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SUBJECT- Direct Tax

Test Code – FNJ 7370

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NOTES: (1) WORKING NOTES SHOULD FORM PART OF ANSWERS.
(2) INTERNAL WORKING NOTES SHOULD ALSO BE CONSIDERED.
(3) NEW QUESTION SHOULD BE ON NEW PAGE

Division A – Multiple Choice Questions

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

Division B – Descriptive Questions

ANSWER -1

Computation of Total Income of Lambda Ltd. for the A.Y. 2020-21

	Particulars	Amount (Rs.)	
I	**Profits and gains of business and profession**		
	Net Profit as per the statement of profit & loss		7,50,00,000
	Add : Items debited but to be considered separately or items of expenditure to be disallowed		
	(a) Depreciation as per Companies Act	52,00,000	
	(b) Provisions for wages payable to workers	-	
	[Since the provision is based on a fair estimate of wages payable with reasonable certainty, the provision is allowable as deduction. ICDS X requires a reliable estimate of the amount of obligation and 'reasonable certainty' for recognition of a provision, which is present in this case.		
	As the provision of Rs. 18 lakhs has been debited to statement of profit and loss, no adjustment is required while		

	computing business income]		
	(e) **Loss due to destruction of machinery by fire.**	17,00,000	
	[Loss of Rs. 17 lakhs due to destruction of machinery caused by fire is not deductible since it is capital in nature.		
	Since the loss has been debited to statement of profit and loss, the same is required to added back while computing business income]		
	(f) Provision for gratuity	1,40,00,000	
	[Provision of Rs. 320 lakhs for gratuity based on actuarial valuation is not allowable as deduction.		
	However, actual gratuity of Rs. 180 lakhs paid is allowable as deduction.		
	Hence, the difference has to be added back to income (Rs. 320 lakh (-) Rs. 180 lakhs]		
	(g) **Purchase of raw cotton at a price higher than the fair market value**	20,00,000	
	[Since the purchase is from a related party, a firm in which majority of the directors of the company are partners, at a price higher than the fair market value, the difference between the purchase price (Rs. 20,000 per bale) and the fair market value (Rs. 18,000 per bale) multiplied by the quantity purchased (1000 bales, i.e., [Rs. 2,000 × 1,000) has to be added back]		
	(h) **Advertisement in souvenir of a political party**	2,30,000	
	[Advertisement charges paid in respect of souvenir published by a political party is not allowable as deduction from business profits of the company. Since, the expenditure has been debited to statement of profit and loss, the same has to be added back while computing business income]		2,31,30,000
			9,81,30,000
	Add : Income taxable but not credited to statement of profit and loss		
	AI(ii) **GST not refunded to customers out of GST refund received from State Govt.**		1,00,000
	[The amount of GST refunded to the company by the Government is a revenue receipt chargeable to tax.		
	Out of the refunded amount of Rs. 3 lakhs, the amount of Rs. 2 lakh stands refunded to customers would not be chargeable to tax.		
	The balance amount of Rs. 1,00,000 lying with the company would be chargeable to tax]		
			9,82,30,000
	Less : Items credited to statement of profit and loss, but not includible in business income / permissible expenditure and allowances		
	(b) **Industrial power tariff concession received from State Government**		
	[Any assistance in the form of, inter alia, concession received from the Central or Statement Government would be treated as income. Since the same has been credited to statement of profit and loss, no adjustment is required]		
	(d) **Dividend received from US Company**	12,00,000	
	[Dividend received from foreign company is taxable under "Income from other sources". Since the same has been credited to the statement of profit and loss, it has to be deducted while computing business income]		
	(e) **Scrap value of machinery**	3,00,000	
	[Scrap value of machinery, being capital in nature, has to be reduced from WDV of machinery. Since the same has been credited to the		

	statement of profit and loss, it has to be deducted while computing business income]		
	(i) Long term capital gains of sale of equity shares	3,00,000	
	[The taxability or otherwise of long term capital gain on sale of equity shares has to be considered while computing income under the head "Capital Gains". Since such capital gains has been credited to statement of profit and loss, the same has to be reduced to arrive at the business income]		
	AI(i) **Depreciation as per Income – tax Rules, 1961**	71,00,000	89,00,000
	Profits and gains from business and profession		**8,93,30,000**
II	**Income from Other Sources**		
	Dividend received from foreign company		12,00,000
	[Dividend received from a foreign company is chargeable to tax under the head" Income from other sources"]		
III	**Capital Gains**		
	Long term capital gain on sale of equity shares		3,00,000
	[Long term capital gains in excess of Rs. 1 lakh (i.e., Rs. 2 lakh, being Rs. 3 lakh – Rs. 1 lakh) on sale of equity shares on which STT is paid at the time of acquisition and sale would be taxable @ 10% u/s 112A, without indexation benefit.]		
	Gross Total Income		**9,08,30,000**
	Less : Deduction under Chapter VI – A		
	Under section 89GGB [Contribution by a company to a registered political party is allowable as deduction, since payment is made otherwise than by cash. Expenditure incurred by an Indian company on advertisement in souvenir published by such political party tantamounts to contribution to such political party.]		2,30,000
	Total Income		**9,06,00,000**

Note – As per section 43(6)(c), for computation of written down value (WDV) of a block of asset at the end of the year, the amount of scrap value received has to be reduced from the value of block of assets at the beginning of the previous year and cost of assets purchased during the year. Depreciation is calculated on the value so arrived of the block of asset as on 31.3.2020. In the question, adjustment (e) states that scrap value of Rs. 3 lakh is received in respect of destroyed machinery and same is credited in the statement of profit and loss. In the additional information, since, depreciation as per Income-tax Rules, 1962 is given, no further adjustment for scrap value is done, presuming that the same has already been reduced to arrive at the value of the block as on 31.3 .2020 and depreciation has been calculated on the said value of the block.

Alternatively, since scrap value has been credited to the statement of profit and loss, it is possible to take a view that the amount of scrap value is not reduced while computing t he value of the assets. In such a case, depreciation allowable would be Rs. 70,55,000 [i.e., Rs. 71,00,000 – Rs. 45,000, being 15% of Rs. 3,00,000]. The business income and total income would be Rs. 8,93,75,000 and Rs. 9,06,45,000, respectively.

(14 MARKS)

ANSWER -2

ANSWER -A

As per section 115TD, the accreted income of "Helpage", a charitable trust, registered under section 12AA which is merged with M/s Medicare (P) Ltd., an entity not entitled for registration under section 12AA, would be chargeable to tax at the rate of 34.944% [30% plus surcharge @12% plus cess@4%].

Computation of accreted income and tax liability in the hands of the Helpage trust arising as a result of merger with M/s. Medicare (P) Ltd.

Particulars	Amount (Rs.)
Aggregate FMV of total assets as on 1.4.2019, being the specified date (date of merger) **[See Working Note 1]**	1,39,10,000
Less: Total liability computed in accordance with the prescribed method of valuation **[See Working Note 2]**	82,00,000
Accreted Income	**57,10,000**
Tax Liability @ 34.944% of Rs. 57,10,000 (rounded off)	**19,95,300**
Working Notes:	
(1) Aggregate fair market value of total assets on the date of merger	
- **Land at Noida, being immovable property, purchased on 1.9.2010**	-
Since the trust was registered only on 1.2.2013 and benefit of section 11 and 12 was available to the trust only from A.Y.2013 -14, relevant to P.Y.2012-13, being the previous year in which the application for registration is made, the value of land purchased in P.Y.2010-11, in respect of which benefit under sections 11 and 12 was not availed, has to be ignored for computing accreted income.	
- Land at Gurgaon, being an immovable property, purchased on 1.9.2013	1,20,00,000
[The fair market value of land would be higher of Rs. 120 lakhs i.e., price that the land would ordinarily fetch if sold in the open market and Rs. 100 lakhs, being stamp duty value as on the specified date, i.e., 1.4.2019]	
- Quoted equity shares of A Ltd. [5,000 x Rs. 310 per share]	15,50,000
[Rs. 310 per share, being the average of the lowest (Rs. 300) and	

highest price (Rs. 320) of such shares on the specified date]	
- Preference shares of B Ltd. [2,000 x Rs. 180 per share]	
[The fair market value which it would fetch if sold in the open market on the specified date i.e. FMV on 1.4.2019]	3,60,000
	1,39,10,000
(2) Total liability	
- Reserves and Surplus Rs. 18 lakhs [not includible]	-
- Corpus Fund of Rs. 12 lakhs [not includible]	-
- Provision for taxation Rs. 8 lakhs [not includible]	-
- Other Liabilities	
[Rs. 120 lakhs - Rs. 18 lakhs - Rs. 12 lakhs - Rs. 8 lakhs]	82,00,000
	82,00,000

(8 MARKS)

ANSWER –B

The following category of individuals will be treated as resident in India only if the period of their stay in India during the relevant previous year is 182 days or more :

(a) Indian citizens, who leave India in any previous year, inter alia, for purposes of employment outside India, or

(b) Indian citizen or person of Indian origin who being outside India, inter alia, in an employment, who comes on a visit to India in any previous year.

(i) Since Poulomi is leaving India for the purpose of employment outside India, she will be treated as resident only if the period of her stay during the previous year amounts to 182 days or more. Therefore, poulomi should leave India on or before 28th September, 2019, in which case, her stay in India during the previous year would be less than 182 days and she would become non – resident for the purpose of taxability in India. In such a case only the income which accrues or arises in India or which is deemed to accrue or India or received or deemed to be received in India shall be taxable.
The income earned by her in Singapore would not be chargeable to tax in India for A.Y. 2020 -21, if she leaves India on or before 28th September, 2019.

(ii) If any part of Poulomi's salary will be credited directly to her bank account in Kolkata then, that part of her salary would be considered as income received in India during the previous year under section 5 and would be chargeable to tax under Income – tax Act, 1961, even if she is a non – resident. Therefore, Poulomi should received her entire salary in Singapore and then remit the required amount to her bank account in Kolkata in which case, the salary earned by her in Singapore would not be subject to tax in India.

(iii) In case Poulomi visits India after taking up employment outside India, she would be covered in the exception provided in (b) above and she will be treated as resident only if

the period of her stay during the relevant previous year amounts to 182 days more or more.

Therefore, when Poulomi comes India on leave, she should stay in India for less than 182 days during the relevant previous year so that her status remains as a non resident for the relevant previous year. Moreover, she should not visit Inida again during the current previous year i.e. P.Y. 2019 – 20.

(3*2 = 6 MARKS)

ANSWER -3

ANSWER –A

(i) Any person, being a bookmaker, who is responsible for paying to any person any income exceeding Rs. 10,000 by way of winnings from horse races is liable to deduct tax @ 30% at the time of payment as per section 194BB

In a case where the book – maker credits such winnings and debits the losses to the individual account of the punter, tax would be deducted on the winnings before set – off of losses. Thereafter, the net amount. i.e. the winnings after deduction of tax and losses, would be paid to the individual.

(ii) Section 194 – IB requires any individual responsible for paying to a resident any income by way of rent exceeding Rs. 50,000 per month shall deduct tax @ 5% of such income at the time of credit or payment of rent for the last month of the previous year, whichever is earlier.

Since Mrs. Preeti, an individual, pays rent exceeding Rs. 50,000 per month in the F.Y. 2019 – 20 to Mr. Santosh, she is liable to deduct tax at source @ 5% of such rent for F.y. 2019 – 20 under section 194 – IB.

Thus, Rs. 7,500 [Rs. 60,000 × 5% × 2.5 month] has to be deducted from rent payable for March, 2020. The rent payable to Mr. Santosh for March, 2020 would be Rs. 52,500.

(iii) Every person, being a seller, who receives any amount as consideration for sale of a motor vehicle of the value exceeding Rs. 10 lakhs, shall collect tax from the buyer @ 1% of the sale consideration as per section 206C(IF).

However, this provision applies only in respect or transactions of retail sales and does not apply to sale of motor vehicles by manufacturers to dealers. Therefore, H Ltd., a manufacturer is not required to collect tax at source from NMP Ltd., the dealer, on receipt of consideration for sale of motor cars.

Hence, the amount payable by MMP Ltd. to H Ltd. is Rs. 1,000 lakhs i.e. Rs. 20 lakhs × 50.

(iv) Every person, who is responsible for paying to a resident any sum by way of fees for professional services exceeding Rs. 30,000 shall deduct tax at source at the rate of 10% at the time of credit to the account of the payee or at the time of payment, whichever is earlier, as per section 194J.

“Professional Service” include services rendered by a person in the course of carrying on medical profession.

The CBDT has, vide Circular No. 8/2009 dated 24.11.2009, clarified that since the services rendered by hospitals to various patients are primarily medical services, TPAs (Third Party Administrator’s) , who are making payment on behalf of insurance companies to hospitals for settlement of medical/

insurance claim etc. under various schemes including cashless schemes are liable to deduct tax at source on all such payments to hospitals.

Thus, AKL Ltd., a TPA is liable to deduct tax of Rs. 50,000, being 10% of Rs. 5,00,000 from the payment made to Kay Hospitals Ltd. Hence, the amount payable by AKL Ltd. to Kay Hospitals Ltd. would be Rs. 4,50,000 [Rs. 5,00,000 – Rs. 50,000]

[4*2 = 8 MARKS]

ANSWER –B

In relation to Article 5 on Permanent Establishment, the UN Model Convention varies from the OECD Model Convention in the following aspects:

(i) As per Article 5(3)(a) of the OECD Model Convention, a building site or construction or installation project constitutes a PE if it lasts more than twelve months. The UN Model Convention is wider as it covers "assembly and installation project" and "supervisory" activities in connection thereto and requires the activity in question to continue only for six months for constituting a PE.

(ii) Article 5(3)(b) of the UN Model Convention makes a specific reference to Service PE which is absent in the OECD Model Convention. Under the UN Model Convention, furnishing of services, including consultancy services, by an enterprise through employees or other personnel engaged by the enterprise for such purpose would constitute a PE, but only if activities of that nature continue within a Contracting State for a period or periods aggregating more than 183 days in any 12 month period commencing or ending in the fiscal year concerned.

In the absence of a Service PE reference in OECD Model Convention, the presence has to be ascertained through general principles under Article 5(1).

(iii) The UN Model Convention has an additional Article 5(6) relating to insurance which is absent in OECD Model Convention. As per this Article in the UN Model Convention, an insurance enterprise of a Contracting State shall, except in regard to re-insurance, be deemed to have a permanent establishment in the other Contracting State if it collects premiums in the territory of that other State or insures risks situated therein through a person.

In the absence of similar Article in the OECD Model Convention, a PE of an insurance Enterprise has to be determined in accordance with provisions of Article 5(1) or 5(2) of the OECD Model Convention.

(3*2 = 6 MARKS)

ANSWER -4

ANSWER -A

(I) Agricultural land is not a capital asset and hence, there would be no tax implications in the hands of the seller, Mr. B.

In the hands of the buyer, Mr. A, the provisions of section 56(2)(x) would be attracted where any property is received without consideration or for inadequate consideration. "Property" means a capital asset, namely, immovable property being land or building or both. In this case, since agricultural land is not a capital asset, it would not fall within the definition of property to attract the provisions of section 56(2)(x). therefore, the provisions of section 56(2)(x) would not be attracted in the hands of Mr. A.

Note : If it is assumed that the agricultural land is an urban agricultural land, the tax implications would be as follows :

Mr. B, the seller, can consider the stamp duty value of Rs. 2.20 lakhs per acre on 10.3.2019, being the date of agreement, as the full value of consideration as per section 50C for computation of capital gains (instead of the stamp duty value of Rs. 3 lakhs per acre on 10.5.2019, being the date of sale), since he has received an advance of Rs. 1 lakh by account payee cheque at the time of entering into an agreement.

In the hands of the buyer, Mr. A, Rs. 2 lakhs would be taxable under section 56(2)(x) as "Income from other sources", by considering the difference between the stamp duty value of Rs. 2.20 lakhs per acre on 10.3.2019 and the actual purchase price of Rs. 2 lakh per acre [(Rs. 2.20 lakhs – Rs. 2 lakhs) × 10 acres].

(4 MARKS)

(ii) Since the questions mentions that B and C are Mr. A's distant relatives, it is assumed that they do not fall within the definition of "relative" under section 56(2)(x).

Since cash gift exceeding Rs. 50,000 in aggregate from non – relatives, B & C, was received, not on the occasion of marriage but on the occasion of Mr. A's 61st birthday, the said sum of Rs. 5 lakhs [i.e., Rs. 4.75 lakhs from B and Rs. 25,000 from C] is taxable under section 56(2)(x) as "Income from Other Sources" in the hands of Mr. A.

(2 MARKS)

(iii) Section 56(2)(x) excludes from its scope, any sum of money received from an individual by a trust created or established solely for the benefit of relative of the individual.

In this case, this exclusion would not apply, since Rs. 2 lakhs was received from Mr. Dileep by a trust created for the benefit of his friend's daughter and not his relative. This, Rs. 2 lakhs would be chargeable to tax in the hands of the trust.

(2 MARKS)

ANSWER –B

(i) Kingston Inc, a foreign company, has advanced loan of Rs. 130 crores to Ganga Ltd., an Indian company, which amounts to 52% of book value of assets of Ganga Ltd. Since the loan advanced by Kingston Inc. is 51% or more of the book value of assets of Ganga Ltd., Kingston Inc. and Ganga Ltd. are deemed to be associated enterprises under the Indian transfer pricing regulations.

The deeming provisions would be attracted even if there is a repayment of loan during the same previous year which brings down the said percentage below 51%.

(ii) Charles plc, a foreign company has the power to appoint 44.44% (4 out of 9) of the directors of an Indian company, Andes Ltd.

Two enterprises would be deemed to be associated enterprises **if more than half of the board of directors** of one enterprise **are appointed by the other enterprise.**

In this case, since Charles plc has the power to appoint only 44.44% (which is less than half) of the directors of an Indian company, Andes Ltd., Charles plc and Andes Ltd. are **not** deemed to be associated enterprises.

(iii) Since Aurubis GmbH, a German company, supplies 90.27% of the raw materials and consumables required by Kaveri Ltd., an Indian company, which is more than the

specified threshold of 90%; and the prices and terms of supply are decided by the German company, the two companies are deemed to be associated enterprises

(3*2 = 6 MARKS)

ANSWER – 5

ANSWER –A

Computation of total income of XYZ Limited for the A.Y. 2020-21

Particulars	Rs.(in lacs)	
Business income before setting-off brought forward losses of ABC Ltd.		140.00
Add: Excess depreciation claimed in the scheme of amalgamation of ABC Limited with XYZ Limited.		
Value at which assets are transferred by ABC Ltd.	150	
WDV in the books of ABC Ltd.	100	
Excess accounted	50	
Excess depreciation claimed in computing taxable income of XYZ Ltd. [Rs. 50 lacs × 15 %] [*Explanation 2* to section 43(6)]		7.50
		147.50
Set-off of brought forward business loss of ABC Ltd. **(See Notes 2 & 4)**		(120.00)
Set-off of unabsorbed depreciation under section 32(2) read with section 72A **(See Notes 2 & 4)**		(18.00)
Set-off of unabsorbed capital expenditure under section 35(1)(iv) read with section 35(4) **(See Note 5)**		(2.00)
Business income		7.50

Notes:

1. It is presumed that the amalgamation is within the meaning of section 72A of the Income- tax Act, 1961.

2. In the case of amalgamation of companies, the unabsorbed losses and unabsorbed depreciation of the amalgamating company shall be deemed to be the loss or unabsorbed depreciation of the amalgamated company for the previous year in which the amalgamation was effected and such business loss and unabsorbed depreciation shall be carried forward and set-off by the amalgamated company for a period of 8 years and indefinitely, respectively.

3. As per section 72A(7), the accumulated loss to be carried forward specifically excludes

loss sustained in a speculative business. Therefore, speculative loss of Rs. 4 lacs of ABC Ltd. cannot be carried forward by XYZ Ltd.

4. Section 72(2) provides that where any allowance or part thereof unabsorbed under section 32(2) (i.e., unabsorbed depreciation) or section 35(4) (i.e., unabsorbed scientific research capital expenditure) is to be carried forward, effect has to be first given to brought forward business losses under section 72.

5. Section 35(4) provides that the provisions of section 32(2) relating to unabsorbed depreciation shall apply in relation to deduction allowable under section 35(1)(iv) in respect of capital expenditure on scientific research related to the business carried on by the assessee. Therefore, unabsorbed capital expenditure on scientific research can be set-off and carried forward in the same manner as unabsorbed depreciation.

6. The restriction contained in section 73 is only regarding set-off of loss computed in respect of speculative business. Such a loss can be set-off only against profits of another speculation business and not non-speculation business. However, there is no restriction under the Income-tax Act, 1961 regarding set-off of normal business losses against speculative income. Therefore, normal business losses can be set-off against profits of a speculative business.

   Consequently, there is no loss or allowance to be carried forward by XYZ Ltd. to the F.Y. 2020-21.

(8 MARKS)

ANSWER –B

Computation of total income of Mr. Anil for A.Y.2020-21

Particulars	Rs.	Rs.
Profits and Gains of Business or Profession		
Income from profession carried on in India	8,50,000	
Less: Business loss in Country N	1,10,000	7,40,000
Income from Other Sources		
Agricultural income in Country N [Not exempt u/s 10(1)]	1,30,000	
Dividend received from a company incorporated in Country N [Not exempt u/s 10(34)]	85,000	
Royalty income from a literary book in Country N (after deducting expenses of Rs. 75,000)	5,50,000	7,65,000
Gross Total Income		**15,05,000**
Less: Deduction under Chapter VIA		
Under section 80QQB – Royalty income of a resident from a literary book2		3,00,000
Total Income		**12,05,000**

Computation of tax liability of Mr. Anil for A.Y.2020-21		
Particulars		**Rs.**
Tax on total income [30% of Rs. 2,05,000 plus Rs. 1,12,500]		1,74,000
Add: Health and education cess @4%		6,960
Tax Liability		1,80,960
Calculation of Rebate under section 91:		
Average rate of tax in India [i.e., Rs. 1,80,960 / Rs. 12,05,000 x 100]	**15.0174%**	
Average rate of tax in Country N	**18%**	
Doubly taxed income pertaining to Country N	**Rs.**	
Agricultural Income	1,30,000	
Royalty Income [Rs. 6,25,000 – Rs. 75,000 (Expenses) – Rs. 3,00,000 (deduction under section 80QQB)] [3]	2,50,000	
Dividend income	85,000	
	4,65,000	
Less: Business Loss set off	1,10,000	
	3,55,000	
Rebate under section 91 on Rs. 3,55,000 @ 15.0174% [being the lower of average Indian tax rate (15.0174%) and foreign tax rate (18%)]		53,312
Tax Payable		**1,27,648**
Tax Payable (Rounded off)		1,27,650

(6 MARKS)

ANSWER – 6

ANSWER –A

As per section 245C, an assesse 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.

A proceeding for assessment or reassessment under section 147 shall be deemed to have commenced –

(a) from the date on which a notice under section 148 is issued for any assessment year;

(b) from the date of issuance of the notice referred to in sub – clause (a), for any other assessment year or assessment years for which a notice under section 148 has not been issued, but such notice could have been issued on such date, if the return of

income for the other assessment year or assessment years has been furnished under section 139 or in response to a notice under section 142.

In the case on hand, M/s A Ltd. has received a notice under section 148 for the A.Y. 2016 – 17 and also anticipates similar notices for the A.Y. 2014 – 15 and A.Y. 2015 – 16, for which return of income has been furnished. Thus, a proceeding for assessment is pending before the Assessing Officer i.e., the basic condition for approaching Settlement Commission is satisfied.

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

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

(4 MARKS)

ANSWER –B

As per section 80-IB(1) read with section 80-IB(9), where the gross total income of an assessee includes any profits and gains derived from, *inter alia*, the business of commercial production of mineral oil, deduction will be allowed at 100% of such profits for a period of seven consecutive assessment years.

The issue under consideration in this case is whether transport subsidy, interest subsidy and power subsidy received from the Government can be treated as profits derived from business or undertaking to qualify for deduction under section 80-IB.

This issue came up before the Supreme Court in *CIT v. Meghalaya Steels Ltd. (2016) 383 ITR 217*, wherein it was observed that an important test to determine whether the profits and gains are derived from business or an undertaking is that there should be a direct nexus between such profits and gains and the undertaking or business. Such nexus should not be only incidental. The profits and gains referred to in section 80-IB has reference to net profit, which can be calculated by deducting from the sale price of an article, all elements of cost which go into manufacturing or selling it. Thus, the profits arrived at after deducting manufacturing costs and selling costs reimbursed to the assessee by the Government, is the profits and gains derived from the business of the assessee.

The Supreme Court observed that section 28(iiib) specifically states that income from cash assistance, by whatever name called, received or receivable by any person against exports under any scheme of the Government of India, will be income chargeable to income-tax under the head “Profits and gains of business or profession”. The Apex Court further observed that if cash assistance received or receivable against exports schemes are being included as income under the head “Profits and gains of business or profession”, subsidies which go to reimbursement of cost in the production of goods of a particular business would also have to be included under the head “Profits and gains of business or profession”, and not under the head “Income from other sources”.

Accordingly, the Supreme Court held that transport subsidy, interest subsidy and power subsidy from Government were revenue receipts which were reimbursed to the assessee for elements of cost relating to manufacture or sale of their products. Therefore, there is a direct nexus between profits and gains of the undertaking or business, and reimbursement of such subsidies. The subsidies were only in order to reimburse, wholly or partially, costs actually incurred by the assessee in the manufacturing and selling of its products.

Applying the rationale of the Supreme Court ruling in the above case, the action of the Assessing Officer in not allowing deduction under section 80-IB in respect of transport subsidy, interest subsidy and power subsidy received by Alpha Ltd. from the Government is not correct.

(4 MARKS)

ANSWER –C

(I) Penalty under section 271C is attracted for failure to deduct tax at source. The penalty would be a sum equal to the amount of tax which such person has failed to deduct. Such penalty can be imposed only by the Joint Commissioner. Therefore, Harish & Associates shall be liable for penalty under section 271C equal to the amount of tax which they have failed to deduct under section 194C from the payments made to the contractors. The penalty would be in addition to the disallowance of 30% of expenditure/payment under section 40(a)(ia).

(II) Section 133(6) empowers the Income-tax authority to require any person to furnish information in relation to such points or matters which will be useful for or relevant to any enquiry or proceeding under the Act. Failure on the part of an assessee to furnish the information in relation to such points or matters as required makes him liable for penalty under section 272A(2) of Rs. 100 for every day during which the failure continues.

Note – In a case where no proceeding is pending, the Income-tax authority can exercise this power only after obtaining the approval of the Principal Director/Director or Principal Commissioner/Commissioner as the case may be. In this case, it is presumed that the Income-tax authority has obtained the approval of the Principal Director/Director or Principal Commissioner/ Commissioner before exercising this power.

(2*2 = 4 MARKS)

ANSWER –D

As per section 278C(1) of the Income-tax Act, 1961, where an offence under the Income-tax Act, 1961 has been committed by a Hindu undivided family (HUF), the karta shall be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly. However, the karta shall not be liable to any punishment if he proves that the offence was committed without his knowledge or that he had exercised all due diligence to prevent the commission of such offence.

As per section 278C(2), where an offence under the Income-tax Act, 1961 has been committed by a HUF and it is proved that the offence has been committed with the consent or connivance of, or is attributable to any neglect on the part of any member of the HUF, such member shall also be deemed to be guilty of that offence and shall be liable to be proceeded against and punished accordingly.

(2 MARKS)