PAPER – 7 : DIRECT TAX LAWS

Question No.1 is compulsory.

*Answer any **five** questions from the remaining **six** questions.*

Working notes should form part of the respective answers.

All questions relate to the Assessment Year 2017-18, unless stated otherwise in the question.

Question 1

(a) *Avimanyu, a resident individual held 25% equity shares in FMC Ltd., an Indian company. The company's paid up share capital as on 31st March, 2016 was ₹ 10,00,000 divided into 1,00,000 equity shares of ₹ 10 each issued at a premium of ₹ 20 each. The shares were allotted to the shareholders on 1st October, 2011.*

The company had gone for buy back of 30% of its shares on 30th April, 2016 as per the provisions of the Companies Act, 2013.

The company paid ₹ 60 per share on buy back.

Explain and compute the tax effect in the hands of FMC Ltd. and Avimanyu in the following situations:

(i) Shares of FMC Ltd. are listed on recognized stock exchange;

(ii) Shares of FMC Ltd. are not listed on any recognized stock exchange.

Cost Inflation Index:

Financial Year	*Cost Inflation Index*
2011-12	*785*
2016-17	*1125*

(10 Marks)

(b) *Mr. Rishabh, an individual aged 56 years, resident in India furnishes the following particulars of income earned in India for the P.Y. 2016-17:*

(i) He has purchased his first residential house during his lifetime for ₹ 60,00,000 (including stamp duty and registration fees of ₹ 1,80,000). The registration and possession of the house was completed during April 2016.

(ii) Loan was taken from his friend in the month of April 2016 for purchase of residential house. Interest and repayment of ₹ 25,000 and ₹ 1,00,000, respectively, were made on the said loan during the year 2016-17.

(iii) Rent received on residential house (mentioned above) during the year ₹ 3,00,000.

The Suggested Answers for Paper 7:- Direct Tax Laws are based on the provisions applicable for A.Y.2017-18, which is the assessment year relevant for November, 2017 examination.

(iv) *Sale of unlisted shares on 17-01-2017, ₹ 3,20,000, the same were purchased on 09-01-2015 for ₹ 3,00,000.*

(v) *He sold a plot of land for ₹ 70,00,000 at market value on 05-06-2016. This plot of land was purchased on 20-05-2013 for ₹ 50,00,000 from his friend. The market value of the plot was ₹ 55,00,000 as per registering authorities at the time of purchase.*

(vi) *Short term capital gain on sale of gold during the year ₹ 20,000.*

(vii) *Brought forward short term capital loss of P.Y. 2015-16, ₹ 30,000 on shares traded on recognized stock exchange, on which STT was paid.*

Compute total income of Mr. Rishabh for the A.Y. 2017-18.

Cost Inflation Index are as under:

F.Y.	Index
2013-14	939
2014-15	1024
2015-16	1081
2016-17	1125

(6 Marks)

(c) *X company engaged in developing and exporting software is having two units, namely Unit-A and Unit-B. Unit-A is setup in Special Economic Zone (SEZ) and Unit-B does not fall under section 10AA of the Act. Company furnishes the following information relating to its 3rd year of operation ended on 31-3-2017:*

Items	(Amount in ₹ Lacs)	
	Unit-A	Unit - B
Export Sales	600	780
Domestic Sales	100	220
Duty Draw Back	19	35
Profit on sale of Import Entitlement	12	Nil
Salaries paid	270	160
Other expenses	210	260
Net Profit of the year	251	615

Additional Information:

(i) ***Unit-A****: Expenses of ₹ 12 lacs are disallowable under section 43B and sales proceeds in convertible foreign exchange received in India by 30-9-2016 amounted to ₹ 520 lacs. Export sales of ₹ 600 lacs include freight of ₹ 100 lacs and realization of ₹ 520 lacs includes amount of insurance and freight charges of ₹ 70 lacs.*

(ii) ***Unit-B****: Realisation of export sales in convertible foreign exchange received in India by 30-9-2016 was of ₹ 690 lacs. Expenses charged and are to be disallowed as per section 40A(3) of Act are of ₹ 60 lacs.*

Compute the total income of X Company for the A.Y.2017-18 after claiming deduction under section 10AA. ***(4 Marks)***

Answer

(a) Tax implications on buy back of shares

As per section 46A, in case of buyback of shares, the difference between the value of consideration received by the shareholder and the cost of acquisition of shares would be deemed to be capital gains arising to the shareholder in the year in which such shares were purchased by the company. Accordingly, in this case, **capital gains would arise in the hands of Mr. Avimanyu** in the A.Y.2017-18. Such capital gain will be **long-term capital gains** since the shares have been held for more than 12 months (listed)/24 months (unlisted).

Computation of long-term capital gains

Particulars	₹
Consideration received [₹ 60 × 7,500 shares (25% × 30% ×1,00,000)]	4,50,000
Less: Indexed cost of acquisition of shares [₹30×7,500 shares ×1125/785]	3,22,452
LTCG to be considered	**1,27,548**

(i) Tax treatment in case shares of FMC Ltd. are listed on recognized stock exchange

In the hands of FMC Ltd.

Any payment by a company on purchase of its own shares from a shareholder in accordance with the provisions of the Companies Act will not be treated as dividend in terms of section 2(22).

Therefore, FMC Ltd. shall not be liable to pay dividend distribution tax under section 115-O on payment of ₹18 lakhs on buyback of 30% of its shares.

Moreover, section 115QA does not apply on buy back of shares listed in recognized stock exchange and hence, there would be no tax implication in the hands of the company.

In the hands of Mr. Avimanyu

If the buyback is effected through a recognized stock exchange, and STT is paid on such transaction, then, the entire long-term capital gains would be exempt u/s 10(38). Hence, the tax liability would be Nil.

However, if the buyback is not effected through a recognized stock exchange, then, the long-term capital gains would be taxable@20% (with indexation benefit) or 10%(without indexation benefit) under section 112, whichever is more beneficial to the assessee.

Note *- In such a case, if long-term capital gains is the only source of income of Mr. Avimanyu, the tax liability would be Nil, since the basic exemption limit can be adjusted against long-term capital gains. However, if he has other income and the basic exemption limit has been fully exhausted against such income, then, long-term capital gains would be taxable –*

(i) @20% (plus cess@3%) of Rs.1,27, 548 = ₹ 26,275 ***(or)***

(ii) @10% (plus cess@3%) of Rs.2,25,000 [₹ 4,50,000 – ₹ 2,25,000] = ₹ 23,175

Tax on long-term capital gains would be the lower of (i) and (ii) = ₹ 23,175

(ii) Tax treatment in case shares of FMC Ltd. are not listed on any recognized stock exchange

Particulars	₹
In the hands of FMC Ltd.	
Additional income-tax @23.072% (i.e., 20% plus surcharge@12% *plus* cess@3%) on distributed income of ₹ 9 lakh would be attracted in the hands of FMC Ltd. under section 115QA on buyback of unlisted shares by the company.	₹ 2,07,648
Distributed income	
Consideration paid by FMC Ltd. for buyback of shares (₹ 60 × 30,000 shares)	₹ 18 lakh
Less: Amount received by the company for issue of shares (₹ 30 × 30,000 shares)	₹ 9 lakh
Distributed income	₹ 9 lakh
In the hands of Mr. Avimanyu	
Income arising to Mr. Avimanyu, a shareholder, on account of buyback of unlisted shares by FMC Ltd. [which is subject to additional income tax under section 115QA in the hands of the company] would be exempt in his hands by virtue of section 10(34A).	Nil

(b) Computation of total income of Mr. Rishabh for the A.Y.2017-18

Particulars	₹	₹
Income from house property		
Gross Annual Value[1][Rent received]	3,00,000	
Less: Municipal taxes	-	
Net Annual Value (NAV)	3,00,000	
Less: **Deductions under section 24**		
(a) 30% of NAV	90,000	
(b) Interest on housing loan	25,000	
		1,85,000
Capital Gains		
Short-term capital gain on sale of gold	20,000	
Less: Set-off of brought forward short-term capital loss of P.Y.2015-16 on shares traded in recognised stock exchange as per section 74(1)(a)	20,000	
Taxable short-term capital gain	Nil	
Long-term capital loss on sale of unlisted shares (since held for more than 24 months)		
Sale consideration 3,20,000		
Less: Indexed cost of acquisition [₹ 3,00,000 ×1125/1024] 3,29,590		
	(9,590)	
Long-term capital gains on sale of plot of land (since held for more than 36 months)		
Sale consideration	70,00,000	
Less: Indexed cost of acquisition [₹ 55,00,000 ×1125/939]	65,89,457	
[As per section 49(4), stamp duty value considered for determining income taxable under section 56(2)(vii) for A.Y.2014-15 would be the cost of acquisition for computing capital gains on subsequent sale]		
	4,10,543	

[1] Rent received has been taken as the GAV in the absence of other information

Less: Deduction u/s 54F [For purchase of residential house property within one year before the date of transfer]		
4,10,543 × 60,00,000/70,00,000	3,51,894	
	58,649	
Less: Set-off of long-term capital loss on sale of unlisted shares as per section 70(3)]	(9,590)	
	49,059	
Less: Set-off of balance short-term capital loss of P.Y. 2015-16 (As per section 74(1)(a), brought forward short-term capital loss can be set-off against both long-term capital gain and short-term capital gains)	(10,000)	39,059
Gross Total Income		**2,24,059**
Less: **Deduction under Chapter VI-A**		
Under section 80C [Stamp duty and registration fees of house property], ₹1,80,000, restricted to		1,50,000
Principal repayment of housing loan taken from friend does not qualify for deduction under section 80C		
Total Income		**74,059**
Total Income (rounded off)		**74,060**

(c) Computation of total income of X Company

Particulars	₹ (in lacs)
Profit from Unit A [₹ 251 lacs + ₹ 12 lacs, being disallowance u/s 43B]	263
Profit from Unit B [₹ 615 lacs + ₹ 60 lacs, being disallowance u/s 40A(3)]	675
	938
Less: Exemption under section 10AA [**See Working Note below**]	174
Total Income	**764**

Working Note:

Computation of exemption under section 10AA in respect of Unit A located in a SEZ

Particulars	₹ (in lacs)
Total turnover of Unit A = (₹ 600 lacs + ₹ 100 lacs) – ₹100 lacs, being freight and insurance included therein. Since freight and insurance has been excluded from export turnover, the same has to be excluded from total turnover also [2]	**600**

[2] *CIT v. Dell International Services India P. Ltd. (2012) 206 Taxman 107 (Karnataka)*

Export Turnover of Unit A [See Note for Alternative Answer]		
Sale proceeds received in India		520
Less: Insurance and freight not includible in export turnover		70
		450
Profit "derived from" Unit A		
Net profit for the year		251
Add: Disallowance under section 43B		12
		263
Less: **Items of business income which are in the nature of ancillary profits and hence, do not constitute profit 'derived from' business for the purpose of exemption under section 10AA**		
Duty drawback	19	
Profit on sale of import entitlement	12	
		31
		232
Exemption under section 10AA		
Profit derived from Unit A x $\frac{\text{Export turnover of Unit A}}{\text{Total turnover of Unit A}}$		**174**
= 100% of 232 x 450/600 =		

Note – *In the question, it has been mentioned that in respect of Unit A, out of the export sales of ₹ 600 lacs, sale proceeds received in India by 30.9.2016 amounted to ₹ 520 lacs. The above solution has been worked out considering that ₹ 520 lacs represents the total sales proceeds received in India and hence, constitutes the export turnover after deducting freight received amounting to ₹ 70 lacs included in the said figure. However, it is also possible to assume that the remaining amount of ₹ 80 lacs (₹ 600 lacs – ₹ 520 lacs) was received during the year after 30.9.2016, and accordingly consider the export turnover of ₹ 600 lacs in total after deducting freight of ₹ 100 lakhs included therein. In this case, the export turnover would be ₹ 500 lacs and deduction under section 10AA would be ₹ 193.33 lakhs. The total income of the company, after claiming deduction under section 10AA, would be ₹ 744.67 lacs.*

Question 2

Jupiter Construction Ltd., an Indian company is engaged in the business of executing civil contracts awarded by various companies, Central Government and State Governments in relation to infrastructure facility.

Statement of Profit & Loss for the year ended 31st March, 2017 reveals a net profit (before tax) amounting to ₹ 85,00,000 after debiting/crediting the following items:

(a) *Interest of ₹3,00,000 due to a public financial institution for the last quarter of the financial year 2016-17 paid on 20th October, 2017.*

(b) *₹6,00,000 paid in India to Mr. Philip, a non-resident towards fee for technical services without deduction of tax at source. TDS was, however, paid on 30th October, 2017.*

(c) *Damages amounting to ₹15,00,000 paid to the Government of West Bengal as per the terms of contract for defects found in construction of a flyover after 5 years of its construction.*

(d) *Depreciation charged ₹20,00,000.*

(e) *Marked to market loss amounting to ₹6,00,000 in respect of an unsettled derivative contract. The contract was settled in May, 2017 with a gain of ₹1,00,000.*

(f) *Profit of ₹10,00,000 on sale of land to Neptune Inc., U.S.A. which is a wholly owned subsidiary company.*

(g) *Retention money amounting to ₹10,00,000 held by a public sector undertaking which can be released after expiry of two years on the satisfaction of certain performance criteria as per the terms of contract.*

(h) *₹3,00,000 being interest on fixed deposit made with a bank as margin money for obtaining a guarantee required by a State Government for a particular contract.*

(i) *Dividend of ₹10,00,000 received from a Real Estate Investment Trust (REIT), the break-up of which is as follows*

- *Component of short-term capital gain on sale of development properties by the REIT ₹6,00,000.*
- *Component of rental income from properties owned by the REIT ₹4,00,000.*

Other Information:

(i) *Depreciation as per Income-tax Rules ₹25,00,000.*

(ii) *Land sold to Neptune Inc. was acquired at a cost of ₹30,00,000 in the financial year 2012-13. Value on the date of sale assessed by the Stamp Valuation Authority was ₹50,00,000 (Cost Inflation Index- Financial Year 2012-13 : 852; Financial Year 2016-17 :1125)*

(iii) *The company informs you that till Assessment Year 2016-17 the company did not include retention money in its total income in absence of right to receive such money based on judicial pronouncements, which has also been accepted by the Assessing Officer consistently.*

(iv) *During the year 20 new employees (qualifying as "workman" under the Industrial Disputes Act, 1947) were recruited. All these new employees contribute to recognized provident fund. 15 employees out of 20 employees joined on 1st May, 2016 and the other 5 employees joined in November, 2016. 10 employees, who joined on 1st May, 2016 were offered salary of ₹24,500 per month and the other employees who joined on the same date drew salary of*

₹ 32,000 per month. One employee who joined on 1st May, 2016 at salary of ₹ 24,500 per month drew his salary by bearer cheques of ₹ 12,500 and ₹ 12,000 every fortnight in a month.

(v) The company's accounts are required to be audited under sections 44AB of the Income-tax Act.

Compute total income for the Assessment Year 2017-18 indicating reasons for treatment of each item and ignoring the provisions relating to minimum alternate tax (MAT). The due date for filing of return of income for Assessment Year 2017-18 be taken as 30-09-2017. ***(16 Marks)***

Answer

Computation of Total Income of Jupiter Construction Ltd. for the A.Y.2017-18

	Particulars	Amount (₹)	
I	**Profits and gains of business and profession**		
	Net profit as per the statement of profit and loss	85,00,000	
	Add: **Items debited but to be considered separately or to be disallowed**		
	(a) **Interest to public financial institution paid on 20.10.2017**	3,00,000	
	[Disallowance under section 43B would be attracted for A.Y.2017-18, since the interest is paid after 30.9.2017, being the due date of filing of return]		
	(b) **Fees for technical services paid to non-resident without deduction of tax at source**	6,00,000	
	[Disallowance of 100% of the amount paid towards fees for technical services to a non-resident without deduction of tax at source would be attracted under section 40(a)(i). Tax deducted subsequently was also paid after the due date 30.9.2017]		
	(c) **Damages paid to State Government for defects in construction of flyover**	-	
	[Payment of damages as per the terms of the contract for defects in construction is compensatory in nature and incurred in the normal course of construction business, and hence, such expenditure is deductible under section 37.		
	Since such payment is debited to the statement of profit and loss, no further adjustment is required]		

	(e) **Marked to market losses** [As per ICDS I, marked to market losses cannot be recognized unless the recognition of such loss is in accordance with the provisions of any other ICDS. Since such losses have been debited to the statement of profit and loss, they have to be added back for computing business income]	6,00,000	
		1,00,00,000	
	Less: **Items credited to statement of profit and loss, but not includible in business income**		
	(f) **Profit on sale of land to wholly owned subsidiary** [Income is chargeable to tax under the head "Capital Gains". Since the same has been credited to statement of profit and loss, it has to be reduced while computing business income]	10,00,000	
	(g) **Retention money** [ICDS III requires recognition of contract revenue, including retention money, on percentage of completion method. Since such amount has been credited to the statement of profit and loss, no adjustment is required]	-	
	(h) **Interest on bank fixed deposit** [Since the fixed deposit has been made with a bank as margin money for obtaining a guarantee required by a State Government for a particular contract, interest income of such deposit is inextricably linked to the business of the assessee and hence, has to be treated as business income and not as income from other sources [*CIT v. K and Co. (2014) 364 ITR 93 (Del)]* Since the same has been credited to the statement of profit and loss, no adjustment is required]	Nil	
	(i) **Dividend received from REIT** Short-term capital gain component of ₹ 6 lakhs is taxable in the hands of REIT and hence, exempt in the hands of the unit holder under section 10(23FD). Since ₹ 6 lakhs has been credited to the statement of profit and loss, the same has to be deducted for computing business income	6,00,000	

	Rental component of income distributed by REIT As per section 115UA(3), such income would be deemed as income in the hands unit holder. By virtue of section 115UA(1), income distributed by REIT to a unit holder would be deemed to be of the same nature and same proportion in the hands of the unit holder as it had been received by or accrued to the REIT. Accordingly, rental component of income would be taxable under the head "Profits and gains of business and profession" as per the Supreme Court decision in *Chennai Properties and Investments Ltd. (2015) 373 ITR 673*, since REIT is engaged in the business of letting out real estate properties[3]. Since ₹ 4 lakhs has been credited to the statement of profit and loss, no adjustment is required]	Nil	
		84,00,000	
	***Less:* Permissible deduction**		
	Depreciation Depreciation of ₹ 25 lakh computed as per Income-tax Rules, 1962 is allowable as deduction u/s 32. However, depreciation of ₹ 20 lakh has only been charged in the statement of profit and loss. Therefore, the difference of ₹ 5 lakh has to be deducted for computing business income]	5,00,000	
	Profits and gains from business and profession		79,00,000
II	**Capital Gains**		
	Full value of consideration under section 50C [Higher of Stamp duty value of ₹ 50 lakh and actual consideration of ₹ 40 lakh (i.e., Cost of ₹ 30 lakh + Profit of ₹ 10 lakh)]	50,00,000	
	Less: Indexed Cost of Acquisition [₹ 30,00,000 × 1125/852]	39,61,267	
	***[Note** - Even though Jupiter Construction Ltd. holds 100% of shareholding of Neptune Inc., transfer of land by Jupiter Construction Ltd. to Neptune Inc. would be regarded as a transfer for the purpose of levy of capital gains, since Neptune Inc. is not an Indian company].*		
	Long-term capital gain [Since held for a period of more than 36 months]		**10,38,732**

[3] As per SEBI (REIT) Regulations, 2014, not less than 80% of value of the REIT assets shall be invested in completed and rent generating properties

	Gross Total Income		**89,38,732**
	***Less:* Deduction under Chapter VI-A**		
	Deduction u/s 80JJAA *[See Working Note below]*		7,27,650
	Total Income		**82,11,082**
	Total Income (rounded off)		**82,11,080**

Working Note: Computation of deduction u/s 80JJAA

The asseseee-company is eligible for deduction u/s 80JJAA, **since it has employed "additional employees"** during the year and its accounts are subject to tax audit u/s 44AB.

Total number of employees employed during the year who qualify as "additional employee" [20 employees **(-)** 5 employees, employed for less than 240 days **(–)** 5 employees, whose total monthly emoluments exceed ₹ 25,000]	**10**
Additional employee cost	
Additional employee cost ₹ 24,500 x 10 employees x 11 months	₹ 26,95,000
Less: Employee cost pertaining to one employee who receives salary by bearer cheque (₹ 24,500 × 11)	₹ 2,69,500
Additional employee cost	**₹ 24,25,500**
Deduction u/s 80JJAA is 30% of ₹ 24,25,500	7,27,650

Note: *As per the Supreme Court decision in Sutlej Cotton Mills Ltd. v. CIT (1979)116 ITR 1, marked to market losses arising out of foreign exchange derivative contracts for trading purposes is allowable as deduction. Further, as per judicial decisions, namely, CIT v. Simplex Concrete Piles India (P) Ltd. (1988) 179 ITR 8, CIT v. P & C Constructions (P) Ltd. (2009) 318 ITR 113, Amarshiv Construction (P) Ltd. v. DCIT (2014) 367 ITR 659, retention money does not accrue to the assessee until and unless the defect liability period is over and the Engineer-in-charge certifies that no liability is attached to the assessee. If these judicial interpretations are considered for determining the tax treatment for marked to market losses and retention money, on account of the recent Delhi High Court ruling in The Chamber of Tax Consultants vs. Union of India pronounced on 8.11.2017, the total income would be ₹ 66,11,080.*

Question 3

(a) VKS Ltd. is engaged in developing, operating and maintaining infrastructure facility, which qualifies for deduction under section 80-IA of the Income-tax Act. The company is also engaged in producing cement. Business of the infrastructure facility was commenced in the financial year 2014-15. During the financial years 2014-15, 2015-16 and 2016-17 profits/losses of the two businesses are as follows: ***₹ in lakhs***

Financial Year	*Infrastructure facility*	*Cement manufacturing*
2014-15	*(-) 100*	*120*

2015-16	*60*	*140*
2016-17	*75**	*100*

** includes freight subsidy of ₹ 10 lakhs under the scheme of the Central Government.*

Further Information:

(i) Cement manufacturing unit transferred cement of certain quantity for an aggregate price of ₹ 20 lakhs. Similar quantity was sold to outside customers for ₹ 25 lakhs.

(ii) Profit of infrastructure facility business for financial year 2016-17 has been arrived at after charging purchase of consumable stores amounting to ₹ 10 lakhs from RR Ltd., a subsidiary company of VKS Ltd. as against fair market value of such items amounting to ₹ 7 lakhs.

Compute the amount admissible as deduction under section 80-IA for Assessment Year 2017-18. Give working notes and the reasons in the context of statutory provisions for giving treatment to each of the items. ***(6 Marks)***

(b) Arjun's total income for Assessment Year 2017-18 is ₹ 10 lakhs consisting of salary, capital gain and income from other sources. After considering TDS and advance tax, a sum of ₹ 50,000 towards tax is still payable. Because of various reasons he could not file his return of income within the prescribed time limit. Arjun approaches you for advice on the following issues:

(i) Whether he can file a return of income on 1st December, 2017?

(ii) Whether he will be able to revise his return of income, in case he discovers any omission or mistake in his return filed on 1-12-2017?

(iii) What amount of interest and penalty, he will be subjected to for the defaults, if any, for the relevant assessment year. ***(4 Marks)***

(c) Examine in the context of provisions contained under the Income-tax Act and Rules thereunder whether the Transfer Pricing relating to the International Transactions declared by the assessee who have exercised a valid option for application of safe harbor rules can be accepted by the I.T. Authorities for the A.Y. 2017-18 in the following cases:

(i) Bhisma Ltd. is an Indian company providing services of data processing with the use of Information Technology to YOK Inc. of U.S.A. a foreign subsidiary of the Indian company. Aggregate of the transactions value of services by Bhisma Ltd. to YOK Inc. during the previous year 2016-17 is of ₹ 200 crores having operating margin of ₹ 29 crores and operating expenses of ₹ 150 crores.

(ii) Dhanush Ltd., an Indian company providing services relating to contract of R & D of the Generic Pharmaceutical Drugs to ABC Inc. of UK, a foreign company, which has guaranteed 15% of the total borrowings of the Indian company. Aggregate of the transactions value of services by Dhanush Ltd. to ABC Inc. during the previous year 2016-17 is of ₹ 100 crores having operating margin of ₹ 18 crores and operating expenses of ₹ 60 crores. ***(2 x3 =6 Marks)***

Answer

(a) Computation of amount admissible as deduction u/s 80-IA for A.Y. 2017-18

Particulars	₹ in lakhs	
Net profit of VKS Ltd for A.Y. 2017-18		65
Add: Freight subsidy received		10
[[4]There is a direct nexus between profit and gains of the business and reimbursement of freight subsidy, since reimbursement of a revenue subsidy by the Central Government is towards the elements of cost relating to developing an infrastructure facility. Hence, freight subsidy of ₹10 lakhs received from Central Government is part of the **profits and gains of business "derived from" eligible business** and thus, admissible for deduction under section 80-IA]		
		75
Less: **Difference in price of cement purchased**	5	
[Since cement has been transferred[5] from cement manufacturing unit (non-eligible business) of VKS Ltd to eligible business of Infrastructure facility at ₹ 20 lakhs, which is less than the market value of the cement ₹ 25 lakhs, the profit of infrastructure facility eligible for deduction under section 80-IA shall be computed by deducting ₹ 5 lakh, being the difference between purchase price and fair market value as per section 80-IA(8)]		
Notional loss of ₹ 40 lakhs of F.Y. 2014-15 [See Note for alternate view]	Nil	
Section 80-IA(2) permits an assessee developing, operating and maintaining an infrastructural facility to opt for claiming deduction thereunder for any 10 consecutive assessment years out of 20 years beginning from the year in which the undertaking develops and begins to operate any infrastructure facility. The question is silent as to the year from which VKS Ltd. exercises the option to claim deduction u/s 80-IA.		
Since, in the A.Y.2015-16, it has incurred loss from infrastructure facility, a prudent assessee will not opt A.Y.2015-16 as the initial assessment year for claiming deduction u/s 80-IA. Therefore, it is logical to assume that VKS Ltd. opts for deduction under section 80-IA from A.Y.2016-17 or A.Y.2017-18, since it has incurred losses in the first year of operations i.e., A.Y.2015-16. If it is so assumed, notional loss of ₹ 40 lakhs of A.Y.2015-16 should not be reduced.		
		5
		70

[4] *Circular No. 39/2016, dated 29-11-2016*

[5] It is assumed that the transfer of cement at less than FMV was made during the P.Y.2016-17

Add:	Purchase of consumable stores at a price higher than the fair market value [The difference between the purchase price ₹ 10 lakhs and the fair market value ₹ 7 lakhs has to be added back since the purchase is from a related party RR Ltd, a company in which VKS Ltd has substantial interest, at a price higher than the fair market value. Specific disallowances, related to the business activity against which the Chapter VI-A deduction has been claimed, result in enhancement of the profits of the eligible business. Deduction under Chapter VI-A is admissible on the profits so enhanced on account of such disallowance[6].]		3
Profit eligible for deduction under section 80-IA for A.Y. 2017-18			**73**
100% of ₹ 73 lakhs is allowed as deduction u/s 80-IA for A.Y. 2017-18			

Note – *Where it is assumed that A.Y.2015-16 is the initial assessment year, then, the provisions of section 70(1) and section 80-IA(5) would come into play. As per section 70(1), an assessee is entitled to set off the losses from one source against income from another source under the same head of income. Therefore, in A.Y. 2015-16, VKS Ltd. is entitled to set off the losses of ₹ 100 lakhs of eligible business of Infrastructure facility unit against income of ₹ 120 lakhs of non-eligible Cement manufacturing unit.*

However, once set-off is allowed under section 70(1) against income from another source under the same head, a deduction to such extent is not possible in the subsequent assessment year i.e., the loss of eligible business so set-off under section 70(1) in A.Y.2015-16 has to be first deducted while computing profits eligible for deduction under section 80-IA in the subsequent years. Accordingly, ₹ 60 lakhs would have been deducted from the profits of eligible business for the A.Y. 2016-17 and the balance ₹ 40 lakhs has to be deducted in the current assessment year i.e., A.Y. 2017-18.

In such a case, the deduction under section 80-IA for A.Y.2017-18 would be ₹ 33 lakhs [₹ 73 lakhs (-) ₹ 40 lakhs].

(b) (i) <u>Whether return can be filed on 1st December, 2017?</u>

As per section 139(4), a belated return for any previous year may be furnished at any time -

(a) before the end of the relevant assessment year; or

(b) before the completion of the assessment,

whichever is earlier.

[6] Circular No. 37/2016, dated 02-11-2016

Since Arjun has not filed his return of income within the specified due date under section 139(1), he can file a belated return of income u/s 139(4) for A.Y. 2017-18 on 1st December, 2017, if the assessment is not completed till date.

(ii) Whether revised return can be filed?

As per section 139(5), if any person, having furnished a return within the due date or a belated return, discovers any omission or any wrong statement therein, he may furnish a revised return at any time –

(a) before the expiry of one year from the end of the relevant assessment year or

(b) before the completion of assessment,

whichever is earlier.

In case Mr. Arjun found an omission in the belated return filed by him for A.Y. 2017-18 on 01.12.2017, he can file a revised return u/s 139(5) on or before completion of assessment or before the expiry of one year from the end of A.Y.2017-18 i.e., 31.3.2019, whichever is earlier.

(iii) The quantum of interest and penalty which he will be subjected to for the defaults for the A.Y. 2017-18 are as follows:

For default in filing return of income on or before the due date

Interest under section 234A would be attracted for such default.

Since Mr. Arjun is not liable to tax audit under section 44AB, the due date for filing of return for A.Y. 2017-18 is 31.07.2017. Arjun has filed his return on 1.12.2017 i.e., interest under section 234A will be payable for 5 months (from 1.8.2017 to 1.12.2017) @ 1% per month or part of month on the amount of tax payable on the total income, as reduced by TDS and advance tax paid i.e., tax payable after considering TDS and advance tax.

Interest u/s 234A = ₹ 50,000 x 1% x 5 = ₹ 2,500

Penalty under section 271F is not attracted since Mr. Arjun has filed his return before 31.3.2018.

For default in payment of advance tax

Interest under section 234B would be attracted for default in payment of advance tax.

Considering that advance tax paid by Mr. Arjun[7] would be less than 90% of the assessed tax, Mr. Arjun would be liable to pay interest under section 234B @1% per month or part of the month on the amount of shortfall (i.e., ₹ 50,000 in this case) for 9 months from 1st April, 2017 to 1st December, 2017.

Accordingly, interest under section 234B is 1% × 9 × ₹ 50,000 = ₹ 4,500

[7] It is assumed that Mr. Arjun is not a senior citizen.

Mr. Arjun is also liable to pay interest under section 234C for deferment of advance tax.

(c) (i) YOK Inc. of U.S.A., a foreign company, is a subsidiary of Bhisma Ltd., an Indian company. Hence, YOK Inc. and Bhisma Ltd. are associated enterprises as per section 92A(1). Therefore, providing services of data processing by Bhisma Ltd., an Indian company, to YOK Inc., a foreign company, is an international transaction between associated enterprises, and consequently, the provisions of transfer pricing are attracted in this case.

As per Rule 10TA, data processing services with the use of information technology falls within the definition of "information technology enabled services", and is hence, an eligible international transaction as per Rule 10TC. Since Bhisma Ltd. is providing data processing services to a non-resident associated enterprise and has exercised a valid option for safe harbour rules, it is an eligible assessee as per Rule 10TB.

Since the aggregate value of transactions entered into in the P.Y. 2016-17 does not exceed ₹ 500 crore, Bhisma Ltd. should have declared an operating profit margin of not less than 20% in relation to operating expense, to be covered within the scope of safe harbour rules as per Rule 10TD.

However, since Bhisma Ltd. has declared an operating profit margin of only 19.33% [i.e., 29/150 x100], the same is not in accordance with the circumstance mentioned in the Rule 10TD. Hence, it is not binding on the income-tax authorities to accept the transfer price declared by Bhisma Ltd in respect of such international transaction.

(ii) ABC Inc. of UK, a foreign company, guarantees 15% of the total borrowings of Dhanush Ltd., an Indian company. Since ABC Inc. guarantees not less than 10% of the total borrowings of Dhanush Ltd., ABC Inc. and Dhanush Ltd. are deemed to be associated enterprises. Therefore, provision of contract R & D services relating to generic pharmaceutical drug by Dhanush Ltd., an Indian company, to ABC Inc., a foreign company, is an international transaction between associated enterprises, and consequently, the provisions of transfer pricing are attracted in this case.

Provision of contract R & D services in relation to generic pharmaceutical drug is an eligible international transaction as per Rule 10TC. Since Dhanush Ltd. is providing such services to a non-resident associated enterprise and has exercised a valid option for safe harbour rules, it is an eligible assessee as per Rule 10TB.

Irrespective of the aggregate value of transactions entered into in the P.Y.2016-17, Dhanush Ltd. should have declared an operating profit margin of not less than 29% in relation to operating expense, to be covered within the scope of safe harbour rules.

In this case, since Dhanush Ltd. has declared an operating profit margin of 30% [i.e., 18/60 x 100], the same is in accordance with the circumstance mentioned in Rule 10TD. Hence, the income-tax authorities shall accept the transfer price declared by Dhanush Ltd in respect of such international transaction.

Question 4

*Answer any **four** out of the following five cases. Your answer should cover these aspects:*

(i) Issue involved;

(ii) Provisions applicable;

(iii) Analysis; and

(iv) Conclusion.

(a) Jashan Hotels Pvt. Ltd., engaged in the business of owning, operating and managing hotels, allowed its employees to receive tips from the customers, by the virtue of their employment. The tips were also collected directly by the hotel-company from the customers, when payment was made by them through credit cards. The hotel-company, thereafter, disbursed the tips to the employees. The Assessing Officer treated the receipt of the tips as income under the head "Salary" in the hands of the various employees and held that the company was liable to deduct tax at source from such payments under section 192. Since the company had not deducted tax at source on such payments, the Assessing Officer treated the company as an assessee-in-default under section 201(1) of the Act. Discuss the correctness of the action of the Assessing Officer.

(b) Radhakrishna Cooperative Society, the assessee, is engaged in marketing of fertilizers and purchase and processing of seeds. The assessee had claimed deduction under section 80P(2)(d) on dividend income received from NAFED and one Cooperative bank and also on interest on deposits with Co-operative banks. The Assessing Officer contended that the aforesaid income were not included in the total income and wants to invoke section 14A by disallowing the expenditure incurred with respect to earning income which is not liable to income tax.

Discuss whether the action taken by the Assessing Officer is tenable in law.

(c) Mr. Vivek, a resident assessee holds 80% of equity shares in a company and is the executive director of the company. In his personal capacity, he is the owner of certain premises (building) in which he was carrying on a proprietary business. Subsequently the assessee ceased to carry on the business of proprietary firm and leased the building to the company for its business. The company incurred ₹ 3.2 crores towards construction and improvement of this premises, which it continued to use otherwise than as the owner of the premises. The Assessing Officer held that the amounts spent by the company towards repairs and renovation of the building is taxable as deemed dividend in the hands of the assessee.

Is the action taken by the Assessing Officer valid?

(d) Rural Health Care Trust was formed on 1st April, 2015 with the object of providing medical relief to people residing in rural areas of Assam. The trust applied for registration under section 12AA on 15th May, 2016 to the Commissioner of Income-tax. Till the due date for filing return of income for Assessment Year 2017-18, the Commissioner of Income-tax has

not passed any order granting or refusing to grant such registration. The trust has filed its return of income for Assessment Year 2017-18 claiming exemption under section 11 taking a view that as the order has not been passed by the Commissioner of Income-tax within the prescribed period, the trust should be deemed to be registered under section 12AA.

Discuss and explain whether the view taken by the trust is correct.

(e) *ABC Ltd., a listed company, filed its return of income in which a claim for deduction under Chapter VI-A was made. The case was subjected to scrutiny assessment and order under section 143(3) was passed reducing the claim for deduction under Chapter VI-A. After 4 years from the end of assessment year, a notice under section 148 was issued giving reasons such as subsequent tribunal and other court decisions which show that the deduction was excessively allowed in this case.*

Is the action of the Assessing Officer valid? ***(4 × 4 = 16 Marks)***

Answer

(a) **Provision applicable:** Section 192(1) requires any person responsible for paying any income chargeable under the head "Salaries" to deduct tax at source at the time of payment. If an employee receives income chargeable under a head other than "Salaries", section 192 does not get attracted at all.

Issue Involved: The issue under consideration in this case is whether "tips" received by the hotel-company from its customers and distributed to the employees fell within the meaning of "Salaries" to attract tax deduction at source under section 192 and whether the assessee can be treated as assessee-in-default for non-deduction of tax at source.

Analysis: This issue came up before the Supreme Court in *ITC Ltd. v. CIT (TDS) (2016) 384 ITR 14* wherein it was observed that in respect of tips collected by the company from the customers and distributed to the employees, the person responsible for paying the employee is not the employer at all, but a third person, namely the customer.

Tips are received by the employer in a fiduciary capacity as trustee for payments that are received from customers which they disburse to their employees for service rendered to the customer. There is, therefore, no reference to the contract of employment when these amounts are paid by the employer to the employee. Due to this reason the tips received by the employees could not be regarded as profits in lieu of salary in terms of section 17(3). The payments of collected tips included and paid by way of a credit card by a customer, would not be payments made "by or on behalf of" an employer. The contract of employment not being the proximate cause for the receipt of tips by the employee from a customer, such payments would be outside the scope of sections 15 and 17, and hence section 192 would not get attracted.

Further, there is no vested right in the employee to claim any amount of tip from his employer. Tips are purely voluntary amounts that may or may not be paid by customers for services rendered to them.

Also, income from tips would be chargeable in the hands of the employees as "Income from Other Sources", on account of such tips being received from customers and not from the employer, and hence, section 192 would not get attracted at all.

Conclusion: Applying the rationale of the above Supreme Court ruling to the case on hand, the action of the Assessing Officer in concluding that "tips" received by the hotel-company from its customers and distributed to the employees fell within the meaning of "Salaries" to attract tax deduction at source under section 192 and in treating Jashan Hotels Pvt. Ltd. as an assessee-in-default under section 201(1) for non-deduction of tax at source under section 192 on the amount of tips collected by it from the customers and distributed to its employees, **is not correct**

(b) **Provision applicable:** As per section 14A, expenditure incurred in relation to income which does not form part of the total income under the Act, will not be allowed in computing the total income of the assessee.

Issue Involved: The issue under consideration is whether the provisions of section 14A can be invoked in disallowing the expenditure incurred in respect of the income for which deduction is claimed under Chapter VI-A.

Analysis: This issue came up before the Delhi High Court in case of *CIT v. Kribhco (2012) 349 ITR 0618*, wherein it was observed that the words "do not form part of the total income under this Act" used in section 14A are significant and important. Income which qualifies for deductions under section 80C to 80U has to be first included in the gross total income of the assessee and then allowed as a deduction.

However, income referred to in Chapter III do not form part of the total income and therefore, as per section 14A, no deduction shall be allowed in respect of expenditure incurred by the assessee in relation to such income which does not form part of the total income.

Deduction under section 80P covered in Chapter VIA is different from the exclusions/exemptions provided under Chapter III.

Conclusion: Applying the rationale of the above Delhi High Court ruling in this case, the action taken by the Assessing Officer in disallowing the expenditure incurred with respect to income for which deduction under Chapter VI-A is claimed, by invoking the provisions of section 14A is, therefore, **not tenable in law**.

(c) **Provision applicable:** As per section 2(22)(e), in case a company, not being a company in which the public are substantially interested, makes payment of any sum by way of advance or loan to a shareholder holding not less than 10% of voting power/share capital of the company, then, the payment so made shall be deemed to be dividend in the hands of such shareholder to the extent to which the company possesses accumulated profits.

Issue Involved: The issue under consideration in this case is whether the expenditure of ₹ 3.20 crores incurred by the company towards repair and renovation of a building taken on lease from a shareholder, who holds 80% of the equity shares in the company and is

the executive director of such company, can be treated as deemed dividend in the hands of the such shareholder.

Analysis: This issue came up before the Bombay High Court in *CIT v. Vir Vikram Vaid (2014) 367 ITR 365*, wherein the High Court observed that no money had been paid by way of advance or loan by the company to the shareholder who has substantial interest in the company. Further, the amount spent by the company is towards repairs and renovation of the premises owned by the shareholder but occupied by the company as lessee.

Therefore, the expenditure incurred by the company on repairs and renovation of the premises cannot be brought within the definition of "advance or loan" given to the shareholder having substantial interest in the company, even though he is the owner of the premises. Hence, it cannot be treated as payment by the company on behalf of the shareholder or for the individual benefit of such shareholder.

Conclusion: Applying the rationale of the above Bombay High Court ruling in this case, the action taken by the Assessing Officer, in treating the amounts spent by the company towards repair and renovation of a building taken on lease from a shareholder, as deemed dividend under section 2(22)(e) in the hands of the shareholder is, therefore, **not** valid.

(d) **Provision applicable:** As per section 12AA(2), every order granting or refusing registration shall be passed before the expiry of six months from the end of the month in which the application was received.

Issue Involved: The issue under consideration in this case is whether, in a case where the Commissioner of Income-tax has not passed any order for granting or refusing to grant registration within the time limit prescribed under section 12AA, can the trust take a view that it is deemed to be registered under section 12AA**.**

Analysis: This issue came up before the Apex Court in *CIT v. Society for the Promotion of Education (2016) 382 ITR 6*, wherein the Supreme Court affirmed the decision of the Allahabad High Court in the said case observing that non-consideration of the application for registration within the time fixed by the legal provision would lead to deemed grant of registration, since the assessee cannot be made to suffer merely because timely decisions are not taken by the Revenue Officers.

Accordingly, in this case, the trust would be deemed to be registered since no order granting or refusing to grant registration has been passed by the CIT on or before 30th November, 2016 and even thereafter upto the due date of filing of return for the A.Y.2017-18. Therefore, the trust can claim exemption under section 11 in its return of income for the A.Y.2017-18, since the provisions of section 11 and 12 would apply in relation to the income of the trust from the assessment year immediately following the financial year in which the application is made, namely, F.Y.2016-17.

Conclusion: Applying the rationale of the above Supreme Court Ruling to this case, the view taken by the Rural Health Care Trust that the trust would be deemed to be registered under section 12AA, since no order granting or refusing to grant registration has been

passed by the Commissioner of Income-tax within the prescribed period of six months is **correct**.

(e) **Provision applicable:** As per proviso to section 147, where any assessment earlier completed u/s 143(3) is sought to be opened beyond a period of four years from the end of the relevant assessment year, two conditions have to be fulfilled cumulatively.

The first condition is that there must be reason to believe that income chargeable to tax has escaped assessment.

The second condition is that such escapement of income should have arisen due to failure on the assessee's part to fully and truly disclose all material facts required for the assessment.

Issue Involved: The issue under consideration in this case is whether notice under section 148 issued after 4 years from the end of the assessment year is valid solely on the ground that subsequent tribunal and other court decisions show that the deduction was excessively allowed.

Analysis: The above issue came up before the Bombay High Court in *Allanasons Ltd v. Dy. CIT (2014) 369 ITR 648*, wherein it was observed that even a subsequent change of law cannot be taken as income escaping assessment for triggering reassessment provisions beyond 4 years from the end of the assessment year unless there was a failure on the part of the assessee to disclose fully and truly all material facts necessary for assessment.

Thus, subsequent decision of Tribunal or High Court by itself is not adequate for reopening the assessment completed earlier under section 143(3) unless there is a failure on the part of the assessee to disclose complete facts.

Conclusion: Applying the rationale of the Bombay High Court ruling to this case, the notice issued under section 148 by the Assessing Officer solely on the ground that subsequent tribunal and other court decisions show that the deduction was excessively allowed is, therefore, **not valid**, assuming that there is no failure on the part of the assessee to disclose fully and truly any material fact necessary for assessment[8].

Question 5

(a) LLM Bank Ltd. carrying on banking business is incorporated in Melbourne, Australia. It has branches in different countries including India. During the financial year 2016-17, the Indian branch of the bank paid interest of ₹ 20 lakhs and ₹ 15 lakhs, respectively, to its head office in Melbourne and to the branch office in California. State with reasons whether interest so paid shall be liable to tax in India in the hands of head office and California branch. ***(4 Marks)***

[8] assuming that there is no failure on the part of the assessee to disclose fully and truly any material fact necessary for assessment.

(b) *In 2012, Brijesh borrowed ₹ 15 lakhs at 15% interest per annum from Ashok for his business purpose. This loan has not been repaid so far by Brijesh. His average bank balance in current account was around ₹ 7 lakhs on which the bank was not paying him any interest. On 1st June, 2016, Brijesh's wife, Tina, borrowed from him ₹ 7.50 lakhs repayable on demand at 7.5% interest per annum. She lent this money and received interest @ 18% p.a. In course of assessment of Brijesh, the Assessing Officer disallowed 50% of this interest paid to Ashok on the ground that the loan to the extent of 50% has been diverted for non-business purpose i.e. for lending to wife. Further, interest earned by Tina by advancing ₹ 7.50 lakhs was included in the hand of Brijesh by invoking section 64(1)(iv). Examine the correctness of the action of the Assessing Officer.* ***(4 Marks)***

(c) *During October 2016, a search was conducted under section 132 in the business premises of Mr. Q. At that time, the following assessments of Mr. Q were pending before the Assessing Officer:*

Assessment under section 143(3) for A.Y. 2014-15 and A.Y. 2015-16; and reassessment proceeding under section 147 for A.Y. 2013-14. Based on the above facts, you are required to explain the provisions applicable in case of the following:

(i) In respect of which assessment years can notice be issued for making post-search assessment?

(ii) Fate of pending assessments and reassessment.

(iii) State the consequence, if the post-search assessment orders are annulled by the Income Tax Appellate Tribunal. ***(4 Marks)***

(d) *What would be the penalty leviable under section 270A in case of DEF Ltd, an Indian Company, if none of the additions or disallowances made in the assessment or reassessment qualify under section 270A(6) and the under-reported income is not on account of misreporting?*

	Particulars of total income of A.Y. 2017-18	***Amount in ₹***
(1)	*As per the return of income furnished u/s 139(1)*	*(6,00,000)*
(2)	*Determined under section 143(1)(a)*	*(3,00,000)*
(3)	*Assessed under section 143(3)*	*(1,00,000)*
(4)	*Reassessed under section 147*	*4,00,000*

Note: *The total turnover of DEF Ltd. for the P.Y. 2016-17 was ₹ 10 crores.* ***(4 Marks)***

Answer

(a) As per section 5(2), the total income of a non-resident would include all income which is, *inter alia*, deemed to accrue or arise to him in India in that year.

In the case of a non-resident, being a person engaged in the business of banking, any interest payable by the Permanent Establishment (PE) in India of such non-resident to the

head office or any PE or any other part of such non-resident outside India, shall be deemed to accrue or arise in India [*Explanation* to section 9(1)(v)].

In the present case, the Indian branch, being a fixed place of business, is the PE in India of LLM Bank Ltd., being a non-resident engaged in the banking business, since such business is carried on in India through the Indian branch [Clause (iiia) of section 92F].

Accordingly, the interest of ₹ 20 lakhs paid to its head office in Melbourne and ₹15 lakhs paid to the other branch office in California by the Indian branch [being the PE in India of LLM Bank Ltd, a non-resident engaged in the business of banking] shall be deemed to accrue or arise in India and shall be liable to tax in India in the hands of head office and California branch, respectively, in addition to any income attributable to the PE in India.

(b) There are two issues to be addressed in this case.

The first issue is whether the action of the Assessing Officer in disallowing 50% of interest paid by Mr. Brijesh to Mr. Ashok on the loan of ₹15 lakh borrowed from him due to the fact that loan to the extent of 50% i.e., ₹7.50 lakhs, has been given to his wife, is correct, on the contention that the same tantamounts to diversion for non-business use.

The second issue is whether the action of the Assessing Officer in including the excess interest earned by his wife Ms. Tina (by further advancing such amount) in the hands of Mr. Brijesh, by invoking section 64(1)(iv), is correct.

First issue: Correctness of action of the AO in disallowing 50% of interest paid by Mr. Brijesh to Mr. Ashok

From the given facts and reasoning, it is apparent that loaning an amount lying in a non-interest earning current account to his wife@7.5%, on the condition that the same is repayable on demand as and when needed for business purposes would not tantamount to diversion of funds borrowed for non-business purposes. It is possible that the assessee had interest-free funds from out of which he could have given the impugned loan to his wife.

Further, there is no nexus between the amount borrowed from Mr. Ashok in 2012 and loan given to wife in 2016.

Therefore, disallowance of 50% of interest paid to Mr. Ashok on sum of money borrowed four years back for business purposes, on the ground that part of such amount is loaned to his wife at concessional rate tantamounting to diversion for non-business purpose, is **not** correct.

Second issue: Correctness of action of the AO in including the excess interest earned by Tina in the hands of her husband, Mr. Brijesh, by applying section 64(1)(iv)

As per section 64(1)(iv), in computing the total income of any individual, there shall be included all such income as arises directly or indirectly to the spouse of such individual from assets transferred directly or indirectly otherwise than for inadequate consideration.

In the present case, the interest income is earned by Ms. Tina, by advancing ₹ 7.50 lakhs (received from her husband as a loan carrying interest @7.5%, repayable on demand) and earning interest@18% thereon. Such income does not arise from any asset transferred to her by her husband. Loan presupposes repayment of money borrowed. Granting of loan cannot therefore be treated as direct or indirect transfer of asset.

In case of *R. K Murthi v. CIT (1961) 42 ITR 379*, the Madras High Court held that giving a loan cannot tantamount to a transfer of an asset. There is no prohibition against a husband advancing monies to his wife.

Therefore, the action of Assessing Officer in including the excess interest earned by his wife Ms. Tina by advancing the sum loaned to her by Mr. Brijesh, in the hands of Mr. Brijesh, is **not** correct.

(c) (i) Assessment years for which notice u/s 153A can be issued

Notice under section 153A can be issued for six assessment years preceding the assessment year relevant to the previous year in which the search is conducted. In this case, search is conducted in the previous year 2016-17, the relevant assessment year for which is A.Y.2017-18. Therefore, notice can be issued for the six preceding assessment years i.e. for assessment years 2011-12 to 2016-17.

(ii) Fate of pending assessment/reassessment

As per section 153A, the assessment or reassessment relating to any assessment year, falling within the above period of six assessment years, pending on the date of initiation of the search under section 132, shall abate. In other words, they will cease to be applicable.

Therefore, the assessments under section 143(3) for assessment years 2014-15 and 2015-16 and the reassessment proceeding under section 147 for assessment year 2013-14 **shall abate**.

(iii) Consequence when the post-search assessment order is annulled by the ITAT

As per section 153A, where the post-search assessment order is annulled in any appeal or any other legal proceeding, the abated assessment and reassessment proceedings shall stand revived.

Therefore, the assessments under section 143(3) relating to assessment years 2014-15 and 2015-16 and the reassessment proceeding relating to assessment year 2013-14, which abated on initiation of search, **shall stand revived**, if post-search assessment orders are annulled by the Tribunal.

(d) DEF Ltd. is deemed to have under-reported its income since:

(1) the assessment under 143(3) has the effect of reducing the loss determined in a return processed under section 143(1)(a); and

(2) the reassessment under section 147 has the effect of converting the loss assessed under section 143(3) into income.

Therefore, penalty is leviable under section 270A for under-reporting of income.

Computation of penalty leviable under section 270A

Particulars	₹	₹
Assessment under section 143(3)		
Under-reported income:		
Loss assessed u/s 143(3)	(1,00,000)	
(-) Loss determined under section 143(1)(a)	(3,00,000)	
Income under-reported	**2,00,000**	
Tax payable on under-reported income@30%	60,000	
Add: EC & SHEC@3%	1,800	
	61,800	
Penalty leviable@50% of tax payable		30,900
Reassessment under section 147		
Under-reported income:		
Total income reassessed under section 147	4,00,000	
(-) Loss assessed under section 143(3)	(1,00,000)	
Income under-reported	**5,00,000**	
Tax payable on under-reported income@30%	1,50,000	
Add: EC & SHEC@3%	4,500	
	1,54,500	
Penalty leviable@50% of tax payable		77,250

Note: *Penalty@50% under section 270A has to be computed on the tax payable (including cess). For A.Y. 2017-18, the rate of tax applicable in case of domestic company whose turnover for the previous year 2014-15 does not exceed ₹ 5 crore is 29%. Otherwise, the rate of tax would be 30%.*

The question does not mention the turnover of P.Y. 2014-15. In the above solution, penalty under section 270A has been computed by considering the rate of tax as 30%. However, it is possible to consider the rate of tax as 29%, on the assumption that the total turnover of the company during the P.Y. 2014-15 does not exceed ₹ 5 crore. In such a case, penalty leviable under section 270A as a result of assessment under section 143(3) and reassessment under section 147 would be ₹ 29,870 and ₹ 74,675, respectively.

Question 6

(a) Mr. T prefers appeal with CIT(Appeals) after receiving assessment order under section 143(3) of the Income-tax Act. After filing his appeal, he realizes that certain important issues were not raised in the statement of facts and grounds of appeal submitted. The appellant wants to produce additional evidences before the CIT(Appeals). State the circumstances where the appellant shall be entitled to produce additional evidence, i.e. documentary, before the Commissioner of Income Tax (Appeals) other than the evidence produced during the proceedings before the Assessing Officer. ***(4 Marks)***

(b) Discuss the correctness or otherwise of the following statements with reference to the provisions of Income-tax Act, 1961:

(i) Central Board of Direct Taxes issues orders, instructions and directions to other income tax authorities as it may deem fit which has to be compulsorily followed by them.

(ii) The Settlement Commission may suo moto *amend any order passed by it to rectify any mistake apparent from the record.*

(iii) If assessee does not pay the self assessment tax before furnishing the return of income, the return furnished shall be deemed to be a defective return. ***(3 x 2 = 6 Marks)***

(c) Discuss the TDS/TCS applicability in context of Assessment Year 2017-18 in the following cases and state the amount of the TDS/TCS as per Income-tax Act, 1961. (All issues as under are independent)

(i) Mr. Shan, an individual, whose turnover from the business carried on by him during the financial year immediately preceding the financial year exceed ₹ 100 lakh, paid fee to an architect of ₹ 50,000 for furnishing his residential house.

(ii) Mr. Shyam purchased a house in Mumbai for consideration of ₹ 90 lakh by cheque from the builder for the use of his residence.

(iii) Mr. Soham purchased licensed copy of computer software from the software vendor (resident of India) along with all right to use it for ₹ 50,000 to be used for business purposes. ***(3 x 2 = 6 Marks)***

Answer

(a) As per Rule 46A(1) of the Income-tax Rules, 1962, an appellant shall be entitled to produce before the Commissioner (Appeals), evidence, either oral or documentary, other than the evidence produced by him during the course of proceedings before the Assessing Officer, only in the following circumstances -

(a) where the Assessing Officer has refused to admit evidence which ought to have been admitted

(b) where the appellant was prevented by sufficient cause from producing the evidence which he was called upon to produce by the Assessing Officer

(c) where the appellant was prevented by sufficient cause from producing before the Assessing Officer any evidence which is relevant to any ground of appeal

(d) where the Assessing Officer has made the order appealed against without giving sufficient opportunity to the appellant to adduce evidence relevant to any ground of appeal.

(b) (i) The statement is correct/partially correct.

As per section 119(1), the CBDT may issue orders, instructions and directions to other income-tax authorities as it may deem fit which has to be compulsorily followed by them.

However, as per the proviso to section 119(1), no such orders, instructions or directions shall be issued—

(a) so as to require any income-tax authority to make a particular assessment or to dispose of a particular case in a particular manner; or

(b) so as to interfere with the discretion of the Commissioner (Appeals) in the exercise of his appellate functions.

(ii) The statement is correct.

Under section 245D(6B), the Settlement Commission may, with a view to rectifying any mistake apparent from the record, amend any order passed by it under section 245D(4) at any time within a period of 6 months from the end of the month in which the order is passed.

(iii) The statement is <u>not</u> correct.

Consequent to deletion of clause (aa) of *Explanation* to section 139(9) with effect from A.Y.2017-18, a return which is otherwise valid would not be treated defective merely because self-assessment tax and interest payable in accordance with the provisions of section 140A has not been paid on or before the date of furnishing of the return.

(c) (i) TDS@10% under section 194J would be attracted in respect of fees for professional services exceeding ₹ 30,000 paid to a resident during any financial year. However, TDS provisions u/s 194J would not be attracted, if the fee is paid exclusively for personal purposes.

In this case, since the fee paid by Mr. Shan is for furnishing of his residential house, it is exclusively for personal purposes. Therefore, Mr. Shan is **<u>not</u>** required to deduct tax at source under section 194J on the fees of ₹ 50,000 paid to an architect for furnishing his residential house even if, in such a case, the turnover from the business exceeds ₹100 lakhs during the preceding financial year or the amount of fees for professional services exceeds ₹30,000 during the financial year.

(ii) As per section 194-IA, tax is required to be deducted at source @1% on the amount of consideration paid for purchase of a residential house, being an immovable property, if the amount of consideration is ₹ 50 lakhs or more.

Therefore, Mr. Shyam is required to deduct tax at source of ₹ 90,000 (1% of ₹ 90,00,000) from the amount of consideration paid for purchase of a residential house in Mumbai.[9]

(iii) As per *Explanation 4* to section 9(1)(vi), consideration for transfer of all or any right to use of computer software (including granting of a licence) would fall within the meaning of "royalty".

Tax deduction at source@10% under section 194J would be attracted where the amount of royalty exceeds ₹ 30,000.

However, an individual is not required to deduct tax at source under section 194J on the sum paid by way of royalty, even if it exceeds ₹ 30,000.

Therefore, Mr. Soham, being an individual, is not required to deduct tax at source on the amount of ₹ 50,000 paid towards purchase of licensed copy of computer software from the software vendor.

Question 7

(a) Explain the significance of the PE, when such transactions are governed by the Double Taxation Avoidance Agreements (DTAA). ***(4 Marks)***

(b) "Rule 10MA(2)(iv) of Income-tax Rules requires that the application for rollback provision, in respect of an international transaction, has to be made by the applicant for all the rollback years in which the said international transaction has been undertaken by the applicant.

You are required in this context to explain whether the rollback has to be requested for all the four years or applicant can choose the years out of the block of four years. ***(4 Marks)***

(c) The assessment of Nargis Agro Ltd., for Assessment Year 2014-15 was completed under section 143(3). The order so passed does not contain any specific direction for payment of interest under section 234B, but was being accompanied by form ITNS-150 containing and giving the calculation of interest payable under section 234B on the Assessed Tax.

The assessee being aggrieved of the levy of interest under section 234B seeks your opinion. Kindly advice. ***(4 Marks)***

(d) "Chapter- VIII of the Finance Act, 2016 has amended the provisions of section 10 and section 40(a) to address the issues and problems relating to taxation of e-commerce transactions.

[9] assuming that the transferor is a resident.

Explain in this context the following:

(i) Equalisation Levy

(ii) Meaning of Specified Service ***(2 x 2 =4 Marks)***

Answer

(a) Double Taxation Avoidance Agreements (DTAAs) generally contain an Article providing that business income is taxable in the country of residence, unless the enterprise has a permanent establishment (PE) in the country of source, and such income can be attributed to the PE.

Section 92F(iiia) defines the term "Permanent Establishment" to include a fixed place of business through which the business of an enterprise is wholly or partly carried on.

As per this definition, to constitute a permanent establishment, there must be a place of business which is fixed and the business of the enterprise must be carried out wholly or partly through this place.

Section 9(1)(i) requires existence of business connection for deeming business income to accrue or arise in India. DTAAs however provide that business income is taxable only if there is a PE in India.

It is well established that the beneficial provisions of the DTAA will prevail over the provisions of the Act. Therefore, in cases where transactions are covered by DTAAs, where there is no PE in India, business income cannot be brought to tax due to existence of business connection as per section 9(1)(i).

(b) Subject to the provisions of Rule 10MA, the agreement may provide for determining the arm's length price or specifying the manner in which arm's length price shall be determined in relation to the international transaction entered into by the person during the rollback year.

The relevant limb of the rule mandates that the applicability of rollback provision, in respect of an international transaction, has to be requested by the applicant for all the rollback years in which the said international transaction has been undertaken by the applicant

As per Circular No.10/2015 dated 10.06.2015 issued by the CBDT, the applicant does not have the option to choose the years for which it wants to apply for rollback in application filed under rule 10MA(2)(iv) of Income-tax Rules, 1962.

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 rollback year.

However, for other rollback years, it can still apply for rollback.

(c) Interest under section 234B is attracted for non-payment of advance tax or shortfall payment of advance tax. As per the provisions of section 234B, the moment an assessee who is liable to pay advance tax has failed to pay such tax or where the advance tax paid by the assessee is less than 90% of the assessed tax, the assessee becomes liable to pay simple interest @1% per month or part of the month.

The issue under consideration is whether interest liability under section 234B would arise in the absence of specific direction for payment of interest in the assessment order. This issue came up before the Supreme Court in *CIT v. Bhagat Construction Co (P) Ltd (2016) 383 ITR 9,* wherein it was observed that levy of interest under section 234B is automatic when the conditions of section 234B are met and the income-tax computation sheet/form [Form ITNS-150] is part of the assessment order, even though the assessment order does not contain a specific direction for payment of interest.

Applying the rationale of the Apex Court ruling to the case on hand, Nargis Agro Ltd. becomes liable to pay interest under section 234B for A.Y. 2014-15 even if the assessment order passed under section 143(3) does not contain any specific direction for payment of such interest, since the order is accompanied by Form ITNS-150 containing and giving calculation of interest payable under section 234B.

(d) (i) Equalisation Levy

Chapter VIII of the Finance Act, 2016 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 on business or profession or from a non-resident having permanent establishment in India.

(ii) Meaning of Specified Services

(1) Online advertisement;

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

Specified Service also includes any other service as may be notified by the Central Government.