (Cash) – Violation :** The second deposit in cash on 04.01.2019 is in violation of Section 269SS, as there is already outstanding deposit of Rs. 15,000 & another cash deposit of Rs. 17,000 would make the aggregate amount of loan to Rs. 32,000, which exceeds the limit of Rs. 20,000. Hence, penalty u/s 271D is attracted, which is equal to the amount of loan taken from Mr. Garib.
3. **First repayment of loan of Rs. 16,500 – Violation :** The repayment on 04.07.2019 is in violation of section 269T, as the aggregate loan amount outstanding along with interest on 04.07.2019 exceeds Rs. 20,000. Hence, penalty u/s 271E is attracted, which is equal to the amounts so repaid, i.e., Rs. 16,500.

4. **Second Repayment of Loans of Rs. 18,500 –** No Violation: The second repayment on 25.01.2020 is not in violation as per sec 269T, as neither the loan amount with interest nor the aggregate loan alongwith interest held by Mr. Amir on 25.01.2020 exceed the limit of Rs. 20,000.
5. **Loan in Joint Names :** If the Loan was taken in joint names of Amir and Aiyashi, it will not make any difference as regards the contraventions of the provisions of Section 269SS and 269T.

(5*1 = 5 MARKS)

ANSWER : B

Section 149 requires issue of notice under section 148 within a period of 6 years from the end of the relevant assessment year, where income escaping assessment exceeds Rs. 1 lakh. Accordingly, in respect of A.Y. 2011 – 12, notice can be issued upto 31.3.2018. Section 150(1) enables issue of notice at any time to give effect to a finding contained in an appellate order. However, this is subject to the provisions of section 150(2), which places a restriction that if on the date of passing of the order which was the subject – matter of appeal, no notice could have been issued, then, such notice cannot be issued by virtue of the enabling provision contained in section 150(1).

In this case, the income was taxable in the A.Y. 2006 – 07 as per the order of the Appellate Tribunal. The six year time limit, in this case, expires on 31.3.2013. Since the original assessment in respect of such income was made on 28.3.2013, the notice issued under section 148 consequent to the Appellate Tribunal order is valid.

Had the assessment order for A.Y. 2011 – 12 been made on 4.4.2013 (instead of 28.3.2013), then the same would have been outside the six year time limit from A.Y. 2006 – 07. Hence, since notice could not have been issued at that point of time, it cannot be now issued invoking the provisions of section 150(1).

(5 MARKS)

ANSWER : C

Under section 268A(1), the CBDT is empowered to issue orders, instructions or directions to the other income-tax authorities, fixing such monetary limits, as it may deem fit, to regulate filing of appeal or application for reference by any income-tax authority.

Under section 268A(2), where an income-tax authority has not filed any appeal or application for reference on any issue in the case of an assessee for any assessment year, due to above-mentioned order/instruction/direction of the CBDT, such authority shall not be precluded from filing an appeal or application for reference on the same issue in the case of the same assessee for any other assessment year or any other assessee for the same or any other assessment year. Further, in such a case, it shall not be lawful for an assessee to contend that the income-tax authority has acquiesced in the decision on the disputed issue by not filing an appeal or application for reference in any case.

In view of above provision, it would be in order for the Income-tax Department to move an appeal to the Tribunal against the orders of the CIT(A) in respect of A.Y. 2019-20 both for Bela and Tara.

(4 MARKS)

ANSWER : 5

ANSWER : A

Computation of gross total income of Ms. Janaki for A.Y. 2019 – 20

Particulars		Amounts (Rs.)	
I. Salaries :			
Salary as computed			48,000
II. Income from House property :			
- House 1 income		37,000	
- House 2 Loss		(27,000)	10,000
III. Profits and gains of business or profession			
(i) Textile business loss		(20,000)	
(ii) Chemical business – Bad debts recovered taxable u/s 41(4)	40,000		
Less : set off of brought forward Loss of P.Y. 2016 – 17 u/s 72	(25,000)	15,000	
		(5,000)	
(iii) Leather business income	62,000		
(iv) Interest on securities held as stock – in – trade	10,000	72,000	
		67,000	
Less: b/f loss of business Rs. 80,000 restricted to Rs. 67,000 **(Note I)**		(67,000)	NIL
Total			**58,000**
Less : Unabsorbed depreciation loss of Rs. 15,000 restricted to Rs. 10,000 **(Note ii)**			(10,000)
Gross total Income			**48,000**

Note :

(i) The unabsorbed loss of Rs. 13,000 (Rs. 80,000 – Rs. 67,000) of Textile business can be carried forward to A.Y. 2020 – 21 for set off u/s 72, even though the business is discontinued. It is eligible to be carried forward up to A.Y. 2024 – 25.

(ii) The unabsorbed depreciation of Rs. 15,000 is eligible for set off against any income other than salary income. Accordingly, a sum of Rs. 10,000 is adjusted against Income from house property. The balance Rs. 5,000 is eligible for carry forward and set off to A.Y. 2020 – 21 for indefinite period of time.

(iii) Recovery of bad debts earlier allowed as deduction is taxable in the previous year in which it is recovered even if the business is discontinued. Further, as per section 41(5) where the business is no longer existing and there is income chargeable to tax under section 41 in respect of that business, any loss not being speculative loss, which arose in that business during the previous year in which it ceased to exist (unabsorbed), shall be set off against the income chargeable to section 41(4), as aforesaid.

(9 MARKS)

ANSWER : B

BEPS Action Plan 6 – Preventing Treaty Abuse requires introduction of Limitation of Benefits (LOB) clause or Principal Purpose Test (PPT) rule or both to protect against treaty shopping. Treaty shopping is a practice by which a resident of a third country takes advantage of beneficial treaty provisions between two countries by establishing a shell or conduit company in one of the two countries, where tax incidence is low.

Given the risk to revenues posed by treaty shopping, countries have committed to ensure a minimum level of protection against treaty shopping (the minimum standard). That commitment will require countries to include in their tax treaties an express statement that their common intention is to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance, including through treaty shopping arrangements.

Accordingly, on 10th May, 2016, India and Mauritius has signed a protocol amending the India-Mauritius tax treaty at Mauritius. In the said treaty, for the first time, it has been provided that gains from the alienation of shares acquired on or after 1.4.2017 in a company which is a resident of India may be taxed in India. The tax rate on such capital gains arising during the period from 1.4.2017-31.3.2019 should, however, not exceed 50% of the tax rate applicable on such capital gains in India. A Limitation of Benefit (LOB) Clause has been introduced which provides that a resident of a Contracting State shall not be entitled to the benefits of 50% of the tax rate applicable in transition period if its affairs are arranged with the primary purpose of taking advantage of concessional rate of tax. Further, a shell or a conduit company claiming to be a resident of a Contracting State shall not be entitled to this benefit. A shell or conduit company has been defined as any legal entity falling within the meaning of resident with negligible or nil business operations or with no real and continuous business activities carried out in that Contracting State.

(5 MARKS)

ANSWER : 6

ANSWER : A

Computation of taxable income of Healthcare Trust for A.Y. 2019-20

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)5 [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 @30%		60,000
(See Note 2 below)		
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
Health and education cess@4%		5,620
Tax payable		**1,46,120**

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, Healthcare Trust accumulated Rs.20,00,000 in the previous year 2012-13 for extension of one of its hospitals for a period of
5 years. Period of accumulation thus expired on 31.3.2018. The assessee has spent Rs.15,00,000 out of accumulated sum of Rs.20,00,000 up to 31.3.2018. Therefore, the unutilised amount of Rs.5,00,000, which is not utilized in the P.Y.2018-19 also, is deemed to be income of the previous year 2018-19 (A.Y. 2019-20).

(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 –

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

Therefore, in this case the exemption would be Rs.1 lakh
The total tax payable by such institution would be

(i) 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

(ii) 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.

(8 MARKS)

ANSWER : B

	Particulars	Amounts (Rs.)
(i)	Section 194H requires deduction of tax at source @ 5% from commission and brokerage payments to a resident. However, no tax is to be deducted at source where the amount of such payment does not exceed Rs. 15,000. In the given case, 'ABC Packaging Ltd.', the consignee, has not remitted the commission of Rs. 50,000 to the consignor 'XYZ Developers' while remitting the sales consideration. Since the retention of commission by the consignee/ agent amounts to constructive payment of the same to him by the consignor / principal, deduction of tax at source is required to be made from the amount of commission (CBDT Circular No. 619, dated 4/12/1991]. Therefore, XYZ Developers has to deduct tax at source on Rs. 50,000 at the rate of 5%.	**2,500**
(ii)	Section 194B provides that the person responsible for paying to any person any income by way of winnings from any lottery or crossword puzzle, card game and any other game of any sort in an amount exceeding Rs. 10,000 shall deduct tax at source @ 30%. However, in case where winnings are wholly in kind, the person responsible for paying shall, before releasing the winnings, ensure that tax, has been paid in respect of the winnings. Where the winnings are wholly in kind, the responsibility case under section 194B is to ensure that tax is paid by the winner of the prize before the prize is released in his favour. This can be done, by collecting from the winner, a sum equal to the tax deductible at source on the winnings in kind and, thus, meeting the liability for TDS, before releasing the winnings. For this purpose, the value of the winnings in kind shall be taken as the cost incurred by the payer in acquiring the said winnings in kind [Circular No. 763, dated 7/2/1998] In the given case, P marketing has released the car without ensuring tax payment of Rs. 1,20,000, being 30% of Rs. 4,00,000 (being the value of car) by Mr. S. P Marketing is therefore liable for penalty under section 271C and prosecution under section 276B **[CIT v Hindustan Lever Ltd. (2014) 361 ITR 1 (Kar)]**	

(6 MARKS)