

Gurukripa's Guideline Answers to Nov 2015 Exam Questions

CA Final – Direct Taxes

Question No.1 is compulsory **(4 X 5 = 20 Marks)**.

Answer **any five** questions from the **remaining six** questions **(16 X 5 = 80 Marks)**. [Answer any 4 out of 5 in Q.4]

Working Notes should form part of the answer.

Wherever necessary, suitable assumptions should be made and indicated in answer by the Candidates.

Note: References are from **"Padhuka's Direct Taxes – A Ready Referencer – For CA Final"**

Students can also refer to **"Paduka's Practical Guide on Direct Taxes – For CA Final"** for easy revision.

All questions pertaining to Income Tax relate to **Assessment Year 2016–2017**, unless stated otherwise in the Question.

Question 1(a): LLP – Sec.10AA, Sec.35AD, AMT **10 Marks**
 PQR LLP, a Limited Liability Partnership set up a unit in Special Economic Zone (SEZ) in the Financial Year 2010–2011 for production of washing machines. The Unit fulfills all the conditions of Section 10AA of the Income–Tax Act. During the Financial year 2013–2014, it has also set up a Warehousing Facility in a district of Tamil Nadu for storage of Agricultural Produce. It fulfills all the conditions of Section 35AD. Capital Expenditure in respect of Warehouse amounted to ₹ 75 Lakhs (including Cost of Land of ₹ 10 Lakhs). The Warehouse became operational with effect for 1st April 2014 and the expenditure of ₹ 75 Lakhs was capitalized in the books on that date.

Relevant details for the financial year 2015–2016 are as follows:

Particulars	₹
Profit of unit located on SEZ	40,00,000
Export Sales of above unit	80,00,000
Domestic Sales of above unit	20,00,000
Profit from Operation of Warehousing Facility (before considering deduction under Section 35AD)	1,05,00,000

Compute Income Tax (including AMT u/s 115JC) payable by PQR LLP for Assessment Year 2016–2017.

Solution: **Similar to Illustration in Page No.18.3 [N 12]**

1. Computation of Exemption u/s 10AA & Taxable Business Income

Step 1	Computation of Total Turnover	Total Turnover = Export Sales Add Domestic Sales = ₹ 80 Lakhs Add ₹ 20 Lakhs = ₹ 100 Lakhs
Step 2	Computation of Exemption	Exemption = Profit of Business of the Undertaking × $\frac{\text{Export Turnover}}{\text{Total Turnover}}$ = ₹ 40 Lakhs × $\frac{₹ 80 \text{ Lakhs}}{₹ 100 \text{ Lakhs}}$ = ₹ 32 Lakhs
Step 3	Computation of Taxable Business Income	Taxable Business Income = Profits of Business Less Sec.10AA Deduction = ₹ 40 Lakhs Less ₹ 32 Lakhs = ₹ 8 Lakhs

Note: Where a deduction is claimed u/s 35AD in respect of the Specified Business, no deduction shall be allowed u/s 10AA in relation to such Specified Business. Hence, Profit from Warehousing Facility is not considered for exemption u/s 10AA.

2. Computation of Total Income & Tax Payable under Normal Provisions

Particulars	₹	₹
Profits and Gains of Business or Profession		
Profits derived from SEZ Unit		8,00,000
Profits from Warehousing Facility	1,05,00,000	
Less: Deduction u/s 35AD [Note]	(97,50,000)	7,50,000

Particulars		₹	₹
	Gross Total Income		15,50,000
Less:	Deduction under Chapter VI-A		NIL
	Total Income		15,50,000
	Tax on above at 30%		4,65,000
Add:	EC at 2%		9,300
Add:	SHEC at 1%		4,650
	Net Tax Payable		4,78,950

Note: Cost of Land is not eligible for Deduction u/s 35AD. Hence, Eligible Weighted Deduction for Agricultural Warehousing is 150% on ₹ 65 Lakhs (₹ 75 Lakhs – ₹ 10 Lakhs).

3. Computation of Alternate Minimum Tax u/s 115JC

Particulars		₹
	Total Income (as computed above)	15,50,000
Add:	Deduction u/s 10AA & 35AD (₹ 32 Lakhs + ₹ 97.50 Lakhs)	1,29,50,000
Less:	Depreciation u/s 32 (for Warehouse @ 10%) (₹ 65 Lakhs × 10%)	(6,50,000)
	Adjusted Total Income	1,38,50,000
	Tax on above at 18.50%	25,62,250
Add:	EC at 2%	51,245
Add:	SHEC at 1%	25,623
	Net Tax Payable	26,39,120

Note: Land is not a Depreciable Asset. Hence, Depreciation is not allowable.

4. Tax Payable on Total Income

Since the Tax Payable under the normal provisions of the Act is less than the AMT payable u/s 115JC, Adjusted Total Income shall be deemed to be Total Income of ABC LLP, and the Tax Payable for AY 2016–2017 is ₹ 26,39,120.

5. AMT Credit Carried Forward

Particulars		₹
	AMT Credit to be carried forward u/s 115JEE – Tax liability u/s 115JC	26,39,120
Less:	Tax Liability as per normal provisions of Income Tax Act, 1961	4,78,950
	AMT Credit [Carried forward for Next 10 AYs]	21,60,170

Question 1(b): Demerger – Capital Gains Effects on Companies, Shareholders, etc. 10 Marks

SS(P) Ltd, a Domestic Indian Company having two undertakings engaged in manufacture of Cement and Steel, decided to hived off Cement Division to RV(P) Ltd, a Domestic Indian Company by way of demerger. The Net Book Value of Assets of SS(P) Ltd before demerger was ₹ 40 Crores. The Net Book Value of Assets transferred to RV(P) Ltd was ₹ 10 Crores. The demerger was made in January 2016. In the Scheme of demerger, it was fixed that for each Equity Share of ₹ 10 each (fully paid up) of SS(P) Ltd, two Equity Shares of ₹ 10 each (fully paid up) were to be issued.

One Mr. N.K. held 25,000 Equity Shares in SS(P) Ltd which were acquired in the financial year 2001–2002 for ₹ 6,00,000. Mr. N.K. received 50,000 Equity Shares from RV(P) Ltd consequent to demerger in January 2016. He sold all the Shares of RV(P) Ltd for ₹ 8,00,000 in March 2016. In this background, you are requested to answer the following–

- Does the transaction of demerger attract any Income Tax Liability in the hands of SS(P) Ltd and RV(P) Ltd?
- State the conditions in brief, which are to be satisfied under the Act for a Demerger.
- Compute the Capital Gain that could arise in the hands of Mr. N.K. on receipt of Shares of RV(P) Ltd.
- Compute the Capital Gain that could arise in the hands of Mr. N.K. on sale of Shares of RV(P) Ltd.
- Will the sale of Shares by Mr. N.K. affect the tax benefits availed by SS(P) Ltd and / or RV(P) Ltd?
- Is Mr. N.K. eligible to avail any tax exemption under any of the provisions of the Income–Tax Act, 1961 on the sale of Shares of RV(P) Ltd? If so, state in brief.

Note: Cost Inflation Index: Financial Year 2001–2002 = 426, Financial Year 2015–2016 = 1081

Solution:

	Hint Answer	Page Reference
(i)	No. This transaction is not a Transfer u/s 47(vib).	Page 7.14, Para 7.2.5
(ii)	Conditions for Demerger are specified u/s 2(19AA).	Page 19.3, Para 19.1.6
(iii)	Receipt of Shares on Demerger is not a Transfer u/s 47(vib). Hence, Capital Gains in this case = Nil .	Page 7.14, Para 7.2.5, Point 3
(iv)	Sale of Shares of RV(P)Ltd, leads to Capital Gains. Holding Period shall be taken from FY 2001–2002. Refer Working Note below for LTCG Computation.	Page 7.14, Para 7.2.5, Point 3
(v)	Since Mr. NK sold his Shares only in March 2016 (after becoming a Shareholder in Resulting Co. in January 2016), it will not affect the tax benefits availed by both Companies.	Page 19.3, Para 19.1.6, Point 1(e)
(vi)	Since Mr. NK sold Shares of a Private Company, exemption u/s 10(38) will not apply. However, he can avail Capital Gain Exemption u/s 54EC / 54F.	Page 7.43, Para 7.4.4 & Page 7.35, Para 7.4.1

Working Note Computation of Capital Gains:

1. Cost of Acquisition of Resulting Company's Shares on Demerger [Sec.49(2C)]:

$$= \frac{\text{Cost of Acquisition of Demerged Co's Shares} \times \text{Net Book Value of Assets transferred to Resulting Co.}}{\text{Net Worth of the Demerged Company before Demerger}}$$

Net Worth of Demerged Co. = Paid up Share Capital and General Reserve as per books, before demerger. In this case, as the Net Worth of SS(P) Ltd before demerger is not given, Net Book Value before demerger is considered.

$$= ₹ 6,00,000 \times \frac{₹ 10 \text{ Crores}}{₹ 40 \text{ Crores}} = ₹ 1,50,000.$$

2. Computation of Long Term Capital Gain / (Loss):

Particulars	₹
Sale Consideration	8,00,000
Less: Indexed Cost of Acqn = Cost of Acqn × $\frac{\text{CII of year of Transfer}}{\text{CII of year of Acquisition}} = ₹ 1,50,000 \times \frac{1081}{426}$	(3,80,634)
Long Term Capital Gain	4,19,366

Holding Period in demerged Company shall also be considered for computing Indexation Benefit.

Question 2: Companies – Computation of Total Income

16 Marks

Parik Hospitality Limited is engage in the business of running hotels of 3–star category. The Company's Statement of Profit and Loss for the previous year ended 31st March 2016 shows a Net Profit of ₹ 152 Lakhs after debiting or crediting the following items:

- (a) Payment of ₹ 0.25 Lakh and ₹ 0.30 Lakh in cash on 3rd December 2015 and 10th December 2015 respectively for purchase of Crab, Lobster and Squid to Mr. Raja, a Fisherman, and Mr. Khalid, a Middleman for these products respectively.
- (b) Contribution towards Employees' Pension Scheme notified by the Central Government under Section 80 CCD, for a sum of ₹ 3 Lakhs calculated at 12% of Basic Salary and Dearness Allowance payable to the Employees.
- (c) Payment of ₹ 6.50 Lakhs towards transportation of various materials procured by one of its Hotels to M/s. Bansal Transport, a Partnership Firm, without deduction of tax at source. The Firm has furnished its Permanent Account Number in the tender document.
- (d) Profit of ₹ 12 Lakhs on sale of plot of land to Avimunya Limited, a Domestic Company, the entire Shares of which are held by the Assessee Company. The plot was acquired by Parik Hospitality Limited on 1st June 2014.
- (e) Contribution of ₹ 2.50 Lakhs to Indian Institute of Technology with a specific direction for use of the amount for Scientific Research Programme approved by the Prescribed Authority.
- (f) Expense of ₹ 10 Lakhs on foreign travel of two Directors for a collaboration agreement with a Foreign Company for a Brewery Project to be set up. The negotiation did not succeed and the Project was abandoned.
- (g) Fees of ₹ 1 Lakh paid to Independent Directors for attending Board Meeting without deduction of tax at source under Section 194J.

- (h) Depreciation charged ₹ 10 Lakhs.
 (i) ₹ 10 Lakhs, being the additional compensation received from the State Government pursuant to an interim order of Court in respect of land acquired by the State Government in the previous year 2012–2013.
 (j) Dividend received from a Foreign Company ₹ 5 Lakhs.

Additional Information:

- (i) As a Corporate Debt Restructuring, the Bank has converted unpaid interest of ₹ 10 Lakhs upto 31st March 2015 into a new loan account repayable in five equal annual instalments. The first instalment of ₹ 2 Lakhs was paid in March 2016 by debiting new loan account.
 (ii) Depreciation as per Income–Tax Act: ₹ 15 Lakhs.
 (iii) The Company received a bill for ₹ 2 Lakhs on 31st March 2016 from a supplier of vegetables for supply made in March, 2016. The bill was omitted to be recorded in the books in March 2016. The bill was paid in April 2016 and the necessary entry was made in the books then.

Compute Total Income of Parik Hospitality Limited for the Assessment Year 2016–2017, indicating the reason for treatment of each item. Ignore the provisions relating to Minimum Alternate Tax.

Solution:

Assessee: ABC Ltd.

Previous Year: 2015–2016

Assessment Year: 2016–2017

1. Computation of Profits & Gains of Business or Profession

(₹ Lakhs)

Particulars	Deduction from Profit	Net Profit + Addition to Profit
Net profit as per Profit and Loss Account (Given)		152.00
Adjustments for –		
Depreciation as per Profit and Loss Account		10.00
Income Tax Depreciation allowable u/s 32	15.00	
Cash Payment on 03.12.2015 – Covered under Rule 6DD Exceptions (W.N.1)	–	–
Cash Payment on 10.12.2015 – Disallowed u/s 40A(3) (W.N.1)		0.30
Contribution to Notified Pension Scheme disallowable u/s 36(1)(iva) (W.N.2)		0.50
Payment to Transport Contractor without deduction of TDS – Allowable (W.N.3)		–
Gain on Sale of Land to Subsidiary – considered under Capital Gains	12.00	
Contribution to IIT u/s 35(2AA) (W.N.4)	2.50	–
Fees to Independent Directors without Deduction of TDS (W.N.3)		0.30
Enhanced Compensation – considered under Capital Gains	10.00	
Payment of Term Loan (Interest Portion) – Sec.43B (W.N.5)	2.00	
Dividend from Foreign Company – Considered under Income from other Sources	5.00	
Bill Company from a supplier of vegetables for supply (W.N.10)	2.00	–
Sub–Total	48.50	163.10
Profits & Gains of Business or Profession		114.60

2. Computation of Total Income

(₹ Lakhs)

Particulars		
Profits & Gains of Business or Profession (as above)		114.60
Capital Gains		
Gain on Sale of Land to Subsidiary	12.00	
Less: Exempt u/s 47(iv) (W.N.7)	12.00	–
Enhanced Compensation (W.N.8)		10.00
Income from other Sources		
Dividend from Foreign Company (W.N.9)		5.00
Gross Total Income		129.60
Less: Deduction under Chapter VI–A		Nil
Total Income		129.60

Working Notes:

No.	Description	Reference
1	(a) U/s 40A(3), Expenditure in respect of which aggregate payment made to a person in a day in excess of ₹ 20,000 made otherwise than by way of Account Payee Cheque / Demand Draft is not allowable as deduction. (b) But as per Rule 6DD, read with Circular No.10/2008, payment made for Fish or Fish Products to the Producer, i.e. Fisherman, can be made in cash, hence it is allowable. Since it is already debited to P&L A/c, no further adjustment is required. (c) The above exception will not be available on the payment for the purchase of Fish or Fish Products from a person who is not a 'Producer' and is only a Trader, Broker or any other Middleman, by whatever name called.	Page 6.75, Para 6.4.4, Point 6
2	Contribution towards Notified Employees' Pension Scheme is allowable only upto 10% of the Salary u/s 36(1)(iva). Hence, amount disallowed = Excess 2% = ₹ 3 Lakhs X 2%/12%	Page 6.52, Para 6.31B
3	(a) U/s 40(a)(ia), any payment made to a Resident, on which Tax is deductible, but tax has not been deducted, 30% of Amount paid without deduction of tax will be disallowed in computing the income of the previous year. The disallowed amount will be allowed in the year of payment. (b) TDS not required for payment to a Contractor, in the business of Plying, Hiring or Leasing Goods Carriages, if the Contractor owns 10 or less Goods Carriages at any time during the PY and furnishes a declaration to that effect along with his PAN, to the Payer. In this case, it is assumed that M/s Bansal Transport owns 10 or less Goods Carriages during PY. Hence, Disallowance u/s 40(a)(ia) shall not apply.	Page 41.11, Para 41.2.6
4	U/s 35(2AA), 200% of sum paid to IIT with a specific direction for use for an Approved Scientific Research Program is allowable as deduction. Already, this expenditure would have been debited to P&L at ₹ 2.5 Lakhs (i.e. 100%). Hence, another 100% is now allowed.	Page 6.39, Para 6.3.5 C
5	At the time of conversion of Unpaid Interest into Term Loa, expenditure is not allowed as deduction u/s 43B. However, at the time of actual payment, the paid amount is allowed as deduction. [Kalpna Lamps & Component Ltd (2002) 255 ITR 491 (Mad)], [M.M. Aqua Technologies Ltd [2015] 60 taxmann.com 237 (Del) (HC)]	Page 6.77
6	Feasibility Studies were conducted for the existing business with a common administration and common fund, and the studies were abandoned without creating a new asset. But, the expenses were of Revenue Nature. [Priya Village Roadshows Limited. (2011) 322 ITR 594 (Del.)] Applying the principles of above, Foreign Travel Expenses incurred is allowed, inspite of the Project was abandoned.	Page 6.59, Priya Village Roadshows Ltd Case
7	Transfer of Capital Asset by a Holding Company to its 100% Subsidiary is not considered as transfer, and not chargeable to Capital Gain Tax u/s 47(iv). Hence, Profit on Sale of Plot of Land to Avimunya Ltd is not taxable. Since this amount would have been credited to P&L, it is now reduced from Total Income.	Page 6.8, Para 6.1.6
8	Enhanced Compensation is taxable on receipt basis only. Since it is already credited, no further adjustment is required.	Page 6.8, Para 6.1.6
9	Dividend from Foreign Company is taxable. Since it is already credited, no further adjustments. Exemption u/s 10(34) is not applicable.	Page 8.12, Para 8.3.2
10	Since a Company should follow Mercantile Basis of Accounting , though the payment for Vegetables Suppliers' Bill has been made in April 2016, it has to be allowed for the Previous Year 2015-2016. Sec.43(2) states that the term " paid " shall be understood as paid or incurred, in accordance with the method of accounting ordinarily employed by the Assessee.	Refer Sec.43(2)

Question 3(a): State with reasons the validity of the following statements:

4 Marks

Statements	Validity	Page Reference
(i) Before completing the assessment of any Foreign Company, the Assessing Officer has to forward a draft of the proposed order of assessment to the Assessee.	Valid	Page 27.31, Para 27.5.5, Hint: Sec.144C Dispute Resolution Provisions are applicable for a Foreign Company.
(ii) Charitable Trusts and Institutions registered under Section 12AA, cannot claim exemption under any of the Clauses of Section 10.	Invalid	Page 23.22, Para 23.4.6 Hint: Profits u/s 10(21), 10(23A), 10(23B), 10(23BB), 10(23C) will continue to be exempt, since Sec. 11(4A) does not override Sec.10.

Question 3(b): Offences by HUF **2 Marks**
 Explain Section 278C applicable in respect of Offences committed by Hindu Undivided families.

Solution: **Refer Page 45.13, Para 45.2.4**

Question 3(c): Penalty for failure to furnish TP documents **4 Marks**
 Fox Limited failed to furnish information and documents sought by the Transfer Pricing Officer (TPO). Can the TPO levy penalty for such failure? How much would be the quantum of penalty imposable for the said failure?

Solution: **Refer Page 45.2, Para 45.1.1 / Page 27.29, Para 27.5.3**

Hint Answer: TPO referred u/s 92CA can levy penalty for such failure.
 Quantum of Penalty = 2% of Value of each International Transaction / Specified Domestic Transaction.

Question 3(d): **6 Marks**
 Details given below relate to Investments made in new Plant & Machinery by Companies which are eligible for deduction under Section 32AC of the Act. (₹ in crores)

Company Name	Previous Year 2014 – 15	Previous Year 2015–16
ABC Ltd	30	85
MNO Ltd	20	50
RST Ltd	70	20

Compute deduction under Section 32AC and given reasons in brief for the amount computed.

Solution: **Refer Principles in Page 6.33, Para 6.3.3**

Computation of Deduction u/s 32AC(1A)

Company	Deduction for AY 2015–2016	Deduction for AY 2016–2017
ABC Ltd	15% × ₹ 30 Crores = ₹ 4.5 Crores	15% × ₹ 85 Crores = ₹ 12.75 Crores
MNO Ltd	Nil (Investment < ₹ 25 Crores)	15% × ₹ 50 Crores = ₹ 7.5 Crores
RST Ltd	15% × ₹ 70 Crores = ₹ 10.5 Crores	Nil (Investment < ₹ 25 Crores)

Question 4(a): Time Limit u/s 263 **4 Marks**
 The assessment of South West Bank Limited for Assessment Year 2011–2012 was made under Section 143(3) on 30th November 2012 allowing deduction under Section 36(1) (vii) on account of Provision for Doubtful Debts and deduction in respect of Foreign Exchange Rate difference as claimed in the Return of Income. Subsequently, the Assessing Officer initiated re-assessment proceeding under Section 147 in respect of deduction under Section 36(1)(viii) of Special Reserve created by the Bank. The order under Section 147 was passed on 31st December 2014. Later, the Principal Commissioner after examining the record of assessment initiated revisionary proceeding under Section 263 by issue of Show Cause Notice to the Bank and passed an order under Section 263 on 31st August 2015 for disallowing in part deduction under Section 36(1)(vii) and deduction for Foreign Exchange Rate difference. The Bank claims that the order passed by the Principal Commissioner under Section 263 is barred by limitation. Examine the correctness or otherwise of the claim of the Bank.

Solution: **Similar to Illustration in Page 38.7 [M 08]**

1. Principle:

- (a) U/s 263(1), the CIT can call and examine any order of the Assessing Officer, and he can revise such order if the AO's order is erroneous and prejudicial to the interest of the revenue.
- (b) U/s 263(2), the revision order shall be passed within 2 years from the end of the financial year in which the order to be revised was passed.

2. Analysis:

- (a) If the Commissioner seeks to revise the original assessment u/s 263 on other items not considered in re-assessment u/s 147, the period of limitation begins from the original assessment order and not from the re-assessment in which the items were not dealt with. Doctrine of Merger is not applicable in this case. **[CIT vs Alagendran Finance Ltd 293 ITR 1 (SC)]**

- (b) Assessment Order u/s 143(3) was passed on 30.11.2012, i.e. during the Financial Year 2012–2013, and that can be revised by the CIT u/s 263 within 2 years from that year, i.e. on or before 31.03.2015.
- (c) In the given case, the CIT passed the order on 31.08.2015, i.e. beyond the time limit of 2 years.

3. **Conclusion:** Hence, in the given case, the contention of the Assessee is valid in law.

Question 4(b):Sec.2(22)(e) – Deemed Dividend

4 Marks

Mr. Santhanam holding 25% voting power in VKS Manufacturing Private Limited permitted his own land to be mortgaged to a bank for enabling the Company to obtain a Loan. Mr. Santhanam requested the Company to release the property from the mortgage. The Company failed to do so, but for retaining the benefit of Bank Loan, it gave an advance of ₹ 10 Lakhs to Mr. Santhanam, which was authorized by a resolution passed by the Board of Directors. The Company's Accumulated Profit on the date of payment of advance was ₹ 50 Lakhs. The Assessing Officer proposes to tax the amount of ₹ 10 Lakhs by invoking the provision of Section 2(22)(e). Is the proposition of the Assessing Officer correct in law?

Solution:

Refer Page 8.13, Para 8.3.2

Advances to a Shareholder to protect Co.'s Interest	Advance given to the Assessee by the Company was not in the nature of a gratuitous advance, instead it was given to protect the interest of the Company. So, the said Advance cannot be treated as Deemed Dividend in the hands of the Shareholder u/s 2(22)(e). [Pradip Kumar Malhotra (2011) 338 ITR 538 (Cal.)]
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Hint Answer: In the given case, the advance given to Mr. Santhanam is not a gratuitous advance, and hence the provisions of Sec.2(22)(e) are not attracted. Hence, the contention of Assessing Officer is **not correct**.

Question 4(c): Partnership Firm – Allowability of Remuneration

4 Marks

X & Co. a Partnership Firm consisting of three Partners enhanced Working Partner Salary from ₹ 25,000 per month for each Partner to ₹ 50,000 per month for each Partner. The increase in Working Partner Salary was authorized by the Deed of partnership.

The Assessing Officer during the course of assessment contended that the remuneration paid to Working Partners @ ₹ 50,000 per month of each partner as excessive and applied Section 40A (2) (a) though the payment was within the statutory limit prescribed under Section 40(b)(v). Decide the correctness of action of the Assessing Officer.

Solution:

Refer Page 6.73 Para 6.4.3, Page 17.4 & Para 17.2.2

- Principle:** So long as the remuneration is within ceiling limit provided in law, recourse to Sec.40A(2) cannot be taken. **[Great City Manufacturing Company 33 taxmann 258]**
- Analysis & Conclusion:** Since the enhancement of remuneration is authorized by the Partnership Deed & is also within the statutory limit prescribed u/s 40(b)(v), the AO's contention in this case is not correct.

Question 4(d): AOP vs Individual Capacity – Inherited Property

4 Marks

Two brothers say, A and B inherited lands equally consequent to the demise of their father. Subsequently, those lands were compulsorily acquired by the State Government. Both A and B received compensation, enhanced compensation and interest on enhanced compensation. They admitted these as Income in their individual status. Now the Assessing Officer wants to assess income from compulsory acquisition of lands in the status of Association of Persons (AOP). Is the action of Assessing Officer justified in law?

Solution:

Refer Page 22.1, Para 22.1, Laxmi Pvt Ltd & Sons 316 ITR 330 (All) Case Decision.

Hint Answer: A & B should be taxed in their individual capacity, and not as AOP.

Question 4(e): Power to call for information u/s 133

4 Marks

A Co-Operative Society engaged in Banking Business received a letter from the Assistant Commissioner of Income-Tax (ACIT), to furnish details of all persons who have made Time Deposit of ₹ 1 Lakh or above during the period from 01.04.2014 to 31.03.2015.

There is no pending proceeding against the Co-Operative Society at the time of receipt of letter. As a Chartered Accountant, what would be your advise to the Co-operative society regarding legality of the notice?

Solution: Similar to Illustration in Page 32.5

- Principle:** With the prior approval of DIT / CIT, the A.O. may collect information from Banking Company or any other Department, even if no assessment is pending. [**Kathiroom Service Cooperative Bank Ltd. vs. CIT (CIB) 2013 (SC)**], [**Ketchery Service Co-op. Bank Ltd 263 ITR 161 (Ker.)**]
- Analysis and Conclusion:** In the above case, the Co-Operative Society may have to provide the information, even if no proceeding is pending, if the notice is issued with the prior approval of the DIT / CIT.

Question 5(a): Income escaping Assessment – Principles to be followed by AO and Assessee **4 Marks**
 RKJ Private Limited's assessment for Assessment Year 2011–2012 was completed under Section 143(3) on 15th November 2012. The Company received a notice under Section 148 dated 15th July 2015 requiring the Company to submit a return of income for Assessment Year 2011–2012 on the ground of escapement of certain income from assessment.

The Company has approached you for advice on the principles to be followed by it before notice under Section 143(2) for the purpose of reassessment is issued by the Assessing Officer.

State the principles to be followed by the Company and the Assessing Officer.

Solution: Refer Page 33.3, Para 33.2.3 & Page 34.6, Para 34.3

- Principles to be followed by the Company:** Refer Page 34.6, Para 34.3, Point 2.
- Principles to be followed by the AO:**
 - AO should have reason to believe that any income chargeable to tax has escaped Assessment.
 - The scope of Income escaping Assessment is as per Sec. 147.
 - AO should serve a Notice on the Assessee, as per Sec. 148 requirements.
 - Notice should be issued within the specified Time Limits and with prior sanction as per Sec. 151.

Question 5(b): Income Distribution by REIT – Tax / TDS effect. **4 Marks**
 A Real Estate Investment Trust (REIT) received Income of ₹ 120 Lakhs from Special Purpose Vehicle Company. The break-up of the income so received is as follows:

Interest	₹ 90 Lakhs
Dividend	₹ 30 Lakhs

The REIT distributes ₹ 90 Lakhs to its unit-holders. 40% of the Unit Holders are Non-Residents.

Examine the tax implication of the above transactions in the hands of the REIT and Unit Holders including the requirement to deduct tax at source.

Solution: Refer Principles in Page 19.60, Para 19.4.3 D, Similar to Illustration in Page 19.61

- Interest Income of ₹ 90 Lakhs from SPV:**
 - Interest Income is **not taxable** in the hands of REIT, due to pass through status enjoyed by it in respect of Interest Income from SPV. [**Sec.10(23FC)**]. Therefore, SPV is not required to deduct TDS on Interest Payment to REIT. [**Sec.194A(3)(xi)**]
 - Interest Component of Income distributed by the REIT has the following impact–

If Payee /Unit-Holder is –	Taxable in Payee's Hands at rate of	TDS to be deducted by REIT at –	TDS Amount [See Note]
• Resident	Normal Rates of Tax	10%	(a) ₹ 90 Lakhs × 75% × 60% × 10% = ₹ 4.05 Lakhs
• Non-Corporate Non-Resident (or) Foreign Company	5%	5%	(b) ₹ 90 Lakhs × 75% × 40% × 5% = ₹ 1.35 Lakhs
Total			₹ 5.40 Lakhs

Note: The Interest Component of Income received from the REIT in the hands of each Unit-Holder would be determined proportionately. So, ₹ 90 Lakhs distributed out of ₹ 120 Lakhs Income = 75%

2. Dividend Income of ₹ 30 Lakhs from SPV:

- (a) No Tax Liability in the hands of REIT, since Dividend is subject to Dividend Distribution Tax u/s 115-O in the hands of the SPV. [**Sec.115-O & Sec.10(34)**]
- (b) No Tax Liability on the dividend component of Income distributed to Unit Holders by REIT. [**Sec.10(23FD)**]. Hence, no TDS thereon.

Question 5(c): Associated Enterprise – TP Adjustments – Total Income 6 Marks

XE Ltd is an Indian Company in which Zilla Inc. a US Company has 28% Shareholding and voting power. Following transactions were effected between these two Companies during the financial year 2015–2016.

- (i) XE Ltd sold 1,00,000 pieces of T-Shirts at \$ 2 per T-Shirt to Zilla Inc. The identical T-Shirts were sold to unrelated party namely Kennedy Inc. at \$ 3 per T-Shirt.
- (ii) XE Ltd borrowed \$ 2,00,000 from a Foreign Lender based on the guarantee of Zilla Inc. For this, XE Ltd paid \$ 10,000 as Guarantee Fee to Zilla Inc. To an unrelated party for the same amount of loan, Zilla Inc. collected \$ 7,000 as Guarantee Fee.
- (iii) XE Ltd paid \$ 15,000 to Zilla Inc. for getting various potential customers details to improve its business. Zilla Inc. provided the same service to unrelated parties for \$ 10,000.

Assume the rate of exchange as 1 \$ = ₹ 64. XE Ltd is located in a Special Economic Zone (SEZ) and its Income before transfer pricing adjustments for the year ended 31st March, 2016 was ₹ 1,200 Lakhs. Compute the adjustments to be made to the Total Income of XE Ltd. State whether it can claim deduction under Section 10AA for the Income enhanced by applying transfer pricing provisions.

Solution: **Similar to Illustration in Page 27.6 [RTP]**

Computation of Total Income

Assessee: XE Ltd

Previous Year: 2015–2016

Assessment Year: 2016–2017

Note: Since Zilla Inc. holds Shares carrying > 26% of the voting power in XE Ltd, it is an Associated Enterprise u/s 92A(2)(a).

Particulars	₹ in Lakhs	₹ in Lakhs
Income as computed under Chapter IVD (before adjustments)		1,200.00
Add: Adjustments for International transactions		
• Excess Payment for getting Potential Customers (\$ 5,000 × ₹ 64)	3.20	
• Excess Guarantee Fee Paid (\$ 3,000 × ₹ 64)	1.92	
• Difference in Price of T-Shirts @ \$1 each for 1,00,000 Pieces (\$1 × 1,00,000 × ₹ 64)	64.00	69.12
Taxable Profits and Gains from Business or Profession		1,269.12

Allowability of Deduction u/s 10AA: Refer Page 27.26, Para 27.4.4

No deduction shall be allowed u/s 10A/10B/10AA or under Chapter VI A on the enhanced income.

Question 6(a): Total Income, No DTAA, Tax Impact 7 Marks

Mr. Kamesh, an Individual resident in India furnishes you the following particulars of income earned in India, Country "X" and Country "Y" for the previous year 2014–2015. India has not entered into Double Taxation Avoidance Agreement with these two countries.

Particulars	₹
Income from Profession carried on in India	7,50,000
Agricultural Income in Country "X" (Gross)	50,000
Dividend received from a Company incorporated in Country "Y" (Gross)	1,50,000
Royalty Income from a literary book from Country "X" (Gross)	6,00,000
Expenses incurred for earning Royalty	50,000
Business Loss in Country "Y" (Proprietary Business)	65,000
Rent from a house situated in Country "Y" (Gross)	2,40,000
Municipal Tax in respect of the above house (not allowed as deduction in Country "Y")	10,000

Note: Business Loss in Country "Y" not eligible for set off against other incomes as per law of that country.

The rates of tax in Country "X" and Country "Y" are 10% and 25% respectively.

Compute Total Income and Tax Payable by Mr. Kamesh in India for Assessment Year 2016–2017.

Solution: Refer Principles in Page 28.4, Bombay Burmah Trading Corpn Ltd Case & Illustrations

Assessee: Kamesh (Resident)

Previous Year: 2015–2016

Assessment Year: 2016–2017

1. Computation of Total Income and Tax Payable

Particulars	₹	₹
Income from House Property		
Annual Value u/s 23(1)(a)/(b) = Rent receivable for whole year	2,40,000	
Less: Municipal Taxes Paid	(10,000)	
Net Annual Value	2,30,000	
Less: Deduction u/s 24 – 30% of Net Annual Value	(69,000)	1,61,000
Profits and Gains from Business or Profession		
(a) Income from Profession in India	7,50,000	
(b) Royalty Income (₹ 6,00,000 – ₹ 50,000)	5,50,000	
(c) Business Loss in Country 'Y'	(65,000)	12,35,000
Income from other Sources		
(a) Dividend received from Country 'Y'	1,50,000	
(b) Agricultural Income from Country 'X'	50,000	2,00,000
Gross Total Income		15,96,000
Less: Chapter VI–A Deduction u/s 80QQB		
(a) Actual Royalty received (₹ 6,00,000 – ₹ 50,000)	5,50,000	
(b) Prescribed Amount, whichever is lower	3,00,000	3,00,000
Total Income		12,96,000
Tax on Total Income [₹ 1,25,000 + (₹ 12,96,000 – ₹ 10,00,000)]		2,13,800
Add: Education Cess @ 2%		4,276
Add: Secondary and Higher Education Cess @1%		2,138
Total Tax Payable		2,20,214
Less: Relief u/s 91		(71,795)
Net Tax Payable (Rounded off)		1,48,420

2. Computation of Country–wise Income & Relief u/s 91

Particulars	India	Country 'X'	Country 'Y'
Income from House Property	1,61,000	–	1,61,000
Profits and Gains from Business / Profession	12,35,000	5,50,000	(65,000)
Income from other Sources	2,00,000	50,000	1,50,000
Less: Deduction under Chapter VI–A	(3,00,000)	(3,00,000)	
Income chargeable to Tax in India	12,96,000	3,00,000	2,46,000
Tax Liability	2,20,214		
Average Rate of Tax	$\frac{2,20,214}{12,96,000} = 16.99\%$	10% (Given)	25% (Given)
Rate for computing Relief u/s 91 (Least of Indian Tax Rate or Tax Rate of Foreign Country)		10%	16.99%
Relief u/s 91 (Foreign Income chargeable to Tax × Above Tax Rate)		30,000	41,795

Question 6(b): Search Assessment – Presumptions

3 Marks

Books of account and certain assets are found to be in possession of the person, whose premises are searched. What are the rebuttable presumptions regarding those items?

Solution:

Refer Page No. 35.4, Para No.35.1.4

Question 6(c): HUF – Taxation in different Scenarios 6 Marks

Mr. Ram (age 56) is Karta of his HUF. The HUF consists of himself, his wife and two sons viz. Mr. C (age 28) and Minor D (age 16). The HUF is assessed to Income Tax and has Business Income from the year 2000–2001 onwards. The Business Income of HUF for the year ended 31.03.2016 is ₹ 5,00,000 (computed). Mr. Ram is employed in a Private Company and his Salary Income for the same period is ₹ 6,10,000 (computed).

You are requested to answer the following treating each of them as independent situations:

- (i) Mr. C gave cash gift of ₹ 1,00,000 to be HUF of Mr. Ram. What would be the Total Income of HUF?
- (ii) The HUF has one House Property fetching rent of ₹ 10,000 per month and some movable assets. There is a proposal to make a partial partition of HUF by allotting the house property to Mr. C. Is it advisable to do a partial partition?
- (iii) Minor D earned ₹ 70,000 by use of his special skill and talent. How would his income be taxed?
- (iv) A Car owned personally by Mr. Ram was blended with HUF during the year. It was leased out for a monthly rent of ₹ 10,000 from 01.10.2015. How would this income be taxed?

Solution:

	Hint Answer	Page Reference
(i)	Gifts Received by a HUF from any Member of HUF is not taxable u/s 56(2)(vii). Hence, Total Income of HUF remains at ₹ 5,00,000.	Page 8.4, Para 8.2.1
(ii)	Since 01.04.1978, Partial Partition is prohibited under the Income Tax Act. Where a partial partition has taken place, HUF shall continue to be assessed, as if no such partial partition had taken place. Hence, it is not advisable to do a partial partition.	Page 16.4, Para 16.4
(iii)	Income of Minor Child shall not be clubbed if such Income is on account of exercise of any special skill or talent. Hence, Minor D's Income ₹ 70,000 will be taxed in his hands.	Page 9.6, Para 9.2.1
(iv)	As per Sec.64(2), Income from Individual's Asset blended with HUF for inadequate consideration, will be taxed only in the Individual's hands .	Page 9.8, Para 9.2.2

Question 7(a): Refusal to admit Appeal – CIT (A)'s Powers 3 Marks

Can Commissioner (Appeals) refuse to admit an appeal even though such appeal is filed within time?

Solution: **Refer Page 39.3, Para 39.2.2, Point 5**

CIT (A) can refuse to admit an Appeal filed within time, if at the time of filing such Appeal, the Assessee has not paid –

- (a) Tax due on the **Income Returned** (not Income Assessed), if Return of Income has been filed, or
- (b) Advance Tax Payable, if no Return of Income has been filed [subject to exemption by CIT(A)].

Question 7(b): TDS – Non-Filing of Statement – Consequences 6 Marks

Mr. Madhusudan is regular in deducting tax at source and depositing the same. In respect of the quarter ended 31st December 2015 a sum of ₹ 75,000 was deducted at source from the Contractors. The Statement of Tax deducted at source under Section 200 was filed on 23rd March 2016 for the quarter ended 31.12.2015.

- (i) Is there any delay on the part of Mr. Madhusudan in filing the Statement of TDS?
- (ii) If the answer to (i) above is in the affirmative, how much amount can be levied on Mr. Madhusudan for such default under Section 234 E?
- (iii) Is there any remedy available to him for reduction/waiver of the levy?

Solution:

	Hint Answer	Page Reference
(i)	Yes, there is a delay in e-filing of TDS Returns / Statements. Due date for furnishing the e-TDS Returns falls on 15 th January 2016, for the quarter ending 31 st December 2015, since Madhusudan is an Individual Deductor (assumed).	Page 41.37, Para 41.4.8
(ii)	Failure to file TDS Return u/s 200(3) shall be liable for a fee of ₹ 200 per day of default, and shall not exceed the amount of tax deductible. Here, delay = 16 + 29 + 23 = 68 days. So, Fee u/s 234E = Least of ₹ 200 × 68 days = ₹ 13,600 or ₹ 75,000 being TDS Amount. Least Amount = ₹ 13,600. [Note: In addition, Penalty u/s 271–H is also leviable.]	Page 41.41, Para 41.5.2, Point 2,3
(iii)	Penalty u/s 271–H may be waived by CIT / PCIT by virtue of powers u/s 273A(4). However, there is no reduction / waiver of Fee u/s 234E.	Page 45.10, Para 45.1.5

Question 7(c): TDS – Applicability

4 Marks

Smt. Vijaya, Proprietor of Lakshmi Enterprises, made Turnover exceeding ₹ 100 Lakhs during the previous year 2014–2015. Her turnover for the year ended 31.03.2016 was ₹ 90 Lakhs.

Decide whether provisions relating to deduction of tax at source as attracted for the following payments made during the financial year 2015–2016:

- (i) Purchase Commission paid to one agent ₹ 25,000 towards purchases made during the year.
- (ii) Payments of Civil Engineer of ₹ 5,00,000 for construction of Residential House for self use.

Solution:

	Hint Answer	Page Reference
(i)	During the preceding Financial Year, Individual Assessee is subject to Tax Audit u/s 44AB, since Turnover > ₹ 100 Lakhs. Hence, Smt. Vijaya is liable to deduct TDS u/s 194H, 194C, etc.	Page 4.16, Para 41.2.11
(ii)	Since Commission Payments exceed ₹ 5,000, TDS shall be deducted at 10% u/s 194H. TDS amount = ₹ 2,500 for Purchase Commission Expense.	Page 41.4, Para 41.2.11
(iii)	Sums paid by Individual / HUF towards professional service exclusively for their personal purposes do not require TDS u/s 194–J or 194–C. Hence, there is no need to deduct TDS for the payment made to Civil Engineer in this case.	Page 41.21, Para 41.2.14 & Page 41.11, Para 41.2.6

Question 7(d): Settlement Commission – Power to amend order

3 Marks

Explain the powers of Settlement Commission to amend its order.

Solution:

Refer Page 37.7, Para 37.4, Point 5

Power to rectify its own order Sec.245D(6B), Rectification of Mistake.

STUDENTS' NOTES

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