



FINAL CA – May 2018

DIRECT TAXATION

Test Code – F41

Branch: MULTIPLE Date: 28.01.2018

(50 Marks)

compulsory.

Note: All questions are

Question 1 (10 marks)

Computation of Book Profit for levy of MAT under section 115JB for A.Y. 2018 – 19 (7 marks)

Particulars		
Net Profit as per Statement of Profit and Loss		95,00,000
Add: Net profit to be increased by the following amounts as per Explanation 1 no section 115JB:		
<ul style="list-style-type: none"> Provision for the income – tax (including interest of ₹ 50,000) [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 ₹ 50,000 towards interest payable to be added back as per clause (a) of Explanation 1 to section 115JB] 	5,00,000	
<ul style="list-style-type: none"> Depreciation [to be added back as per clause (g) of Explanation 1 to section 115JB] 	4,00,000	
<ul style="list-style-type: none"> Reserves for currency exchange fluctuation [amount carried to any reserves, by whatever name called, to be added back as per clause (b) of Explanation 1 to section 115JB] 	1,30,000	
		10,30,000
		1,05,30,000
Less: Net profit to be decreased by the following amounts as per Explanation 1 to section 115JB:		
<ul style="list-style-type: none"> Dividend received on investment in Indian companies [Dividend income is to be reduced while computing the book profit as per clause (ii) of Explanation 1 to section 115JB, since such dividend is exempt under section 10(34)] 	1,40,000	
<ul style="list-style-type: none"> Net agricultural income [Net agricultural income is to be reduced as per clause (ii) of Explanation 1 to section 115JB, since it is exempt under section 10(1)] 	6,00,000	
<ul style="list-style-type: none"> Royalty received from patents developed and registered in India. [Such royalty is to be reduced while computing book profit as per clause (fig) of Explanation 1 to section 115JB since the name is chargeable to tax under section 115BBF] 	40,00,000	
<ul style="list-style-type: none"> Depreciation other than depreciation on revaluation of assets is to be reduced while computing book profit as per clause (iia) of Explanation 1 to section 115JB [₹ 4,00,000 - ₹ 1,90,000] 	2,10,000	

<ul style="list-style-type: none"> Unabsorbed depreciation or brought forward business loss whatever is less, as per books of accounts. [Lower of unabsorbed depreciation ` 4,10,000 and brought forward business loss ` 60,000 as per books of account is to be reduced while computing book profit as per clause (iii) of Explanation 1 to section 115JB] 	60,000	50,10,000
Book Profit		55,20,000

Computation of Minimum Alternative Tax payable under section 115JB(3 marks)

Particulars	`
18.50% of book profit (` 55, 20.000 x 18.50%)	10,21,200
Add: Education cess@2%	20,424
Secondary and higher education cess@1%	10,212
Minimum Alternative Tax under section 115JB	10,51,836
MAT liability (rounded off)	10,51,840

Notes:

(1) Only the specified items mentioned under Explanation 1 to section 115JB can be added back to 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 in the said Explanation 1, the same cannot be added back for computing book profit:

- a. Sales tax liability
- b. Unpaid interest to financial institutions
- c. Penalty for infraction of law

(2) Long term profit on sale of rural agricultural land is not chargeable to tax under the normal provisions of the Income-tax Act, 1961, since rural agricultural land is not a capital asset as per section 2(14). However, the same cannot be reduced while computing book profit, since no express provision is there under section 115JB to exclude such profits while computing book profit. Therefore, profit on sale of rural agricultural land reflected in the statement of profit and loss shall be part of book profit, though the same is not chargeable to tax as per the normal provisions of the Act, since rural agricultural land is not a capital asset under section 2(14).

Note – An alternative view is possible that the capital gains on sale of rural agricultural land is to be reduced while computing book profit, by considering the same as agricultural income.

(3) No adjustment is required in respect of interest on borrowed capital of ` 1,00,000 payable to Y, not debited to Statement of Profit and Loss, since the net profit as per the Statement of Profit and Loss prepared as per the Companies Act has to be considered and the items specified for exclusion / inclusion under section 115JB alone have to be considered while computing the book profit for levy of MAT.

(4) Depreciation as per Income-tax Act, 1961 is not relevant for computing book profit for levy of MAT.

Question 2 (5 marks) (1 mark each)

- (i) **Issue Involved:** The issue under consideration in this case is whether consideration for supply of software embedded in hardware would tantamount to royalty for attracting deemed accrual of income under section 9 (1)(vi).
- (ii) **Provisions applicable:** As per section 9(1)(vi), income by way of royalty payable by a person who is a resident would be deemed to accrue or arise in India, where the royalty is

payable in respect of any right, property or information used or services utilized for the purposes of a business or profession carried on by such person in India or for the purposes of making or earning any income from any source in India. For this purpose, royalty includes transfer of all or any right for use or right to use a computer software irrespective of the medium through which such right is transferred.

(iii) Analysis: The facts of the case are similar to the facts in case of Alcatel Lucent Canada,

wherein the above issue came up before the Delhi High Court. The Court observed that the software supply is an integral part of GSM mobile telephone system and is used by the cellular operators for providing cellular services to its customers. Where payment is made for

hardware in which the software is embedded and the software does not have independent functional existence, no amount could be attributed as 'royalty' for software in terms of section 9(1)(vi).

(iv) Conclusion: In this case, if it is assumed that the software that was loaded on the hardware and embedded in the system does not have any independent existence, then there could not be any independent use of such software. If it is so assumed, the rationale of the Delhi High Court ruling can be applied to the case in hand. Accordingly, the action of the Assessing Offices in treating the consideration for supply of software embedded in hardware as royalty under section 9(1)(vi) is not correct.

Question 3 (4 marks)

The issue under consideration is whether winnings of prize money on unsold lottery tickets held by the distributor of lottery tickets can be subject to tax at the rate of 30% prescribed under section 115BB. **(1 mark)**

In CIT v. Manjoo and Co., the Kerala High Court observed that the receipt of winnings from lottery by the distributor was not on account of any physical or intellectual effort made by him and therefore cannot be said to be "income earned" by him in business. **(1 mark)**

The unsold lottery tickets cease to be stock-in-trade of the distributor because, after the draw, those tickets are unsalable and have no value except waste paper value and the distributor will get nothing on account of the tickets except any prize winnings ticket if held by him, which, if produced will entitle him for the prize money. **(1 mark)**

Further, winnings from lotteries are assessable under the special provisions of section 115BB, irrespective of the head under which such income falls. Therefore, the Kerala applicable on prize money winnings received by a distributor on unsold lottery tickets held by him. **(1/2 mark)**

Applying the rationale of the Kerala High Court ruling to the case on hand, the Assessing Officer's intention to tax the prize money received by the distributor on unsold lottery tickets held by him at the rate prescribed under section 115BB is justified. **(1/2 mark)**

Question 4 (5 marks)

Most Appropriate Method – According to Section 92C (1), the arm's length price shall be determined having regard to the most appropriate method. The most appropriate method shall be the method which is best suited to the facts and circumstances of each particular transaction, and which provides the most reliable measure of an arm's length price in relation to an international transaction. **(2 marks)**

The most appropriate method shall be selected having regard to the following, namely. **(1/2 mark for each point)**

- (i) The nature and class of the international transactions;
- (ii) The class or classes of associated enterprises entering into the transactions and the functions performed by them taking into consideration assets employed or risk assumed;
- (iii) The availability, coverage and reliability of data necessary for application of the method;
- (iv) The degree of comparability existing between the international transaction and the uncontrolled transaction and between the enterprises entering into such transactions;
- (v) The extent to which reliable and accurate adjustments can be made to account for differences, if any, between the transactions being compared and the enterprises entering into such transactions.
- (vi) The nature, extent and reliability of assumptions required to be made in application of a method.

Question 5 (6 marks)

India has a DTAA with the Foreign Country (4 marks)

Computation of Tax Payable by Ms. Indu for A.Y. 2018 – 19

Particulars		
Income from business in India		3,25,000
Less: Deduction under Chapter VI – A		
<ul style="list-style-type: none"> • Deduction under section 80D in respect of medical premium for her mother to be restricted to ` 25,000. (Ms. Indu would not be entitled for deduction of ` 30,000 even if her mother is 82 years old, since the higher limit of deduction of ` 30,000 is available in respect of an individual who is of the age of 60 years or more and resident in India during the previous year)		25,000
Total Income		3,00,000
Income from business in the foreign country		6,00,000
		9,00,000
Tax on Total Income		
Upto ` 2,50,000		Nil
<ul style="list-style-type: none"> • 2,50,000 to ` 5,00,000 @ 10% 		12,500
<ul style="list-style-type: none"> • 5,00,000 to ` 9,00,000 @ 20% 		80,000
		92,500
Add: Education cess and SHEC @3%		2,775
Tax Payable		95,275
Average tax rate in India (95,275 x 100 / 9,00,000)		10.586%
Tax liability		
As per DTAA with the foreign country, the income earned in foreign country would not be taxable in India, but it has to be included in the total income only for computation of tax rate. Accordingly, Ms. Indu would only be liable to pay tax on income earned in India @ 10.586% and not on the foreign income.		
Indian Income included in total income = ` 3,25,000		
<ul style="list-style-type: none"> • 25,000 = ` 3,00,000. Tax @ 10.586% of ` 3,00,000 (rounded off)		34,405

India has no DTAA with the Foreign Country (2 marks)

Computation of Tax Payable by Ms. Indu for A.Y. 2018 – 19	
Tax on both Foreign and Indian Income (as computed in (i) above)	95,275
Less: Relief under section 91 on foreign income of ` 6,00,000 @ 10.586% [lower of average Indian-tax rate (10.586%) or foreign tax rate (20%)] would be allowed	63,516
Tax Payable	31,759
Tax Payable (rounded off)	31,780

Note: Where India does not have a DTAA with the foreign country, then an assessee shall be allowed relief 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.

Question 6 (4 marks)

By virtue of section 2(42A), for calculating the period for which the shares received upon demerger are held, the period for which shares were held in the demerged company shall be considered.

By virtue of section 49(2C), The cost acquisition of share of resulting company shall be

Cost of acquisition of shares held by the assessee in the demerged company * (net book value of the assets transferred in demerger / net worth of the demerged company immediately before such demerger)

Question 6 (6 marks)

Section 80JJAA states as under:

SECTION 80JJAA: DEDUCTION IN RESPECT OF EMPLOYMENT OF NEW EMPLOYEES

Where the gross total income of an assessee to whom section 4AB applies, includes any profits and gains derived from business, there shall, subject to the conditions, be allowed a deduction of an amount equal to thirty per cent of additional employee cost incurred in the course of such business in the previous year, for three assessment years including the assessment year relevant to the previous year in which such employment is provided.

Note 1: “additional employee cost” means total emoluments paid or payable to additional employees employed during the previous year:

In the first year of a new business, emoluments paid or payable to employees employed during that previous year shall be deemed to be the additional employee cost;

Note 2: “additional employee” means an employee who has been employed during the previous year and whose employment has the effect of increasing the total number of employees employed by the employer as on the last day of the preceding year, but does not include, -

- (a) An employee whose total emoluments are more than twenty – five thousand rupees per month; or
- (b) An employee employed for a period of less than two hundred and forty days during the previous year; or
- (c) An employee who does not participate in the recognised provident fund;

- No deduction under section 80JJAA shall be available in respect of salary paid to

- i. Casual Labour → Since they do not participate in recognized provident fund
- ii. Workmen employed through contractor → since they do not participate in recognized provident fund.
- iii. Skilled Labour employed from 01 - 10 – 2017 → Since employed for less than 240 days. **(3 marks)**

- Deduction under section 80JJAA shall be available for:

Skilled Labour	50 x 12,500 = 6, 25,000	
Semi – Skilled Labour	50 x 6,000 = <u>3, 00,000</u>	
	= <u>9, 25, 000</u>	

Deduction every year i.e. from Assessment Year 2018 – 19 to Assessing Year 2020 – 21
2, 77, 500 **(3 marks)**

Question 7 (10 marks)

Computation of total income and tax liability of PQR LLP for A.Y.2018-19

(under the regular provisions of the Income-tax Act, 1961) (3 marks)

Particulars		
Profits and gains of business or profession		
Unit in SEZ	40,00,000	
Less: Deduction under section 10AA [See Note (1) below]	32,00,000	
Business income of SEZ unit chargeable to tax	8,00,000	8,00,000
Profit from operation of warehousing facility	1,05,00,000	
Less: Deduction under section 35AD [See Note (2) below]	97,50,000	

Business income of warehousing facility chargeable to tax		7,50,000
Total Income		15,50,000
Computation of tax liability (under the normal/regular provisions)		
Tax@30% on `15,50,000		4,65,000
Add: Education cess@2% and SHEC@1%		13,950
Total tax liability		4,78,950

Computation of adjusted total income of PQR LLP for levy of Alternate Minimum Tax (3 marks)

Particulars		
Total Income (as computed above)		15,50,000
Add: Deduction under section 10AA		32,00,000
		<u>47,50,000</u>
Add: Deduction under section 35AD	97,50,000	
Less: Depreciation under section 32		
On building @10% of ` 65 lakhs ₁	6,50,000	91,00,000
Adjusted Total Income		1,38,50,000
Alternate Minimum Tax@18.5%		25,62,250
Add: Surcharge@12% (since adjusted total income > `1 crore)		3,07,470
		<u>28,69,720</u>
Add: Education cess@2% and SHEC@1%		86,092
		<u>29,55,812</u>
Tax liability under section 115JC (rounded off)		29,55,810

Since the regular income-tax payable is less than the alternate minimum tax payable, the adjusted total income shall be deemed to be the total income and tax is leviable @ 18.5% thereof *plus* surcharge@12% and cess@3%. Therefore, the tax liability is ` 29,55,810. **(2 marks)**

AMT Credit to be carried forward under section 115JEE	
Tax liability under section 115JC	29,55,810

Less: Tax liability under the regular provisions of the Income-tax Act, 1961	4,78,950
	24,76,860

Notes:

(1) Deduction under section 10AA in respect of Unit in SEZ =

$$\frac{\text{Export turnover of the Unit in SEZ} \times \text{Profit of the Unit in SEZ}}{\text{Total turnover of the Unit in SEZ}}$$

$$\frac{` 80,00,000}{` 40,00,000 \times \frac{` 80,00,000}{1,00,00,000}} = ` 32,00,000$$

- (a) Weighted deduction@150% of the capital expenditure is available under section 35AD for A.Y.2017-18 in respect of specified business of setting up and operating a warehousing facility for storage of agricultural produce which commences operation on or after 01.04.2012.

Further, the expenditure incurred, wholly and exclusively, for the purposes of such specified business, shall be allowed as deduction (weighted deduction, in this case) during the previous year in which he commences operations of his specified business if the expenditure is incurred prior to the commencement of its operations and the amount is capitalized in the books of account of the assessee on the date of commencement of its operations.

Deduction under section 35AD would, however, not be available on expenditure incurred on acquisition of land.

In this case, since the capital expenditure of ` 65 lakhs (i.e., ` 75 lakhs – ` 10 lakhs, being expenditure on acquisition of land) has been incurred in the F.Y.2015-16 and capitalized in the books of account on 1.4.2016, being the date when the warehouse became operational,

97,50,000, being 150% of ` 65 lakhs would qualify for deduction under section 35AD.

(2 marks)
