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FINAL MAY 2019 EXAM

SUBJECT- DT

Test Code – FNJ 7100

BRANCH - () (Date :)

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Answer 1:

(A)

The provisions containing taxation of IT-enabled business process outsourcing units are not contained in the Income-tax Act, 1961 but are given **in Circular No.5/2004 dated 28.9.2004** issued by CBDT. The provisions are –

A non-resident entity may outsource certain services to a resident Indian entity. If there is **no business connection** between the two, the resident entity may **not be a Permanent Establishment** of the non-resident entity, and the resident entity would have to be assessed to income-tax as a separate entity. In such a case, the **non-resident entity will not be liable under the Income-tax Act, 1961.**

However, it is possible that the non-resident entity **may have a business connection** with the resident Indian entity. In such a case, the **resident Indian entity could be treated as the Permanent Establishment of the non-resident entity.** **(3 marks)**

Since in the given case it is clearly stated that there is no business connection between ABC Ltd. and X Inc., we cannot conclude ABC Ltd. as a Permanent Establishment of X Inc. and assessment of ABC Ltd. will be completed as a separate entity under Income Tax law and X Inc. would not be required to pay tax in India. **(1 mark)**

However, ABC Ltd. would be constituted as a permanent establishment of X Inc. in India if there would be business connection among them and X Inc. would required to pay tax in India in such a scenario. **(1 mark)**

(B)

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

"Specified Service" means

(1) online advertisement;

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

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

However, equalisation levy shall not be levied-

- where the non-resident providing the specified services has a permanent establishment in India and the specified service is effectively connected with such permanent establishment.
- the aggregate amount of consideration for specified service received or receivable during the previous year does not exceed Rs. 1 lakh.
- where the payment for specified service is not for the purposes of carrying out business or profession **(3 marks)**

Where PQR Inc. has no permanent establishment in India

In the present case, equalisation levy @6% is chargeable on the amount of Rs. 5,00,000 received by PQR Inc., a non-resident not having a PE in India from ABC Ltd., an Indian company. Accordingly, ABC Ltd. is required to deduct equalisation levy of Rs. 30,000 i.e., @6% of Rs. 5 lakhs, being the amount paid towards online advertisement services provided by PQR Inc., a non-resident having no permanent establishment in India. Non-deduction of equalisation levy would attract disallowance under section 40(a)(ib) of 100% of the amount paid while computing business income. **(2 marks)**

Answer 2:
(A)

Computation of tax of AOPs is governed by section 167B of the Income-tax Act, 1961. Tax on total income of AOP is computed as follows:

(i) If individual share of a member is known, and the total income of any member, excluding his share from such AOPs, exceeds the basic exemption limit, then the AOPs will pay tax at the maximum marginal rate.

(ii) If individual share of a member is known and no member has total income (excluding his share from AOPs) exceeding the basic exemption limit, then the AOP will pay tax at the rates applicable to an individual.

Section 86 provides for assessment of share in the hands of members of AOPs as follows:

A member's share in the total income of AOPs will be treated as follows:-

(i) If an AOPs has paid tax at the maximum marginal rate or a higher rate, the member's share in the total income of AOPs will not be included in his total income and will be exempt.

(ii) If the AOPs has paid tax at regular rates applicable to an individual, the member's share in the income of AOPs will be included in his total income and he will be allowed rebate at the average rate of tax in respect of such share. **(2 marks)**

Tax Liability of J K Associates, AOPs

(i) As K's income, other than that from the AOPs, exceeds the basic exemption limit, the AOPs shall pay tax at maximum marginal rate of 35.88 % (i.e. 30% plus 15% surcharge plus health and education cess@4%). Thus, the tax payable by AOP = Rs. 6,00,000 x 35.88 % = Rs. 2,15,280. **(1 mark)**

(ii) Since none of the members have income, other than income from the AOPs, exceeding the basic exemption limit, the AOPs would be taxed at the rates applicable to an individual. Therefore, the AOP's tax liability = Rs. 32,500 + Rs. 1,300 = Rs. 33,800.

Tax Liability of J and K

	Particulars		**J** **Rs.**	**K** **Rs.**
(i)	Share of profit from AOP		Exempt	Exempt
	Income from other sources		1,00,000	2,70,000
	Total Income		1,00,000	2,70,000
	Tax liability		NIL	1,000
	Less: Rebate under section 87A		-	1,000
	Total tax payable		NIL	NIL
(ii)	Share of profit from AOP		3,60,000	2,40,000
	Income from other sources		1,00,000	1,20,000
		(A)	4,60,000	3,60,000
	Tax liability		10,500	5,500
	Add: Health and Education cess@4%		420	220
	Total tax payable	(B)	10,920	5,720
	Average rate of tax [B/A x 100]		2.374%	1.589%

Total tax liability	10,920	5,720
Less: Rebate under section 86 read with section 110 in respect of share of profit from AOP (share in AOP x Average rate of tax)	8,546	3,814
Tax liability of members	2,374	1,906
Tax Payable (Rounded off)	2,370	1,900

(3 marks)

(B)

The statement is not correct.

The term 'Advance Ruling' has been defined in section 245N(a) to mean:-

(a) a determination by the Authority in relation to a transaction which has been undertaken or is proposed to be undertaken by a **non-resident applicant**; or

(b) a determination by the Authority in relation to the tax liability of a non-resident arising out of a transaction which has been undertaken or is proposed to be undertaken **by a resident applicant with such non-resident**; or

(c) a determination by the Authority in relation to the tax liability of a resident applicant, arising out of a transaction which has been undertaken or is proposed to be undertaken by such applicant, and such determination shall include the determination of any question of law or of fact specified in the application

(d) A resident in relation to his tax liability arising out of one or more transactions valuing

(e) Rs. 100 crore or more in total which has been undertaken or proposed to be undertaken would be an applicant for this purpose.

(f) a determination or decision by the Authority in respect of an issue relating to computation of total income which is pending before any income-tax authority or the Appellate Tribunal and such determination or decision shall include the determination or decision on any question of law or of fact relating to such computation of total income specified in the application.

(g) a determination or decision by the Authority whether an arrangement, which is proposed to be undertaken by any person being a resident or a non-resident, is an impermissible avoidance arrangement as referred to in Chapter X-A or not. **(4 marks)**

Answer 3:

The amount of capital gains arising to R has to be computed applying the provisions of section 94(7), which provides that where:

(a) any person buys or acquires any securities or unit within a period of three months prior to the record date; and

(b) such person sells or transfers -

(i) such securities within a period of three months after such date; or

(ii) such unit within a period of nine months after such date; and

(c) the dividend or income on such securities or unit received or receivable by such person is exempted,

then the **loss,** if any, arising to him on account of such purchase and sale of securities or unit, **to the extent such loss does not exceed the amount of dividend** or income received or receivable on such securities or unit, shall be **ignored for the purpose of computing his income chargeable to tax".**

For this purpose, "**record date**" means such date as may be fixed by a company for the purpose of

entitlement of the holder of the securities to receive dividend; "securities" includes stocks and shares. **(3 marks)**

Computation of capital gains of Mr. R for the assessment year 2019-20 **(2 marks)**

Particulars	Rs.	Rs.
Long-term capital gain on sale of building		75,000
Less: Short-term capital loss on sale of shares		
700 shares	7,000	
300 shares	7,500	14,500
Taxable long-term capital gains		**60,500**

Computation of capital gain on sale of shares of A Ltd. by Mr. R **(1 marks)**

Date of purchase of shares		30.5.2018
Record date		10.8.2018
Date of sale of shares	30.9.2018	20.12.2018
Number of shares sold	700	300
Sale price per share	Rs. 35	Rs. 25

(1 marks)

Particulars	Rs.	Rs.
Sale consideration	24,500	7,500
Less: Cost of acquisition	35,000	15,000
	10,500	7,500
Less: Dividend income as per section 94(7)[700×Rs.10×50%] [See Note below]	3,500	-
Short-term capital loss on sale of shares	**7,000**	**7,500**

Note:

(1) 700 shares are sold within 3 months after the record date. Hence, as per section 94(7), the related dividend income should be deducted from the loss.

(2) 300 shares having been sold after 3 months of record date, section 94(7) is not attracted. Therefore, the dividend income of Rs. 1,500 [300×Rs.10×50%] should not be deducted. Such dividend is exempt under section 10(34).

(3) Short-term capital loss can be set-off against long-term capital gains as per the provisions of section 74(1)(a). Therefore, short-term capital loss on sale of shares can be set-off against long-term capital gains on sale of building. **(3 marks)**

Answer 4:

(A)

The interest income received by Mr. X, a non-resident, from a notified infrastructure debt fund would be subject to a **concessional tax rate of 5% under section 115A** on the gross amount of such interest income. Therefore, the tax liability of Mr. X in respect of such income would be Rs. 26,000 (being 5% of Rs. 5 lakhs *plus* health and education cess@4%).

Under **section 194LB, tax is deductible @5% (*plus* health and education cess@4%) on interest** paid

by such fund to a non-resident. However, **since X is a resident of a NJA**, tax would be **deductible@30% (*plus* health and education cess@4%)** as per section 94A, and not @5% specified under section 194LB. This is on account of the provisions of section 94A(5), which provides that "**Notwithstanding anything contained in any other provision of this Act,** where a person located in a NJA is entitled to receive any sum or income or amount on which **tax is deductible under Chapter XVII-B,** the **tax shall be deducted at the highest of the following rates**, namely–

(a) at the rate or rates in force;

(b) at the rate specified in the relevant provision of the Act;

(c) at the rate of thirty per cent."

Mr. X can, however, claim refund of excess tax deducted along with interest. **(4 marks)**

(B)

(1) In this case, passive income is 40% of the total income of the company. The passive income consists of, -

(i) 30% income from the transaction where both purchase and sale is from/to associated enterprises; and

(ii) 10% income from interest.

The A Co. satisfies the first requirement of the test of active business outside India. Since no assets or employees of A Co. are in India the other requirements of the test is also satisfied. Therefore, company is engaged in active business outside India. **(3 marks)**

(2) Merely because the POEM of an intermediate holding company is in India, the POEM of its subsidiaries shall not be taken to be in India. Each subsidiary has to be examined separately. As indicated in the facts since B Co., C Co., and D Co. are independently engaged in active business outside India and majority of Board meetings of these companies are also held outside India. The POEM of B Co., C Co., and D Co. shall be presumed to be outside India. **(3 marks)**

Answer 5:

(A)

CIT v. Govindbhai Mamaiya (2014) 367 ITR 498 (SC)

Supreme Court's Observations: The Supreme Court referred to its earlier decision in the case of Meera & Co v. CIT (1997) 224 ITR 635 in which the earlier precedent in the case of CIT v. Indira Balakrishna (1960) 39 ITR 546 (SC) was followed. The Apex Court noted that **"Association of Persons" means an association in which two or more persons join in a common purpose or common action.**

The Supreme Court also referred to its judgment in G. Murugesan & Bros. v. CIT (1973) 4 SCC 211. In that case, it was held that **an association of persons could be formed only when two or more persons voluntarily combined together for certain purposes.**

In this case, the property in question came to the assessees' possession through inheritance i.e., by operation of law. It is not a case where any 'association of persons" was formed by volition

of the parties. Further, even the income earned in the form of interest is not because of any business venture of the three assessees, but is the result of the act of the Government in compulsorily acquiring the said land. Thus, the **basic test to be satisfied for making an assessment in the status of AOP is absent in this case.**

Apex Court's Decision: The Apex Court, accordingly, held that the income from asset inherited by the legal heirs is taxable in their individual hands and not in the status of AOP. **(5 marks)**

(B)

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).

As per **section 9(1)(vi)**, income by way of royalty payable by a person who is a non-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.**

The facts of the case are similar to the facts in CIT v. Alcatel Lucent Canada (2015) 372 ITR 476, 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).

In this case, since **the software that was loaded on the hardware and embedded in the system does not have any independent existence**, there could not be any independent use of such software. Therefore, the rationale of the Delhi High Court ruling can be applied to the case on hand. Accordingly, the action of the Assessing Officer in treating the consideration for supply of software embedded in hardware as royalty under section 9(1)(vi) is **not** correct. **(5 marks)**