**MOCK TEST PAPER**

**FINAL (NEW) COURSE: GROUP – II**

**PAPER – 7: DIRECT TAX LAWS & INTERNATIONAL TAXATION**

**SOLUTIONS**

**1. (a) Computation of Total Income of Organic Ltd. for the A.Y. 2018-19**

| Particulars | Amount (₹) | |
|---|---|---|
| **Profits and Gains from Business and Profession** | | |
| Net profit as per profit and loss account | | 4,50,00,000 |
| ***Add:*** **Items debited but to be considered separately or to be disallowed/** | | |
| - Depreciation provided on straight line basis **(Note 1)** | 30,00,000 | |
| - Disallowance under section 40A(3) for payment exceeding ₹ 10,000 made in cash for purchases and expenditure **(Note 2)** | 6,00,000 | |
| - Disallowance under section 40A(3) for cash payment exceeding ₹ 35,000 in a day to transport operators for hiring of lorry **(Note 3)** | 1,10,000 | |
| - Expenditure on scientific research on in-house approved research and development facility (considered separately for weighted deduction) **(Note 4)** | 7,50,000 | |
| - Expenditure on earning dividend from foreign company not deductible **(Note 5)** | 50,000 | |
| - Tax has not been deducted on the GST component of professional charges paid to consultant **(Note 6)** | - | |
| - Disallowance under section 40A(2) for excess payment to related person **(Note 7)** | 5,00,000 | |
| - Employee's contribution to EPF **(Note 8)** | 3,50,000 | |
| - Employer's contribution to EPF **(Note 9)** | - | |
| - Donations to electoral trust and registered political party **(Note 11)** | 2,00,000 | 55,60,000 |
| | | **5,05,60,000** |
| ***Less:*** **Items credited but to be considered separately or to be allowed/ permissible expenditure and allowances** | | |
| - Depreciation allowable under the Income-tax Act, 1961 **(Note 1)** | 48,00,000 | |
| - Weighted deduction @ 150% in respect of expenditure on scientific research on in-house approved research and development facility under section 35(2AB) **(Note 4)** | 11,25,000 | |
| - Dividend received from foreign company to be considered under the head "Income from other sources" **(Note 5)** | 6,00,000 | 65,25,000 |
| | | **4,40,35,000** |
| Add: Recovery of bad debts credited in reserve but chargeable under section 41(4) **(Note 10)** | | 1,50,000 |

| | | |
|---|---|---|
| Profits and gains from business and profession | | **4,41,85,000** |
| **Income from Other Sources** | | |
| Dividend from foreign company **(Note 5)** | 6,00,000 | **6,00,000** |
| **Gross Total Income** | | **4,47,85,000** |
| *Less:* Deduction under Chapter VI-A | | |
| Under section 80GGB [Donation to registered political party] **(Note 11)** | | 1,25,000 |
| **Total Income** | | **4,46,60,000** |

**Notes:**

(1) Depreciation provided in the accounts on straight line basis (i.e., ₹ 30 lakhs) has to be added back and depreciation calculated as per Income-tax Rules, 1962 (i.e. ₹ 48 lakhs) is allowable as deduction under section 32.

As per second proviso to section 43(1), the expenditure for acquisition of asset, in respect of which payment to a person in a day exceeds ₹ 10,000 has to be ignored for computing actual cost, if such payment is made otherwise than by way of A/c payee cheque/ bank draft or ECS. Accordingly, depreciation on second hand machinery purchased on 23.10.2017 is not allowable since the payment is made otherwise than by A/c payee cheque/A/c payee draft/ ECS to a person in a day. No adjustment is required to be made since depreciation in respect of such plant and machinery is not included in the depreciation given.

(2) Cash payments exceeding ₹ 10,000 in a day attracts disallowance under section 40A(3). However, Rule 6DD provides for certain exceptions, which includes, *inter alia,* payments which are required to be made on a day on which the banks were closed either on account of holiday or strike or where the payment is made for the purchase of agricultural produce. Therefore, cash payment of ₹ 5.5 lakhs for the purchase of agricultural produce and cash payment of ₹ 12 lakhs made on a bank holiday would not attract disallowance under section 40A(3), assuming such payment was required to be made on 01.04.2017. However, cash payment of ₹ 6 lakhs made on 17-01-2018 due to demand of supplier would attract disallowance under section 40A(3), since the same is not covered under any of the exceptions laid out in Rule 6DD.

(3) In respect of cash payments to transport operators, a higher limit of ₹ 35,000 per day is permissible. Therefore, cash payment of ₹ 25,000 on 10-6-2017 would not attract disallowance under section 40A(3). However, cash payments of ₹ 70,000 and ₹ 40,000 on 25.8.2017 and 10.02.2018, respectively, would attract disallowance under section 40A(3) since the same exceeds ₹ 35,000 per day in cash.

(4) Expenditure incurred on scientific research on in-house research and development facility approved under section 35(2AB) by a company engaged in the business of manufacturing qualifies for weighted deduction@150%. Hence, such expenditure of ₹ 7.5 lakhs is first added back and thereafter, deduction of ₹ 11.25 lakhs (i.e., 150% of ₹ 7.5 lakhs) has been provided under section 35(2AB).

(5) Under section 115BBD, dividend received by an Indian company from a foreign company in which it holds 26% or more in nominal value of the equity share capital of the company, would be subject to a concessional tax rate of 15%. This rate of 15% would be applied on gross dividend, in the sense, that no expenditure would be allowable in respect of such dividend.

Therefore, dividend of ₹ 6 lakhs received by Organic Ltd. from a foreign company, in which it holds 30% in nominal value of equity share capital of the company, would be subject to tax@15% under section 115BBD. Such dividend would be taxable under the head "Income

from other sources". No deduction is allowable in respect of ₹ 50,000 expended on earning this income.

Since such dividend has been credited to the profit and loss account, the same has to be reduced for computing income under the head "Profits and gains of business or profession. Likewise, ₹ 50,000, representing expenditure for earning dividend income, which has been debited to profit and loss account, should be added back for computing business income.

(6) Professional charges have been debited to profit and loss account. It is stated that tax has not been deducted on the GST component of professional charges.

In respect of professional charges, *CBDT Circular No.23/2017 dated 19.7.2017* clarifies that if in terms of the agreement/contract between the payer and the payee, the GST component comprised in the amount payable to a resident is indicated separately, tax shall be deducted at source on the amount paid/payable without including such GST component.

In this case, the GST component is indicated separately in the agreement/contract between the company and the consultant, tax is required to be deducted at source on the professional charges without including such GST component. Therefore, no disallowance is attracted for non-deduction of tax at source on the GST component.

(7) ABC Ltd. is a related person under section 40A(2), since the directors of the Organic Ltd. have substantial interest in ABC Ltd. Therefore, excess payment of ₹ 5 lakh to ABC Ltd. for purchase of goods would attract disallowance under section 40A(2).

(8) Employees' contribution to PF deposited after the due date mentioned under the PF Act is not allowable as deduction as per section 36(1)(va). The same has also been affirmed by the Gujarat High Court in *CIT v. Gujarat State Road Transport Corporation (2014) 366 ITR 170.* Hence, in the above solution, employees' contribution to PF has been disallowed while computing business income. Since the same has been debited to profit and loss account, it has to be added back for computing business income

***Alternate View*** *- An alternate view has, however, been expressed in CIT v. Kiccha Sugar Co. Ltd. (2013) 356 ITR 351 (Uttarakhand), CIT v. AIMIL Ltd (2010) 321 ITR 508 (Del) and CIT v. Nipso Polyfabriks Ltd (2013) 350 ITR 327 (HP) that employees contribution to PF, deducted from the salaries of the employees of the assessee, shall be allowed as deduction from the income of the employer-assessee, if the same is deposited by the employer-assessee with the provident fund authority on or before the due date of filing of return for the relevant previous year. If this view is considered, then no disallowance would be attracted in this case, since the employees' contribution has been remitted before the due date of filing of return of income.*

(9) As per section 43B, employers' contribution to EPF is allowable as deduction since the same has been deposited on or before the 'due date' of filing of return under section 139(1). Since the same has been debited to profit and loss account, no further adjustment is necessary.

(10) Recovery of a debt which was earlier written off under section 36(1)(vii) and was allowed as deduction is chargeable to tax under section 41(4) in the year of such recovery. Accordingly, the amount of ₹ 1.5 lakhs has to be added to income despite the fact that the same was credited by the company in a reserve account.

(11) Donation to an electoral trust and a registered political party is not an allowable expenditure under section 37 since it is not laid out wholly or exclusively for the purposes of business or profession. Hence, the same has to be added back while computing business income.

However, donation made by a company to an electoral trust or registered political party is allowable deduction under section 80GGB from gross total income, subject to the condition that payment is made otherwise than by way of cash. Since the donation to electoral trust is

made in cash, the same does not qualify for deduction under section 80GGB. However, donation of ₹ 1.25 lakh by cheque to a registered political party would be eligible for deduction under section 80GGB.

**(b) Computation of total income and tax liability of Mr. Kashyap for the A.Y. 2018-19**

| Particulars | | | ₹ |
|---|---|---|---|
| Indian Income [Income from Rifle Shooting in India] | | | 17,20,000 |
| Foreign Income [Income from Rifle Shooting in Country X] | | | 14,50,000 |
| **Gross Total Income** | | | **31,70,000** |
| *Less:* Deduction under Chapter VI-A | | ₹ | |
| **Deduction under section 80C** | | | |
| Life insurance premium | | 1,10,000 | |
| Deposit in PPF | | 1,50,000 | |
| | | 2,60,000 | |
| The aggregate of deduction under section 80C has to be restricted to ₹ 1,50,000 | | 1,50,000 | |
| **Deduction under section 80D** | | | |
| Medical insurance premium of ₹ 32,000 paid for his father aged 82 years, allowable as deduction to a maximum of ₹ 30,000, since his father is a senior citizen (assuming that his father is also a resident in India) and payment is made by any mode other than cash. | | 30,000 | 1,80,000 |
| **Total Income** | | | **29,90,000** |
| **Tax on Total Income** | | | |
| Income-tax | | 7,07,000 | |
| *Add:* Education cess @ 2% | | 14,140 | |
| *Add:* Secondary and higher education cess @ 1% | | 7,070 | 7,28,210 |
| Average rate of tax in India (i.e. ₹ 7,28,210/₹ 29,90,000 × 100) | 24.3548% | | |
| Average rate of tax in foreign country (i.e. ₹ 2,61,000/₹ 14,50,000 ×100) | 18.00% | | |
| Rebate under section 91 on ₹ 14.50 lakh @ 18% (lower of average Indian-tax rate or average foreign tax rate) | | | 2,61,000 |
| Tax payable in India (₹ 7,28,210 – ₹ 2,61,000) | | | **4,67,210** |

**Note:** Mr. Kashyap shall be allowed deduction under section 91, since the following conditions are fulfilled;

(a) He is a resident in India during the relevant previous year.

(b) The income accrues or arises to him outside India during that previous year and such income is not deemed to accrue or arise in India during the previous year.

(c) The income in question has been subjected to income-tax in Country X in his hands and he has paid tax on such income in Country X.

(d) There is no agreement under section 90 for the relief or avoidance of double taxation between India and Country X where the income has accrued or arisen.

**2. (a) Computation of book profit for levy of MAT under section 115JB for A.Y. 2018-19**

| Particulars | ₹ | ₹ |
|---|---|---|
| Net Profit as per Statement of Profit and Loss | | 95,00,000 |
| Add: Net Profit to be increased by the followings amounts as per *Explanation 1* below section 115JB(2) | | |
| - Depreciation | 10,00,000 | |
| [to be added back as per clause (g) of *Explanation 1* below section 115JB(2)] | | |
| - Provision for doubtful debts i.e. provision for diminution in value of asset i.e. debtors | 2,00,000 | |
| [to be added back as per clause (i) of *Explanation 1* below section 115JB(2)] | | |
| - Reserve for currency fluctuation reserve | 1,25,000 | |
| [amount carried to any reserves, by whatever name called, to be added back as per clause (b) of *Explanation 1* below section 115JB(2)] | | |
| | | 13,25,000 |
| | | 1,08,25,000 |
| *Less*: Net Profit to be decreased by the followings amounts as per *Explanation 1* below section 115JB(2) | | |
| - Dividend received on investment in Indian companies | 2,50,000 | |
| [Dividend income is to be reduced while computing the book profits as per clause (ii) of *Explanation 1* below section 115JB(2), since such dividend is exempt under section 10(34) | | |
| - Net agricultural income | 5,00,000 | |
| Net agricultural income is to be reduced as per clause (ii) of *Explanation 1* below section 115JB(2), since it is exempt under section 10(1)] | | |
| - Depreciation other than deprecation on revaluation of assets is to be reduced while computing book profit as per clause (iia) of *Explanation 1* below section 115JB(2) [10,00,000 – 1,90,000] | 8,10,000 | |
| | | 15,60,000 |
| **Book profit under section 115JB** | | **92,65,000** |

**Computation of Minimum Alternate Tax under section 115JB**

| Particulars | ₹ |
|---|---|
| 18.50% of book profit (₹ 92,65,000 x 18.50%) | 17,14,025 |
| ***Add:*** Education cess@2% | 34,281 |
| Secondary and higher education cess@1% | 17,140 |
| **Minimum Alternate Tax under section 115JB** | **17,65,446** |
| **MAT Liability (rounded off)** | **17,65,450** |

**Notes:**

(1) Only the specified items mentioned under *Explanation 1* below section 115JB(2) can be added back or deducted to the net profit as per the Statement of Profit and Loss prepared as per the Companies Act for computing book profit for levy of MAT. Since the following items are not specified in the said *Explanation 1*, the same cannot be added back or deducted for computing book profit:

- Penalty for infraction of law
- Unpaid interest to financial institutions
- Profits from a new industrial undertaking eligible for deduction under section 80-IA

(2) For computing the book profit, since provisions for GST is an ascertain liability, it is not added back.

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

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

(5) Long-term capital gains cannot be deducted while computing book profit even if such amount of capital gains is invested in specified assets under section 54EC, since book profit has to be computed by adding/deducting the items mentioned under *Explanation 1* below section 115JB(2) alone. Capital Gains reflected in the statement of profit and loss shall be part of book profit under section 115JB. Capital gains exempted under section 54EC cannot also be excluded for computing book profit. *[CIT v. Veekaylal Investment Co. P. Ltd. (2001) 249 ITR 597 (Bom.) & N J Jose and Co. (P) Ltd. v. ACIT (2010) 321 ITR 132 (Ker.)]*

**(b) Computation of tax payable by Mr. John for the A.Y. 2018-19 as per Chapter XII-A**

| Particulars | ₹ | ₹ |
|---|---|---|
| Tax on long term capital gain (₹ 45,670 × 10%) **[See Notes 1 & 2]** | 4,567 | |
| Tax on interest on debentures being investment income (₹ 1,20,000 × 20%) **[See Notes 1 & 3]** | 24,000 | |
| Tax on balance income of ₹ 2,30,000 | Nil | 28,567 |
| *Add:* Education cess @ 2% | | 571 |
| *Add:* Secondary and higher education cess @ 1% | | 286 |
| **Tax Payable** | | **29,424** |
| **Tax Payable (rounded off)** | | **29,420** |

**Notes:**

**(1) Computation of Total Income of Mr. John for the A.Y. 2018-19 as per provisions of Chapter XII-A**

| Particulars | ₹ | ₹ |
|---|---|---|
| Income from house property (computed) | | 2,30,000 |

| | | |
|---|---|---|
| **Capital Gains on sale of debentures** | | |
| Sale consideration | 6,25,000 | |
| *Less*: Commission to brokers | 7,000 | |
| Net sale consideration | 6,18,000 | |
| *Less:* Cost of acquisition **(Refer Note 2)** | 4,50,000 | |
| Long term capital gain | 1,68,000 | |
| *Less:* Exemption under section 115F | 1,22,330 | 45,670 |
| 1,68,000 x 4,50,000/6,18,000 | | |
| *(If within a period of six months after the date of transfer of a long term foreign exchange asset, the non-resident Indian invested the whole or part of the net consideration in any specified asset, he is eligible to claim deduction as per section 115F)* | | |
| Dividend income received from Indian companies [exempt under section 10(34)] | | Nil |
| Interest on debentures of Indian company **(Refer Note 3)** | | 1,20,000 |
| **Total Income** | | **3,95,670** |

(2) As per section 115D, the indexation benefit would not be available for calculating cost of acquisition for computing long term capital gains under Chapter XII-A.

(3) No expenditure is allowed to be deducted from the interest on debentures being the investment income as per the provisions of section 115D. Therefore, interest on loan taken for purchase of debentures is not deductible.

(4) As per the provisions of section 115E, the tax rate applicable on investment income is 20% and on the long-term capital gain the tax rate applicable shall be 10%. The balance income shall be chargeable to tax as per the normal tax rates.

(5) The debentures referred to in the question are issued by an Indian company which is not a private company and are hence, specified assets. Since the specified assets have been subscribed in convertible foreign exchange, they are foreign exchange assets.

**3. (a) (i) Computation of tax payable by Mr. Anish for the A.Y. 2018-19**

| Particulars | ₹ | ₹ |
|---|---|---|
| Tax on long term capital gain @20% on ₹ 73,90,000 [₹ 75,50,000 less unexhausted basic exemption limit i.e., ₹ 1,60,000 (₹ 2,50,000 - ₹ 90,000)] as per section 112 **[See Working Note]** | | 14,78,000 |
| Tax on other income of ₹ 90,000 | | Nil |
| | | 14,78,000 |
| Add: Surcharge @ 10%, since total income exceeds ₹ 50 lakhs | | 1,47,800 |
| | | 16,25,800 |
| *Add:* Education cess @ 2% | | 32,516 |
| *Add:* Secondary and higher education cess @ 1% | | 16,258 |
| Total tax liability | | 16,74,574 |
| **Total tax liability (rounded off)** | | **16,74,570** |

**Working Note:**

**Computation of total income for the A.Y. 2018-19**

| | Particulars | ₹ |
|---|---|---|
| A | Long-term capital gains | 1,25,50,000 |
| | *Less:* Deduction under section 54EC **[See Notes 1 & 2 below]** | 50,00,000 |
| | Long-term capital gain | 75,50,000 |
| B | Other income | 90,000 |
| | **Total Income** | **76,40,000** |

**Notes:**

(1) In order to claim exemption under section 54EC, the assessee has to invest in specified bonds of RECL or NHAI or any other bond notified by Central Government namely, PFCL or IRFC bonds within a period of 6 months from the date of transfer of the asset.

(2) However, investments made in such bonds by an assessee during any financial year cannot exceed ₹ 50 lacs.

Further, second proviso to section 54EC(1) also provides that the investment made by an assessee in these specified bonds, out of capital gains arising from transfer of one or more original assets, during the financial year in which the original asset or assets are transferred and in the subsequent financial year should not exceed fifty lakh rupees.

In this case, Mr. Anish has invested ₹ 50 lacs in the F.Y.2017-18 and ₹ 50 lacs in the F.Y.2018-19, both within six months from the date of transfer. However, since the amount of investment made during the financial year in which asset transferred and in the subsequent financial year cannot exceed ₹ 50 lacs, he is eligible to claim exemption of only ₹ 50 lacs under section 54EC.

**(ii)** Section 78(2) deals with carry forward of losses in case of succession of business. It provides that only the person, who has incurred the losses, and no one else, would be entitled to carry forward the same and set it off. An exception provided hereunder is in the case of succession by inheritance.

Upon dissolution, the partnership firm SD & Co. ceased to exist. Also, the partnership firm, SD & Co., and the sole proprietor concern are two separate and distinct units for the purpose of assessment. The income earned by the sole proprietor would include his share of loss as an individual but not for the loss suffered by the erstwhile partnership firm in which he was a partner.

The exception given in section 78(2), permitting carry forward of losses by the successor in case of inheritance is not acceptable in the present case since the partnership firm was dissolved and ceased to continue. Taking over of business by a partner cannot be considered as a case of inheritance due to death as per the law of succession.

It was so held by the Delhi High Court in *Pramod Mittal v. CIT (2013) 356 ITR 456.*

Therefore, the action of the Assessing Officer in disallowing the claim of set-off of losses suffered by the erstwhile partnership firm SD & Co. against the income earned as an individual proprietor, **is correct**.

**(iii)** As per the provisions of section 12AA(2), every order granting or refusing registration under section 12AA(1)(b), shall be passed by the registering authority before the expiry of six months from the end of the month in which the application was received.

The Supreme Court, in *CIT v. Society for Promotion of Education (2016) 382 ITR 6,* held that once an application under section 12A was made and the same was not responded to within six months, the trust would be deemed as registered.

Applying the rationale of the above Supreme Court ruling in this case, the trust would be deemed as registered. The contention that the trust is deemed to be registered, since its application for registration has not been disposed of within six months is, therefore, correct.

As per section 12A(2), the benefit of exemption under section 11 and 12 would be available from the A.Y. 2018-19, being the assessment year relevant to the financial year in which such application is made.

**Computation of total income of the institution for the A.Y. 2018-19**

| **Particulars** | **₹ (in crores)** |
|---|---|
| Fees received | 14.00 |
| *Less:* 15% (exempt even if not spent for the objects of the institution) | 2.10 |
| | 11.90 |
| *Less:* Accumulated for specified purpose **(See Note 2)** | 4.00 |
| Balance to be spent | 7.90 |
| Actual amount spent on construction of computer science laboratory **(See Note 1)** | 0.50 |
| Actual amount spent on purchase of land for cricket field **(See Note 1)** | 2.00 |
| **Total Income** | **5.40** |

**Notes:**

(1) The institution must utilise 85% of its income within the previous year for the objects of the institution. The institution can apply its income either for revenue expenditure or for capital expenditure provided the expenditure is incurred for promoting the objects of the institution. Land acquired and meant for use as cricket field for students is a capital expenditure incurred for promoting the objects of the institution and hence, eligible for deduction. Likewise, the amount spent on construction of computer science laboratory is also eligible for deduction.

(2) Section 11(2) provides that a trust/institution can accumulate or set apart its income for a specified purpose by furnishing statement in prescribed format to the concerned Assessing Officer. However, the period for which the funds can be accumulated cannot exceed 5 years. The amount so accumulated should be invested in the specified forms and modes. In this case, the institution has to furnish statement in Form 10 on or before the due date of filing return of income to the Assessing Officer, stating the purpose for which the income is being accumulated or set apart and the period for which the income is being accumulated or set apart, which shall, in no case, exceed five years. Further, the institution has to invest ₹ 4 crore in the specified forms and modes.

**(b)** Any income arising from an international transaction, where two or more "associated enterprises" enter into a mutual agreement or arrangement, shall be computed having regard to arm's length price as per the provisions of Chapter X of the Act.

Section 92A defines an "associated enterprise" and sub-section (2) of this section speaks of the situations when the two enterprises shall be deemed to associated enterprises. Applying the provisions of section 92A(2)(a) to the given facts, it is clear that "Info tech Ltd." is associated with RIDA Inc. of Germany, as per section 92A(2)(a), because this company holds shares carrying more than 26% of the voting power in Info tech Ltd.

**Computation of Arm's Length Price as per Cost Plus Method**

| Particulars | | ₹ (in crores) |
|---|---|---|
| Gross profit Mark up in case of Mira Industries [an unrelated party] | 50.0% | |
| ***Less: Differences to be adjusted*** | | |
| - Value of technical know-how (10% of 50%) | 5.0% | |
| - Quantity discount to RIDA Inc. (15% of 50%) | 7.5% | |
| | 37.5% | |
| ***Add:*** Cost of credit to RIDA Inc., (5% of 100%) | 5.0% | |
| **Arm's Length gross mark up** | **42.5%** | |
| Cost incurred by Info tech Ltd. for executing RIDA Inc's work [100% - 42.5% = 57.5%] | | 25,00,000 |
| ***Add:*** Adjusted gross profit (₹ 25,00,000 x 42.5%/57.5%) | | 18,47,826 |
| **Arm's Length billed value** | | **43,47,826** |
| ***Less:*** Actual Billed Income in case of RIDA Inc. (₹ 2500 x 1500 man hours) | | 37,50,000 |
| **Total Income of Info tech Ltd to be increased by** | | **5,97,826** |

**4. (a) (i)** In this case, tax is deductible@5% under section 194H in respect of purchase commission since the same exceeds the threshold limit of ₹ 15,000 for non-deduction of tax at source thereunder. Tax has to be deducted at the time of credit of such commission to the account of Mr. Kashi or at the time of payment of such commission, whichever is earlier. Tax of ₹ 1,250 (5% of ₹ 25,000) was deductible on 11.8.2017 but actually deducted on 31.01.2018. Tax of ₹ 4,000 [5% of ₹ 80,000 (i.e., ₹ 25,000 + ₹ 55,000)] deducted on 31.01.2018 was paid only on 25.8.2018. Since, there has been a delay in deduction and deposit of tax, interest under section 201(1A) is attracted.

As per the provisions of section 201(1A), if a person who is liable to deduct tax at source fails to deduct tax at source or after deducting such tax, fails to pay the tax as required by the Act, then he is liable to pay interest as follows –

(i) 1% for every month or part of month on the amount of such tax from the date on which such tax was deductible to the date on which such tax is actually deducted.

(ii) 1½% for every month or part of month on the amount of such tax from the date on which such tax was deducted to the date on which tax is actually paid.

Therefore, in the given case, interest under section 201(1A) would be computed as follows –

| | ₹ |
|---|---|
| 1% on tax deductible but not deducted i.e., 1% on ₹ 1,250 for 6 months | 75 |
| 1½% on tax deducted but not deposited i.e. 1½% on ₹ 4,000 for 7 months | 420 |
| Interest chargeable under section 201(1A) | 495 |

**(ii)** This issue came up before the High Court of Allahabad in *CIT-II, Lucknow vs. Sahara India Financial Corporation Ltd. (2007) 158 Taxman 0435.* The High Court held that the provisions of sections 203 and 206 would be applicable only if tax has been deducted at source by the person concerned and he commits default in complying with any of the provisions of section 203 or 206. However, in a case where no tax has been deducted at source, the aforesaid provisions would not be attracted. For failure of the assessee in deducting tax at source, penalty can be imposed upon him under section 271C. Once a person concerned has been subjected to a penalty under section 271C for not deducting tax at source, there would not arise any occasion for levying penalty under section 272A(2)(c) and 272A(2)(g) for non-

compliance of the provisions of sections 206 and 203. In other words, in case the tax has not been deducted at source, the question of issuing the certificate of tax deducted under section 203 and that of filing of return under section 206 would not arise at all. Therefore, the question of imposing penalty for violation of the provisions of section 203 and 206 would also not arise.

Therefore, the action of the Assessing Officer imposing penalty under sections 272A(2)(c) and 272A(2)(g) in a case where tax has not been deducted at source **is not correct in law**.

**(iii) I.** Section 194H requires deduction of tax at source @5% from commission and brokerage payments to a resident. However, no tax is to be deducted at source where the amount of such payment does not exceed ₹ 15,000.

In the given case, 'Shine Packaging Ltd.', the consignee, has not remitted the commission of ₹ 65,000 to the consignor 'ABC Developers' while remitting the sale consideration.

Since, the retention of commission by the consignee/ agent amounts to constructive payment of the same to him by the consignor/ principal, deduction of tax at source is required to be made from the amount of commission [CBDT Circular No. 619 dated 4/12/1991].

Therefore, ABC Developers has to deduct tax at source at the rate of 5% on the amount of commission.

**II.** The definition of "work" under section 194C includes manufacturing or supplying a product according to the requirement or specification of a customer by using material purchased from such customer.

In the instant case, Y Ltd. manufactures the product as per the specification given by X Ltd. **by using the raw materials purchased from X Ltd**. **Therefore, it falls within the definition of "work"** under section 194C.

Consequently, tax is to be deducted @ 2% by X Ltd., on the invoice value excluding the value of material purchased from such customer if such value is mentioned separately in the invoice. If the material component is not mentioned separately in the invoice, tax is to be deducted on the whole of the invoice value.

**III.** As per section 194LB, tax would be deductible @5% on gross interest paid/credited by a notified infrastructure debt fund, eligible for exemption under section 10(47), to a foreign company.

In this case, since the payment is made to a foreign company, education cess @2% and secondary higher education cess @1% have to be added to the applicable rate of TDS. Therefore, the tax is deductible under section 194LB @5% plus education cess @2% and secondary higher education cess @1% on the amount of interest paid by the fund.

**(b) (i)** The matter relates to the admission or rejection of the application filed before the Authority for Advance Rulings on the ground specified in clause (i) of the first proviso to section 245R(2). The said clause provides that the Authority shall not allow the application where the question raised in the application is already pending before any income-tax authority or Appellate Tribunal or any court.

In this case, no application had been filed or contention urged by the applicant foreign company, namely Thirsty Drink Inc., before any income-tax authority/Appellate Tribunal/court, raising the question raised in the application filed with AAR. However, one of the Indian companies, namely, Thumbs Up Ltd., had raised the question before the Assessing Officer, not on the applicant's behalf or with a view to benefit the applicant, but only to safeguard its

own interest, as it had a statutory duty to deduct the proper amount of tax from payments made to the foreign company. Although the question raised pertains to one of the payments made or to be made to the non-resident applicant, it was not one pending determination before any income-tax authority in the applicant's case.

Therefore, as held in *Ericsson Telephone Corporation India AB v. CIT (1997) 224 ITR 203 (AAR),* the application filed by the Indian company, Thumbs Up Ltd., before the Assessing Officer cannot be treated to have been filed by the foreign company, Thirsty Drink Inc.

Hence, the rejection of the application of Thirsty Drink Inc. by the AAR on the ground that the question raised in the application is already pending before an income-tax authority is not justified.

**(ii) 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.

**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.

**5. (a) (i)** Income chargeable to tax shall be deemed to have escaped assessment for the purpose of section 147, where a person, being a resident other than not ordinarily resident in India, holds, as a beneficial owner or otherwise any asset located outside India or is a beneficiary of any asset located outside India or has a signing authority in any account located outside India. Accordingly, the Assessing Officer can serve a notice under section 148 on such assessee requiring him to furnish a return of income within the specified period, for the purpose of making an assessment, reassessment or recomputation under section 147.

Under section 149, an extended time limit of sixteen years is available for issue of notice under section 148 for an assessment or reassessment, in case income in relation to such assets located outside India has escaped assessment.

As per *Explanation* to section 149, the above provisions, so amended by the Finance Act, 2012, would also apply to any assessment year prior to A.Y.2013-14.

In this case, income chargeable to tax shall be deemed to have escaped assessment for the purpose of section 147, since Noorie has assets located outside India.

Therefore, on this basis, the Assessing Officer formed a belief that the income has escaped assessment and consequently, issued notice under section 148 for 11 assessment years i.e. from A.Y.2007-08 to A.Y.2017-18.

Hence, the Assessing Officer is justified in invoking reassessment provisions in respect of the earlier assessment years also. However, the extended time limit of 16 years for invoking reassessment proceedings would be available only in respect of A.Y.2009-10 and thereafter, since Noorie first purchased an asset outside India only in July 2008.

Accordingly, in view of the above provisions, the action of the Assessing Officer in issuing notices to Noorie under section 148 for nine assessment years i.e., from A.Y. 2009-10 to A.Y.

2017-18 is in order. However, he cannot issue notice under section 148 for A.Y. 2007-08 and A.Y.2008-09, since the time limit of 4 years or 6 years, as the case may be, has since elapsed.

**(ii)** As per section 133(6), power is given to an Assessing Officer to issue notice, for the purposes of the Act, requiring any person, including a banking company, to furnish information in respect of such points or matters or to furnish statement of accounts and affairs verified in the manner specified by the Assessing Officer, as may be useful for, or relevant to, *any enquiry or proceeding* under the Act. Therefore, the provisions of this section can be invoked even in case of any enquiry and it is not necessary that any proceeding should be pending against the customer for the same.

However, in respect of an enquiry, in case where no proceeding is pending, this power **cannot** be exercised by any Income-tax authority below the rank of Principal Director or Director or Principal Commissioner or Commissioner, **other than the Joint Director or Deputy Director or Assistant Director,** without the prior approval of the Principal Director or Director or Principal Commissioner or Commissioner, as the case may be.

Therefore, the Assessing Officer can issue notice under section 133(6) asking for particulars relating to a customer in the specified format duly verified in the prescribed manner from the banking company, even if no proceeding is pending against such customer, provided he has obtained the prior approval of the Principal Director or Director or the Principal Commissioner or Commissioner, as the case may be.

Hence, in such a case, the action of bank in refusing to provide the particulars relating to a customer as required by the Assessing Officer on the ground that no proceeding was pending against the customer, is **not** correct.

***Note*** *- The Supreme Court, in the case of Kathiroor Service Co-operative Bank Ltd. v. CIT(CIB)(2014) 360 ITR 0243, held that information of general nature could be called for from banks. In that case, since notices had been issued after obtaining the approval of the Commissioner, the assessing authority has not erred in issuing the notices to the assessees requiring them to furnish information regarding account holders. The Supreme Court, therefore, held that for such enquiry under section 133(6), the notices could be validly issued by the assessing authority.*

**(iii)** **(a)** This proposition is **not correct**. Under the *Explanation* to section 251(2) the Commissioner (Appeals) in disposing of an appeal, may consider and decide any matter arising out of the proceedings in which the order appealed against was passed, even if such matter was not raised before him by the appellant. The power of admission of any grounds of appeal is conferred on the CIT (Appeals) under section 250(5), if he is satisfied that the omission in the grounds of appeal was not wilful or unreasonable.

**(b)** The proposition is **not correct**. Under section 254(2), the Tribunal may, within 6 months from the end of the month in which the order was passed, rectify any mistake apparent from record if it is brought to its notice either by the Assessing Officer or by the assessee. However, an amendment which has the effect of enhancing an assessment or reducing a refund or otherwise increasing the liability of the assessee shall not be made unless a notice has been given to the assessee of the intention to do so and a reasonable opportunity of being heard has been given. The Tribunal, however, has no inherent power to re-appreciate the correctness of its own decision on merits.

**(c)** This proposition has been negatively stated and is **not correct**. Under section 255(4), if the members of a Bench of the Tribunal differ in opinion on any point, the point shall be decided according to the opinion of the majority, if there is a majority. If the members are equally divided, they shall state the point or points on which they differ and the case shall be referred by the President of the Appellate Tribunal for hearing on such point or

points by one or more members of the Tribunal. Such point shall be decided according to the opinion of majority of the members of the Tribunal who heard the case, including those who first heard it.

**(b)** In order to provide equality in terms of tax treatment, Article 24 of OECD Model Convention, Non-discrimination, provides that the tax provision cannot be discriminatory merely because one person is a non-resident.

Para 1 of Article 24 provides that a Nationals of a Contracting State shall not be subjected in the other Contracting State to any taxation or any requirement connected therewith, which is other or more burdensome than the taxation and connected requirements to which nationals of that other State in the same circumstances, in particular with respect to residence, are or may be subjected. This provision shall, notwithstanding the provisions of Article 1, also apply to persons who are not residents of one or both of the Contracting States.

Para 2 of Article 24 provides that Stateless persons who are residents of a Contracting State shall not be subjected in either Contracting State to any taxation or any requirement connected therewith, which is other or more burdensome than the taxation and connected requirements to which nationals of the State concerned in the same circumstances, in particular with respect to residence, are or may be subjected.

As per para 3 of Article 24, the taxation on a permanent establishment which an enterprise of a Contracting State has in the other Contracting State shall not be less favourably levied in that other State than the taxation levied on enterprises of that other State carrying on the same activities. This provision shall not be construed as obliging a Contracting State to grant to residents of the other Contracting State any personal allowances, reliefs and reductions for taxation purposes on account of civil status or family responsibilities which it grants to its own residents.

Para 5 provides that Enterprises of a Contracting State, the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other Contracting State, shall not be subjected in the first-mentioned State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which other similar enterprises of the first-mentioned State are or may be subjected.

As per para 6 of Article 24, the provisions of Article 24 shall, notwithstanding the provisions of Article 2, apply to taxes of every kind and description.

**6. (a) (i)** As per the provisions of section 281B, there can be provisional attachment to protect the interest of Revenue if -

(a) The proceeding for the assessment of any income or for the assessment or reassessment of any income which has escaped assessment should be pending.

(b) Such attachment should be necessary for the purpose of protecting the interest of Revenue in the opinion of the Assessing Officer.

(c) The previous approval of the Principal Chief Commissioner or Chief Commissioner, Principal Commissioner or Commissioner, Principal Director General or Director General or Principal Director or Director has been obtained by the Assessing Officer.

(d) The Assessing Officer, may, by an order in writing attach provisionally any property belonging to the assessee in the manner provided in the Second Schedule.

Such provisional attachment shall cease to have effect after the expiry of a period of six months from the date of order made under section 281B(1). However, the period can be extended by the Principal Chief Commissioner or Chief Commissioner, Principal Commissioner or Commissioner, Principal Director General or Director General or Principal Director or Director, as the case may be, for the reasons to be recorded in writing for a further

period or periods as he thinks fit. The total period of extension in any case cannot exceed 2 years or 60 days after the date of order of assessment or reassessment, whichever is later.

The Assessing Officer shall, by order in writing, revoke provisional attachment of a property made under section 281B(1) in a case where the assesse furnishes a guarantee from a scheduled bank, for an amount not less than the fair market value of such provisionally attached property or for an amount which is sufficient to protect the interests of the revenue.

**(ii)** I. The arrangement of routing investment through Country 'Y' results into a tax benefit. Since there is no business purpose in incorporating company Zen Pvt. Ltd. in Country 'Y', it can be said that the main purpose of the arrangement is to obtain a tax benefit. The alternate course available in this case is direct investment in Revolution (P) Ltd. joint venture by Den Pvt. Ltd. The tax benefit would be the difference in tax liabilities between the two available courses.

The next question is, does the arrangement have any tainted element? It is evident that there is no commercial substance in incorporating Zen Pvt. Ltd. as it does not have any effect on the business risk of Den Pvt. Ltd. or cash flow of Den Pvt. Ltd. As the twin conditions of main purpose being tax benefit and existence of a tainted element are satisfied, GAAR may be invoked.

Additionally, as all rights of shareholders of Revolution (P) Ltd. are being exercised by Den Pvt. Ltd instead of Zen Pvt. Ltd, it again shows that Zen Pvt. Ltd lacks commercial substance.

Hence, GAAR provisions can be invoked in this case.

II. An air conditioner fitted at the residence of a Chief Executive Officer(CEO) as per the terms of his appointment would be a furniture qualifying for depreciation@10%, whereas an air conditioner fitted in a factory would be a plant qualifying for a higher depreciation@15%. The wrong treatment unjustifiably increases the amount of depreciation and consequently, reduces profit and consequent tax liability. Treatment of air-conditioner fitted at the residence of a CEO as a plant fitted at the factory would tantamount to furnishing of false particulars with an attempt to evade tax. Thus, this transaction would be considered as Tax Evasion.

**(iii)** Section 276CC provides for prosecution for willful failure to furnish a return of income within the prescribed time, in a case where tax would have been evaded had the failure not been discovered.

Since the amount of tax which would have been evaded does not exceed ₹ 25 lakh, the imprisonment would be for a term of 3 months to 2 years. In addition, fine would also be attracted.

However, in a case where the return of income is not filed within the due date, prosecution proceedings will not be attracted if the tax payable by the assessee on the total income determined on regular assessment, as reduced by the advance tax, if any, paid and any tax deducted at source, does not exceed ₹ 3,000.

In this case, even though the tax liability of the firm as per the original order of assessment exceeded ₹ 3,000, however, as a result of the order of the Commissioner (Appeals), it got reduced to ₹ 1,000, which is less than ₹ 3,000.

Therefore, since the tax liability of the firm on final assessment was determined at ₹ 1,000, the prosecution proceedings are not maintainable.

In *Guru Nanak Enterprises v. ITO (2005) 279 ITR 30*, where the facts were similar, the Supreme Court held that prosecution was unwarranted.

**(b)** There are six indicators of BEPS activity as per BEPS Action Plan 11. These six indicators of BEPS activity highlight BEPS behaviour using different sources of data, employing different metrics, and examining different BEPS channels. When combined and presented as a dashboard of indicators, they confirm the existence of BEPS, and its continued increase in scale in recent years.

(1) **The profit rates of MNE affiliates located in lower-tax countries are higher than their group's average worldwide profit rate -** For example, the profit rates reported by MNE affiliates located in lower-tax countries are twice as high as their group's worldwide profit rate on average.

(2) **The effective tax rates paid by large MNE entities are estimated to be lower than similar enterprises with only domestic operations** - This tilts the playing-field against local businesses and non-tax aggressive MNEs, although some of this may be due to MNEs' greater utilisation of available country tax preferences.

(3) **Foreign direct investment (FDI) is increasingly concentrated -** FDI in countries with net FDI to GDP ratios of more than 200% increased from 38 times higher than all other countries in 2005 to 99 times higher in 2012.

(4) **The separation of taxable profits from the location of the value creating activity is particularly clear with respect to intangible assets, and the phenomenon has grown rapidly -** For example, the ratio of the value of royalties received to spending on research and development in a group of low-tax countries was six times higher than the average ratio for all other countries, and has increased three-fold between 2009 and 2012.

(5) **Royalties received by entities located in these low-tax countries accounted for 3% of total royalties** - This provides evidence of the existence of BEPS, though not a direct measurement of the scale of BEPS.

(6) **Debt from both related and third-parties is more concentrated in MNE affiliates in higher statutory tax-rate countries** - The interest-to-income ratio for affiliates of the largest global MNEs in higher-tax rate countries is almost three times higher than their MNE's worldwide third-party interest-to-income ratio.