FINAL – November 2017

PAPER 7: DIRECT TAX LAWS
Test Code: PR 7
Branch (MULTIPLE) Date: 8.10.17
(100 Marks)

Note: ***Question No.1 is compulsory. Candidates are required to answer any five questions from the remaining six questions.***

Question 1

a. Tax consequences in the hands of the business trust and its unit holders

(1) **Interest income of ` 7 crore from LMN Ltd.:** There would be no tax liability in the hands of business trust due to pass-through status enjoyed by it under sub-clause (a) of section 10(23FC) in respect of interest income from LMN Ltd., being the special purpose vehicle. Therefore, LMN Ltd. is not required to deduct tax at source on interest payment to the business trust.

However, the business trust has to deduct tax at source under section 194LBA –

- @10%, on interest component of income distributed to resident unit holders; and
- @5%, on interest component of income distributed to non-corporate non-resident unit holders and foreign companies.

Interest component of income distributed to unit holders is taxable in the hands of the unit holders – @ 5%, in case of unit holders, being non -corporate non-residents or foreign companies; and at normal rates of tax, in case of resident unit holders.

The interest component of income received from the business trust in the hands of each unit-holder would be determined in the proportion of 7/15.05, by virtue of section 115UA(1). **(2 marks)**

(2) **Dividend income of ` 3 crore from LMN Ltd.:** The dividend distributed by the SPV to the business trust is exempt by virtue of section 115-O(7), since the SPV is a specified domestic company in which the business trust has become the holder of whole of the nominal value of equity share capital of the company. Further, there would be no tax liability in the hands of the business trust, due to specific exemption provided under sub-clause (b) of section 10(23FC).

Any distributed income referred to in section 115UA, to the extent it does not comprise of interest [referred to in sub-clause (a) of section 10(23FC)] and rental income from real estate assets owned directly by the business trust [referred to in section 10(23FCA)] received by unit holders, is exempt in their hands under section 10(23FD). Therefore, by virtue of section 10(23FD), there would be no tax liability on the dividend component [referred to in sub-clause (b) of section 10(23FC)] of income distributed to unit holders in their hands. **(2 marks)**

(3) **Short-term capital gains of ` 2 crore on sale of listed shares of LMN Ltd.:** As per section 115UA(2), the business trust is liable to pay tax@15% under section 111A in respect of short-term capital gains on sale of listed shares of special purpose vehicle. There would, however, be no tax liability on the capital gain component of income distributed to unit holders, by virtue of the exemption contained in section 10(23FD). **(2 marks)**

(4) **Short-term capital gains of ` 1 crore on sale of developmental properties:** It is taxable at maximum marginal rate of 35.535% in the hands of the business trust as per section 115UA(2). There would be no tax liability in the hands of the unit holders on the capital gain component of income distributed to them, by virtue of the exemption contained in section 10(23FD).(**1 mark)**

(5) **Interest of ` 5 lakh received in respect of investment in unlisted debentures of real estate companies:** Such interest is taxable@35.535%, being the maximum marginal rate, in the hands of the business trust, as per section 115UA(2)**.** However, there would be no tax

liability in the hands of the unit holders on the interest component of income distributed to them, by virtue of section 10(23FD). **(1 mark)**

(6) **Rental income of ` 2 crore from directly owned real estate assets:** Any income of a business trust, being a REIT, by way of renting or leasing or letting out any real estate asset owned directly by such business trust is exempt in the hands of the trust as per section 10(23FCA).

Where the income by way of rent is credited or paid to a business trust, being a REIT, in respect of any real estate asset held directly by such REIT, no tax is deductible at source under section 194-I.

The distributed income or any part thereof, received by a unit holder from the REIT, which is in the nature of income by way of renting or leasing or letting out any real estate asset owned directly by such REIT is deemed income of the unit holder as per section 115UA(3). The business trust has to deduct tax at source@10% under section 194LBA in case of distribution to a resident unit holder and at rates in force in case of distribution to a non-resident unit holder.

The rental income component received from the business trust in the hands of each unit-holder would be determined in the proportion of 2/15.05, by virtue of section 115UA(1). **(2 marks)**

Notes:

(1) Chapter XII-FA contains the special provisions relating to business trusts. Section 115UA(1) provides that any income distributed by a business trust to its unit holders shall be deemed to be of the same nature and in the same proportion in the hands of the unit holder, as it had been received by, or accrued to the business trust.

(2) Sub-clause (a) of section 10(23FC) exempts any income of a business trust by way of interest received or receivable from a Special Purpose Vehicle (SPV). Thus, the business trust enjoys a pass-through status in respect of interest received or receivable from a SPV.

(3) Sub-clause (b) of section 10(23FC) exempts any income of a business trust by way of dividend received from SPV, being a specified domestic company in which a business trust has become the holder of the whole of the nominal value of equity share capital of the company. Such dividend income is also exempt in the hands of the unit-holder.

(4) SPV means an Indian company in which the business trust holds controlling interest and any specific percentage of shareholding, as may be required by the regulations under which such trust is granted registration [not less than 50% as per the current SEBI (Real Estate Investment Trusts) Regulations, 2014].

Such company should hold not less than 80% of its assets directly in properties and should not invest in other SPVs and should not be engaged in any activity other than holding and developing property and any other activity incidental to such holding or development.

Since LMN Ltd. is an Indian company in which the business trust holds controlling interest and 100% of shareholding, it is a special purpose vehicle. It is presumed that LMN Ltd. fulfills the other conditions specified in the regulations to qualify as an SPV.

(5) The distributed income of the business trust, to the extent it comprises of interest referred to in sub-clause (a) of section 10(23FC) and rental income referred to in section 10(23FCA), is deemed to be the income of the unit holder in the previous year of distribution and subject to tax in the hands of the unit holder in that year. Accordingly, the business trust is required to deduct tax at source on the interest component and rental component of income distributed to its unit holders.

(6) Any distributed income referred to in section 115UA, to the extent it does not comprise of interest referred to in sub-clause (a) of section 10(23FC) and rental income referred to in section 10(23FCA), received by unit holders is exempt in their hands under section 10(23FD).

(7) Section 115UA(2) provides that subject to the provisions of sections 111A and 112, the total income of a business trust shall be chargeable to tax at the maximum marginal rate.

b. As per section 50B, any profits and gains arising from the slump sale effected in the previous year shall be chargeable to income-tax as capital gains arising from the transfer of capital assets and shall be deemed to be the income of the previous year in which the transfer took place.

If the assessee owned and held the undertaking transferred under slump sale for more than 36 months before slump sale, the capital gain shall be deemed to be long-term capital gain. Indexation benefit is not available in case of slump sale as per section 50B(2).

Ascertainment of tax liability of Beta Limited from slump sale of software unit (4 marks)

Particulars	` (in lacs)
Sale consideration for slump sale of Software Unit	520
Less: Cost of acquisition being the net worth of Software Unit	185
Long term capital gains arising on slump sale	335
(The capital gains is long-term as the Software Unit is held for more than 36 months)	
Tax liability on LTCG	
Under section 112@20% on ` 335 lacs	67.00
Add: Surcharge@7%	4.69
	71.69
Add: Education cess@2% and SHEC@1%	2.15
	73.84

Working Note: Computation of net worth of Software Unit (3 marks)

Particulars	` (in lacs)
(1) Book value of non-depreciable assets	
(i) Land (Revaluation not to be considered)	40
(ii) Debtors	110
(iii) Inventories	35
(2) Written down value of depreciable assets under section 43(6) ***(See Note below)***	90
Aggregate value of total assets	275
Less: Current liabilities of software unit	90
Net worth of software unit	185

Note: *For computing net worth, the aggregate value of total assets in the case of depreciable assets shall be the written down value of the block of assets as per section 43(6).*

(b) Tax advice (3 marks)

(i) Transfer of any capital asset by a holding company to its 100% Indian subsidiary company is exempt from capital gains under section 47(iv). Hence, Beta Limited should

try to acquire the remaining 18% equity shares in Theta Limited then make the slump sale in the above said manner, in which case the slump sale shall be exempt from tax. For this exemption, Beta Limited will have to keep such 100% holding in Theta Limited for a period of 8 years from the date of slump sale, otherwise the amount exempt would be deemed to be income chargeable under the head "Capital Gains" of the previous year in which such transfer took place.

(ii) Alternatively, if acquisition of 18% share is not feasible, Beta Limited may think about demerger plan of Software Unit to get benefit of section 47(vib) of the Income-tax Act, 1961.

Question 2

Computation of Total Income of M/s. Popular Tele films for the A.Y.2017-18

Particulars		Rs.	Rs.
Profits and Gains from Business or Profession (12 marks)			
Net Profit as per Profit & Loss A/c			10,00,000
Add: Expenses disallowed or considered separately:			
Interest to partners in excess of 12% (Note 1)		3,00,000	
Disallowance under section 40A(3A) for aggregate cash payment exceeding Rs. 20,000 in a single day **(Note 5)**		33,000	
Provision for gratuity **(Note 8)**		4,50,000	
Partners' Remuneration		30,00,000	
Royalty paid to Partner Ram **(Note 4)**		5,00,000	42,83,000
			52,83,000
Less: Interest on income-tax refund **(Note 9)**			1,20,000
Book Profit			**51,63,000**
Less: Partners' remuneration allowable under section 40(b)(v)			
(i) As per limit prescribed in section 40(b)			
On first Rs. 3,00,000	90%	2,70,000	
On the balance Rs.48,63,000	60%	29,17,800	
		31,87,800	
(ii) Remuneration actually paid or payable (Rs. 30,00,000 to 3 partners) + (Royalty Rs. 5 Lacs to Ram)		35,00,000	
(i) or (ii) whichever is less, is deductible			31,87,800
			19,75,200
Capital Gain (3 marks)			
Short-term capital gain on transfer of land **(Note 10)**			6,00,000
Income from other sources (1 mark)			
Interest on income-tax refund			1,20,000

Gross Total Income		**26,95,200**
Deductions under Chapter VI-A		Nil
Total Income		**26,95,200**

1. As per section 40(b), simple interest at 12% p.a. to partners relating to the period after the date of partnership deed is allowable. Excess interest @ 3% paid from 1st June, 2016 to 31st March, 2017 is to be disallowed. Excess interest of 3% being Rs.15,00,000 x 3/15 = Rs.3,00,000.
2. Even though Mohan is a partner in a representative capacity, he is still a partner. Therefore, remuneration to Mohan should also be subject to the limits prescribed in section 40(b). This view finds support from the decision of the Supreme Court in the case of *Rashik Lal & Co. vs CIT (1998) 229 ITR 458 (SC).*

3. As per *Explanation 1* to section 40(b), where an individual is a partner in a firm in representative capacity, the provisions of section 40(b) shall not apply to any interest payable by the firm to such individual in his personal capacity. Mohan represents his HUF in the firm. However, Mohan gave the loan in his individual capacity. Hence, assuming that the provisions of section 40A(2) do not get attracted in this case, such interest shall be allowed as deduction in full even though the interest rate is more than 12% p.a.
4. It may be noted that the limits specified under section 40(b)(v) are applicabl e in case of payment of salary, bonus, commission, or remuneration, by whatever name called, to a working partner. From a plain reading of the section, it is clear that any remuneration, by whatever name called, paid to a working partner, is subject to th e limits laid down in section 40(b)(v). Therefore, the royalty of Rs. 5 Lacs paid to partner Ram would also be subject to the limits laid down in section 40(b)(v). Hence, the same has to be added back for computing book profits.

5. Section 40A(3A) provides for disallowance of any expenditure for which the aggregate payment made is otherwise than by an account payee cheque or account payee bank draft in a single day to a person exceed a sum of Rs. 20,000. Hence, the payments of Rs. 17,000 and Rs. 16,000 in cash on 1.3.2017 to Asif, a hairdresser, shall be disallowed, since the aggregate payment of Rs. 33,000 exceeds the limit of Rs. 20,000.

6. The payment of bill of the assistant cameraman of Rs. 16,000 and Rs. 18,000 respectively on 1st February and 2nd February is not liable for disallowance under section 40A(3) since the aggregate payment in cash on a single day has not exceeded Rs. 20,000.

7. As per section 40(a)(i), any sum payable to a non -resident shall not be allowed as deduction, if tax has not been deducted at source or after deduction, has not been paid on or before the due date specified under section 139(1). Tax deducted from the amount of remuneration credited to payee's account on 31st March 2017 has to be deposited latest by 31st July 2017/ 30th September, 2017 (as the case may be). The firm has paid the tax on 5th July, 2017 and hence, the remuneration shall be allowed. Since the same is already debited to profit and loss account, no further adjustment is made.

9. As per section 40A(7), any provision made for payment of gratuity to employees on their retirement or on termination of employment for any reason is disallowed. However, gratuity of Rs. 2.50 lacs paid to retired employees is allowable as deduction. Hence, the balance provision of Rs. 4.50 lacs (i.e., Rs. 7 lacs – Rs. 2.50 lacs) is to be disallowed. Interest on income-tax refund is assessable under the head "Income from other sources".

10. Distribution of a capital asset by a firm to its partner on dissolution or otherwise attracts capital gains tax liability as per the provisions of section 45(4) and the fair market value of the asset on the date of transfer is deemed to be the full value of consideration received or accruing as a result of the transfer. The words "or otherwise" includes within its scope, cases of distribution of capital assets on retirement of a partner also. [*CIT vs. A. N .Naik Associates (2004) 265 ITR 346 (Bom.)].* Therefore, distribution of a plot of land on retirement of a partner would attract section 45(4). Rs. 16 lacs, being the fair market value of the plot on the date of transfer, is deemed to be the full value of consideration. Therefore, the capital gain would be Rs. 6 lacs (i.e., Rs. 16 lacs – Rs. 10 lacs).

Question 3

a.

i) As per the provisions of section 194H, a person is liable to deduct tax at source at the time of credit or payment of commission to any resident, whichever is earlier. In the present case, Safe Airways Ltd. correctly deducted tax at source under section 194H from the commission@9% of the minimum fixed commercial price paid to the travel agents, who were allowed to sell the air tickets at any price higher than the minimum fixed commercial price subject to a maximum published price. However, the Assessing Officer contented that the airline company was required to deduct tax at source on the difference between the minimum fixed commercial price and the maximum published price by treating it as "additional special commission" in the hands of the agents. **(1 mark)**

The facts of the case are similar to the case of *CIT v. Qatar Airways (2011) 332 ITR 253,* where the Bombay High Court held that the difference between the maximum published price and the minimum fixed commercial price cannot be taken as "additional special commission" in the hands of the agents. This is because the maximum published price is the maximum price and the airline company has granted permission to the agents to sell the tickets at a price lower than the maximum published price**.** Further, the airline company would have no information about the exact rate at which the tickets were ultimately sold by its agents. In order to deduct tax at source on the difference between actual sale price and minimum fixed commercial price, the exact income in the hands of the agents must be ascertainable by the airline company. However, it is not so ascertainable in this case, since the agents are given discretion to sell the tickets at any rate between the minimum fixed commercial price and the maximum published price. **It would be impracticable and unreasonable to expect the airline company to get a feedback from its numerous agents in respect of the price at which the tickets were sold by them.**

Applying the rationale of the above case to the case on hand, Safe Airways Ltd. is not liable to deduct tax at source under section 194H on the difference between the maximum published price and the minimum fixed commercial price, even though the amount earned by the agent over and above the minimum fixed commercial price is taxable as income in their hands.

Therefore, the contention of the Assessing Officer is not tenable in law. **(2 marks)**

(ii) Section 205 of the Income-tax Act, 1961 provides that where tax is deductible at source under the provisions of Chapter XVII, the assessee shall not be called upon to pay the tax himself to the extent to which tax has been deducted from that income. Section 205, therefore, bars a direct demand being made on an assessee to the extent of tax deducted from the income. The Income -tax Department can recover the tax deducted at source from the tenant and not from Subhash in view of the clear mandate in section 205. **(1 mark)**

The Karnataka High Court has, in *Smt. Anusuya Alva v. DCIT (2005) 278 ITR 206,* ruled that tax deducted at source by the tenant from the rent paid but not remitted to the credit of the Central Government can be recovered only from the tenant and not from the landlord. Therefore, in view of the clear mandate in section 205, the Assessing Officer is not justified in law in calling upon Subhash to pay the said tax.**(2 mark)**

b. The matter relates to the admission or rejection of the application filed before the Authority for Advance Rulings on the ground specified in clause (i) of the first proviso to section 245R(2). The said clause provides 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. **(2 mark)**

In this case, no application had been filed or contention urged by the applicant foreign company, namely Macline Cola Co., before any income-tax authority/Appellate Tribunal/court, raising the question raised in the application filed with AAR. However, one of the Indian companies, namely, Coca Cola Ltd., had raised the question before the Assessing Officer, not on the applicant's behalf or with a view to benefit the applicant, but only to safeguard its own interest, as it had a statutory duty to deduct the proper amount of tax from payments made to the foreign company. Although the question raised pertains to one of the payments made or to be made to the non-resident applicant, it was not one pending determination before any income-tax authority in the applicant's case. **(2 marks)**

Therefore, as held in *Ericsson Telephone Corporation India AB v. CIT (1997) 224 ITR 203 (AAR),* the application filed by the Indian company, Coca Cola Ltd., before the Assessing Officer cannot be treated to have been filed by the foreign company, Macline Cola Co. **(1 mark)**

Hence, the rejection of the application of Macline Cola Co. by the AAR on the ground that the question raised in the application is already pending before an income-tax authority is not justified. **(1 mark)**

c.

(i) As per section 282(1), the service of notice or summon or requisition or order or any other communication under this Act may be made by delivering or transmitting a copy thereof to the person named therein -

- by post or such courier services as approved by the CBDT; or
- in such manner as provided in the Code of Civil Procedure, 1908 for the purposes of service of summons; or
- in the form of any electronic record as provided in Chapter IV of the Information Technology Act, 2000; or
- by any other means of transmission of documents as may be provided by rules made by the CBDT in this behalf. **(2 marks)**

The CBDT is empowered to make rules providing for the addresses (including the address for electronic mail or electronic mail message) to which such communication may be delivered or transmitted to the person named therein.

(ii) The service of notice in the given cases should be on the persons mentioned hereunder:- **(2 marks)**

Person	Notice to be addressed and served on
A dissolved firm	Any person who was a partner (not being a minor) immediately before dissolution.
A deceased person	The legal heirs of the deceased.
A partitioned HUF	Last Manager of the HUF, or, if he is dead, then, all adult members of the erstwhile HUF.

Question 4

a. Any income arising from an international transaction, where two or more "associated enterprises" enter into a mutual agreement or arrangement, shall be computed having regard to arm's length price as per the provisions of Chapter X of the Act.

Section 92A defines an "associated enterprise" and sub- section (2) of this section speaks of the situations when the two enterprises shall be deemed to associated enterprises. Applying the provisions of section 92A(2)(a) to (m) to the given facts, it is clear that "Anush Motors Ltd." is associated with :-

i) Rida Ltd. as per section 92A(2)(a), because this company holds shares carrying more than 26% of the voting power in Anush Motors Ltd.;

ii) Kyoto Ltd. as per section 92A(2)(g), since this company is the sole owner of the technology used by Anush Motors Ltd. in its manufacturing process;

iii) Dorf Ltd. as per section 92A(2)(c), since this company has financed an amount which is more than 51% of the book value of total assets of Anush Motors Ltd**. (3 marks)**

The transactions entered into by Anush Motors Ltd. with different companies are, therefore, to be adjusted accordingly to work out the income chargeable to tax for the A.Y. 2017-18. **(5 marks)**

	Particulars	` (in crores)
Income of Anush Motors Ltd. as computed under Chapter IV-D, prior to adjustments as per Chapter X		300.00
Add:	Difference on account of adjustment in the value of international transactions:	

(i)	Difference in price of car @ $ 200 each for 10,000 cars ($ 200 x 10,000 x 63)	12.60
(ii)	Difference for excess payment of royalty of $ 30,00,000 ($ 30,00,000 x 63) [See Note below]	18.90
(iii)	Difference for excess interest paid on loan of EURO 1000 crores (84*1000*1/100)	840.00
Total Income		**1,171.50**

The difference for excess payment of royalty has been added back presuming that the manufacture of cars by Anush Motors Ltd is wholly dependent on the use of know-how owned by Kyoto Ltd.

***Note**: It is presumed that Anush Motors Ltd. has not entered into an Advance Pricing Agreement or opted to be subject to Safe Harbour Rules.*

iv) 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

i) online advertisement;
ii) any provision for digital advertising space or any other facility or service for the purpose of online advertisement and
iii) any other service as may be notified by the Central Government.

However, equalisation levy shall not be levied-

a. where the non-resident providing the specified services has a permanent establishment in India

b. the aggregate amount of consideration for specified service received or receivable during the previous year does not exceed ` 1 lakh.

c. where the payment for specified service is not for the purposes of carrying out business or profession**(2 marks)**

I) Where PQR Inc. has no permanent establishment in India

In the present case, ABC Ltd. is required to deduct equalisation levy of ` 30,000 i.e., @6% of ` 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. **(1 mark)**

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 ` 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. **(1 mark)**

iv) Under section 44BBA, a sum equal to 5% of the aggregate of the following amount is deemed to be the profits and gains chargeable to tax under the head "Profits and gains of business or profession" in respect of a non-resident, engaged in the business of operation of aircraft -

i) the amount paid or payable, whether in or out of India, to the assessee or to any person on his behalf on account of the carriage of passengers, livestock, mail or goods from any place in India; and

ii) the amount received or deemed to be received in India by or on behalf of the assessee on account of the carriage of passengers, livestock, mail or goods from any place outside India. **(2 marks)**

In the present case, the income chargeable to tax of M/s Global Airlines is as follows**(2 marks)**

Particulars	Fare booked from India to outside India whether received in India or not (`)	Fare booked from New York to Mumbai	
		If received in India (`)	If not received in India (`)
Fare	60,00,000 (1,25,00,000 – 65,00,000)	65,00,000	65,00,000
Deemed income @5% u/s 44BBA	3,00,000 (60,00,000 × 5%)	3,25,000 (65,00,000 × 5%)	Nil

Question 5

a. As per section 245C, 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.

"Case" means any proceeding for assessment which may be pending before an Assessing Officer on the date on which such application is made**.(1 mark)**

A proceeding for assessment or reassessment or recomputation under section 147 is deemed to have commenced from the date of issue of notice under section 148. 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 have not been issued but could have been issued on that date. However, a return of income for such other assessment years should have been furnished under section 139 or in response to notice under section 142. **.(1 mark)**

In the case on hand, M/s A Ltd. has received a notice under section 148 for the A.Y.2013- 14 and also anticipates similar notices for the A.Y.2011-12 and A.Y.2012-13, for which return of income has been furnished. Thus, a proceeding for assessment is pending before an Assessing Officer i.e., the basic condition for approaching Settlement Commission is satisfied. **.(1 mark)**

Moreover, since after examination of the books of account, huge amount of concealed income is also noticed, it is presumed that the second condition that the additional amount of income-tax payable on the income disclosed in the application should exceed ` 10 lakhs has also been satisfied.

Based on these facts, assuming that the necessary conditions are fulfilled, our advice as consultant to M/s A Ltd. would be to approach the Settlement Commission to have his case settled and apply for grant of immunity from penalty and prosecution**.(1 mark)**

b.

- **(i) Case 1 : Where Mr. Rajesh has commenced the business of manufacture of paper on 1.4.2016 (5 marks)**

Mr. Rajesh is eligible for deduction under section 80JJAA since he is subject to tax audit under section 44AB for A.Y.2017-18, as his total turnover from business exceeds ` 1 crore and he has employed "additional employees" during the P.Y.2016-17. Since this is the first year of his new business, emoluments paid or payable to employees employed during this year shall be deemed to be the additional employee cost.

Deemed additional employee cost = ` 22,500 × 12 × 42 **[See Working Note below]** = ` 1,13,40,000

Deduction under section 80JJAA = 30% of ` 1,13,40,000 = ` 34,02,000.

Working Note:

Number of additional employees

Particulars	No. of workmen	
Total number of employees employed during the year		162
Less: Contractual employees employed on 1.8.2016, since they do not participate in recognized provident fund and their total monthly emoluments exceed ` 25,000	55	
Regular employees employed on 1.6.2016, since their total monthly emoluments exceed ` 25,000	37	
Regular employees employed on 1.10.2016 since they have been employed for less than 240 days in the P.Y.2016-17.	28	120
Number of "additional employees"		**42**

Note *- Since contractual employees do not participate in recognized provident fund, they do not qualify as additional employees. In any case, their total monthly emoluments exceed ` 25,000, and hence do not qualify as additional employees . Further, 37 regular employees employed on 1.6.2016 also do not qualify as additional employees since their monthly emoluments exceed ` 25,000. Also, 28 regular employees employed on 1.10.2016 do not qualify as additional employees for the P.Y.2016-17, since they are employed for less than 240 days in that year.*

Therefore, only 42 employees employed on 1.4.2016 qualify as additional employees, and the total emoluments paid or payable to them during the P.Y.2016 - 17 is deemed to be the additional employee cost.

Case 2: Where Mr. Rajesh has commenced the business of manufacture of apparel on 1.4.2016 (3 marks)

Yes, the answer would change, since in the case of an assessee engaged in the business of manufacture of apparel, the requirement of minimum period of employment of 240 days in the previous year to qualify as an additional employee for the purpose of deduction under section 80JJAA has been relaxed due to the seasonal nature of business of manufacture of apparel.

The minimum period of employment required in case of this industry, to qualify as an additional employee
for the purpose of deduction under section 80JJAA, is 150 days. Therefore, the 28 regular employees employed on 1.10.2016 would qualify as "additional employees" and the deemed additional employee cost pertaining to these employees would also be eligible for deduction under section 80JJAA.

Deemed Additional Employee Cost = ` 1,13,40,000 (as calculated in (i) above) + 37,80,000 (28 employees × ` 22,500 × 6 months) = ` 1,51,20,000

Deduction under section 80JJAA = 30% × ` 1,51,20,000 = ` 45,36,000

c.

The deduction under section 80GG will be computed as follows:

i. Actual rent paid *less* 10% of total income

1,44,000 (-) (10 4,60,000) = ` 98,000 (A) 100

(ii) 25% of total income

$$\frac{4,60,000}{100} = ` 1,15,000 \text{ (B)}$$

Amount calculated at ` 5,000 p.m.= ` 60,000 (C)

Deduction allowable (least of A, B and C) = ` 60,000 **(4 marks)**

Question 6

a. The applicant does not have the option to choose the years for which it wants to apply for rollback. The applicant has to either apply for all the four years or not apply at all. However, if the covered international transaction(s) did not exist in a rollback year or there is some disqualification in a rollback year, then the applicant can apply for rollback for less than four years. Accordingly, if the covered international transaction(s) were not in existence during any of the rollback years, the applicant can apply for rollback for the remaining years. Similarly, if in any of the rollback years for the covered international transaction(s), the applicant fails the test of the rollback conditions contained in various provisions, then it would be denied the benefit of rollback for that roll back year. However, for other rollback years, it can still apply for rollback . **(4 marks)**

b.

(i) The statement is **incorrect**. **(2 marks)**

Prior to 1.6.2016, under section 253(2A), the Principal Commissioner or Commissioner may, if he objected to any direction issued by the Dispute Resolution Panel (DRP) under section 144C(5) in pursuance of which the Assessing Officer has passed an order completing the assessment or reassessment, direct the Assessing Officer to appeal to the Appellate Tribunal against such order.

Further, section 253(3A) provided that every appeal under section 253(2A) shall be filed within 60 days of the date on which the order sought to be appealed against is passed by the Assessing Officer in pursuance of the directions of the DRP under section 144C(5).

However, in order to minimise litigation, sub- sections (2A) and (3A) of section 253 have been omitted by the Finance Act, 2016 with effect from 1st June, 2016. Thus, the provision for filing of appeal by the Assessing Officer against the order of the DRP has now been done away with.

(ii) The statement is **incorrect**. **(2 marks)**

Prior to 1.6.2016, section 254(2) provided that the Appellate Tribunal may rectify any mistake apparent from the record in its order at any time within four years from the date of the order.

For bringing in certainty to the order of Appellate Tribunal, section 254(2) has been amended by the Finance Act, 2016 with effect from 1st June, 2016 to provide that the Appellate Tribunal may rectify any mistake apparent from the record in its order at any time within ***six months from the end of the month in which the order was passed***.

c. Computation of tax liability of Anuradha for the A.Y. 2017-18

Particulars		`
Indian Income		6,00,000
Foreign Income		1,00,000
Gross Total Income(1 mark)		**7,00,000**
Less: **Deduction under Chapter VI-A (3 marks)**		
Under section 80C		
Deposit in PPF	1,50,000	
Under section 80CCC		
Contribution to approved Pension Fund of LIC	25,000	
	1,75,000	
Under section 80CCE		
The aggregate deduction under section 80C, 80CCC and 80CCD(1) has to be restricted to ` 1,50,000	1,50,000	
Under section 80D		
Medical insurance premium is allowable as deduction under section 80D. Since she is a resident senior citizen, the deduction is allowable to a maximum of ` 30,000 **(See Note 1)**	30,000	
Medical insurance premium of ` 31,000 paid for mother aged 79 years. Since her mother is non-resident in India, she will not be entitled for the higher deduction of ` 30,000 eligible for a senior citizen, who is resident in India. Hence, the deduction will be restricted to maximum of ` 25,000.	25,000	2,05,000
Total Income		**4,95,000**
Tax on Total Income (4 marks)		

Income-tax (See Note below)		19,500	
Less: Rebate u/s 87A		5,000	
		14,500	
Add: Education cess@2%		290	
Add: SHEC@1%		145	14,935
Average rate of tax in India (i.e. ` 14,935/ ` 4,95,000 × 100)	3.02%		
Average rate of tax in foreign country (i.e. ` 10,000/ ` 1,00,000 ×100)	10%		
Rebate under section 91 on ` 1,00,000 @ 3.02% (lower of average Indian-tax rate or average foreign tax rate)			3,020
Tax payable in India (` 14,935 - ` 3,020)			**11,915**

Notes:

1. Section 80D allows a higher deduction of up to ` 30,000 in respect of the medical premium paid to insure the heath of a senior citizen. Therefore, Anuradha will be allowed deduction of ` 30,000 under section 80D, since she is a resident Indian of the age of 60 years.
2. The basic exemption limit for senior citizens is ` 3,00,000 and the age criterion for qualifying as a "senior citizen" for availing the higher basic exemption limit is 60

years. Accordingly, Anuradha is eligible for the higher basic exemption limit of ` 3,00,000, since she is 60 years old.

3. An assessee shall be allowed deduction under section 91 provided all the following conditions are fulfilled:
   (a) The assessee is a resident in India during the relevant previous year.
   (b) The income accrues or arises to him outside India during that previous year.
   (c) Such income is not deemed to accrue or arise in India during the previous year.
   (d) The income in question has been subjected to income-tax in the foreign country in the hands of the assessee and the assessee has paid tax on such income in the foreign country.
   (e) There is no agreement under section 90 for the relief or avoidance of double taxation between India and the other country where the income has accrued or arisen.

In this case, since all the above conditions are satisfied, Anuradha is eligible for deduction under section 91.

Question 7

a. Computation of "Book Profit" for levy of MAT under section 115JB for A.Y.2017-18

Particulars	`	`
Net Profit as per Statement of Profit and Loss		15,00,000

Add: Net profit to be increased by the following amounts as per *Explanation 1* to section 115JB: **(3 marks)**		
- Provision for the loss of subsidiary	70,000	
- Provision for doubtful debts, being the amount set aside as provision for diminution in the value of any asset	75,000	
- Provision for income-tax Further, as per *Explanation 2* to section 115JB, income-tax shall include, *inter alia*, any interest charged under the Act, therefore, whole of the amount of provision for income-tax including ` 45,000 towards interest payable has to be added]	1,05,000	
- Depreciation	3,60,000	6,10,000
		21,10,000
Less: Net profit to be decreased by the following amounts as per *Explanation 1* to section 115JB: **(3 marks)**		
- Share in income of an AOP as a member *[In a case where AOP has paid tax on its total income at maximum marginal rate, no income-tax is payable by the company, being a member of AOP, in accordance with the provisions of section 86. Therefore, share in income of an AOP on which no income-tax is payable in accordance with the provisions of section 86, would be reduced while computing book profit, since the same has been credited to profit and loss account]*	1,00,000	
- Income from units in UTI *[Income from units in UTI shall be reduced while computing the book profits, since the same is exempt under section 10(35)]*	75,000	
- Depreciation other than depreciation on revaluation of assets (` 3,60,000 – ` 1,50,000)	2,10,000	
- Unabsorbed depreciation or brought forward business loss, whichever is less, as per the books of account. *[Lower of unabsorbed depreciation ` 4,00,000 and brought forward business loss ` 6,00,000 as per books of accounts has to be reduced while computing the book profit]*	4,00,000	7,85,000
Book Profit		**13,25,000**

Computation of MAT liability under section 115JB(2 marks)

Particulars	`
18.50% of book profit	2,45,125
Add: Education cess@2%	4,903

Secondary and higher education cess@1%	2,451
Minimum Alternate Tax liability	2,52,479
MAT liability (rounded off)	2,52,480

Notes:

(1) It is only the specific items mentioned under *Explanation 1* to section 115JB, which can be adjusted from the net profit as per the Statement of Profit and Loss prepared as per the Companies Act for computing book profit for levy of MAT. Since the following items are not specified thereunder, the same cannot be adjusted for computing book profit:

- Interest to financial institution (unpaid before filing of return) and
- Penalty for infraction of law

(2) Provision for gratuity based on actuarial valuation is an ascertained liability *[CIT v. Echjay Forgings (P) Ltd. (2001) 251 ITR 15 (Bom.)]*. Hence, the same should not be added back to compute book profit.

(3) As per proviso to section 115JB(6), the profits from unit established in special economic zone cannot be excluded while computing the book profit, and hence, such income would be liable for MAT.

(4) Long-term capital gains cannot be deducted while computing book profit even if such amount of capital gains is invested in specified assets under section 54EC, since book profit has to be computed by adding/deducting the items mentioned under *Explanation 1* to section 115JB alone. Capital Gains reflected in the statement of profit and loss shall be part of book profit under section 115JB. Capital gains exempted under section 54EC cannot also be excluded for computing book profit. *[CIT v. Veekaylal Investment Co. P. Ltd. (2001) 249 ITR 597 (Bom.) & N J Jose and Co. (P) Ltd. v. ACIT (2010) 321 ITR 132 (Ker.)]*

b.

(a) The first contention of Mr. Thomas is not correct. (2 marks)

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 or 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.2017-18, even though his total income of ` 2,95,000, comprising solely of income from house property and bank interest, is less than the basic exemption limit of ` 3,00,000 applicable to a resident senior citizen.

(b) Mr. Thomas's second contention is also not correct. (2 marks)

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.2007-08, income is deemed to have escaped assessment for A.Y.2008-09. Notice under section 148 issued to Mr. Thomas in April 2017 in respect of A.Y.2008- 09 is valid, since the extended time limit of sixteen years from the end of the relevant assessment year has not expired.

C. Mr. Kishore is deemed to have under-reported his income since he has not filed his return of income and his assessed income exceeds the basic exemption limit of `2,50,000. Hence, penalty under section 270A is leviable in his case.

Computation of penalty leviable under section 270A

Particulars	`	`
Assessment under section 143(3)		
Under-reported income: (2 marks)		
Total income assessed under section 143(3)	21,00,000	
(-) Basic exemption limit	2,50,000	
	18,50,000	
Tax payable on under-reported income as increased by the basic exemption limit [30% of ` 11 lakhs + ` 1,25,000]	4,55,000	
Add: EC & SHEC@3%	13,650	
	4,68,650	
Penalty leviable@50% of tax payable**(2 marks)**		2,34,325

Note *– It is assumed that the under-reported income is not on account of misreporting.*

****